RESEARCH

BRISBANE CBD

OFFICE MARKET OVERVIEW APRIL 2015

HIGHLIGHTS

Tenant demand is improving with greater leasing activity expected in 2015. With growth and expansion still fragile the 188,000m² of new supply will push the vacancy to new heights in 2016.

Effective rents have stabilised with only marginal falls over the past year. Face rents across both prime and secondary have grown with this more than balanced by further increases to average incentives.

Investment demand has continued to grow as purchaser attention extends from the Sydney and Melbourne markets. Yield compression in the prime market is now spreading to secondary stock.

KEY FINDINGS

Total Vacancy increased to 15.6% as at January 2015**.** For this cycle the **peak is expected to be 16.3% in early 2017**

Prime and secondary effective rents softened by 1.6% and 2.1% respectively over the past year, but have now stabilised

Increasing tenant confidence and mobility is expected to **benefit the A and B+ grade markets**

The current **spread between prime and secondary yields is 187bps**, well above average levels

JENNELLE WILSON
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SUPPLY & DEVELOPMENT

Withdrawals of stock will dominate in the short term as obsolete buildings are recycled. From late 2015 this will change with three buildings totalling 188,000m² coming to the market from late 2015 and in 2016.

Net supply additions to the Brisbane CBD was negative over the second half of 2014 (-5,297m²), with modest withdrawals and only limited return of refurbished space. In the six months to January 2015, 3,613m² of stock was added to the market, coming from two smaller secondary refurbishment projects of Rowes Arcade (2,500m²) and 138-140 Albert Street (1,113m²). Over the same period there was withdrawal of 8,910m² of stock from two buildings.

The first half of 2015 is expected to be characterised by reductions to stock, as a number of assets purchased for redevelopment are removed from the market. In contrast, the second half of 2015 will see the first of three major construction completions, totalling 188,000m², which will be added prior to the end of 2016. The first completion, the 57,465m², 180 Ann Street, is expected in Q4 2015. The project is being developed by the privately owned Daisho Group and is currently 18% pre-committed with the Commonwealth Bank of Australia taking 10,500m².

480 Queen Street will be completed early in 2016 followed by 1 William Street later in the year. The Grocon developed (onsold to DXS and DWPF), 480 Queen Street has pre-commitments which account for 81% of the office space. The final project in this short construction cycle is 1 William Street (74,853m²), which is fully leased by the State Government. Beyond these projects under construction, most existing office development proposals have been converted into residential or hotel developments. At this stage further significant new supply is not expected prior to late 2018 at the earliest.

Stock Withdrawal

Withdrawals over the past six months comprised 171 George Street (c8,260m²) for a hotel conversion and 650m² of space located at 155 Queen Street, demolished for the construction of a new retail and office building.

Stock withdrawals are expected to ramp up with a total of 143,000m² currently slated for permanent withdrawal between now and the end of 2017. The majority of this withdrawal is from mid-2016 and is tied to the Queens Wharf and BaT projects. At this stage the new Qld Government has indicated the intention to continue with the Queens Wharf project, however the BaT Tunnel may be delayed while alternate funding is sought.

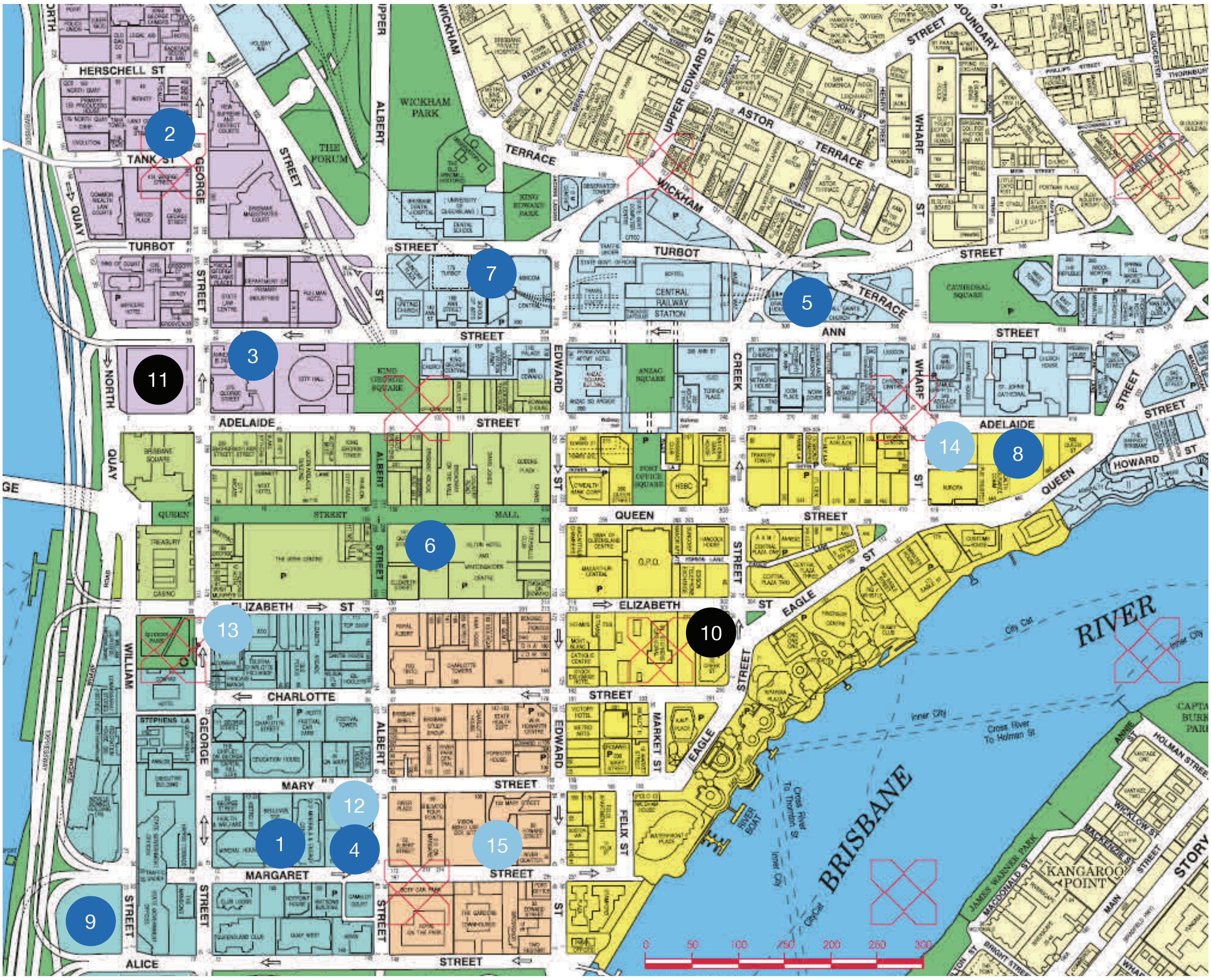
Over the coming six months 363 Adelaide Street (14,700m²) and 240 Margaret Street (3,750m²) will be withdrawn for student accommodation conversion and residential development respectively. Further withdrawals for hotel or residential use are expected to emerge over the coming year, with a number of secondary properties having relatively low occupancy and strong redevelopment potential.

TABLE 1
Brisbane CBD Office Market Indicators as at April 2015

Grade	Total Stock (m²)^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²)^	Average Gross Face Rent ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	1,084,189	10.7	5,200	-	695	36	6.20—7.65
Secondary	1,109,614	20.5	-38,620	-4,436	545	39	8.00—9.60
Total	**2,193,803**	**15.6**	**-33,420**	**-4,436**			

Source: Knight Frank/PCA ^ as at January 2015

MAJOR OFFICE SUPPLY



1 #126 Margaret St—5,718m²
Investec Prop Opportunity Fund
Q1 2013—10% committed

2 #420 George St—6,500m²
Nielson Properties (under contract)
Q2 2013—14% committed

3 ^69 Ann St—6,000m²
Charter Hall CPOF Q3 2014 — *QLD Gas*

4 ^60 Albert St—c7,500m²
DWPF — Q1 2015 — *Arrow/Worley Parsons/Rowland*

5 #310 Ann St—16,500m²
Pidgeon Family—Q1 2015

6 155 Queen St— c2,500m²
ISPT—Q4 2015

7 180 Ann St— 57,465m² [CBA]
Daisho — Q4 2015—18% committed

8 480 Queen St—55,561m² [BHP/ PwC/ Freehills] —81% committed
Grocon (DEXUS/DWPF) — Q1 2016

9 1 William St—74,853m² [State Govt]
Cbus Property/ISPT—Q4 2016
100% committed (15,000m² sub-lease)

10 12 Creek St Annex—6,297m² of GFA
DEXUS Property Group/DWPF—tba

11 300 George St—46,162m²
Shayher Group—tba

12 80 Albert St—9,118m²
Frasers Hospitality—withdrawn Q1 2014
Hotel Conversion

13 171 George St—8,260m² office NLA
Toga Far East Hotels—withdrawn Q4 2014—Hotel Conversion

14 363 Adelaide St—14,700m²
Valparaiso Capital —withdrawn Q1 2015
Student Accommodation Conversion

15 240 Margaret St—3,750m²
Aspial Corporation—withdrawn Q1 2015
Residential Development

Under Construction / Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

Former office buildings withdrawn for hotel or residential conversion/ redevelopment

Source of Map: Knight Frank
As at April 2015, excluding strata
#major refurbishment/entire building available
^sub-lease space >5,000m² contiguous
Sub-lessor identified in *italics*.
Avail office NLA quoted.
Major Pre-commit in [brackets] next to the NLA.

TENANT DEMAND & RENTS

Disappointing demand levels in the second half of 2014 resulted in the total vacancy rate increasing to 15.6% as at January 2015. The prime market vacancy rate was 10.7%, down marginally from 11.2% six months earlier. Despite significant A grade backfill space left by tenants relocating to the Fringe market, the prime market has continued to improve as tenants take the opportunity to upgrade.

TABLE 2
Brisbane CBD—Vacancy Rates

Precinct	Jan 14	Jan 15
Premium	12.8%	9.1%
A Grade	10.9%	11.1%
Prime	**11.2%**	**10.7%**
B Grade	18.7%	23.0%
C Grade	12.6%	12.1%
D Grade	16.1%	16.6%
Secondary	**17.3%**	**20.5%**
Totals	**14.3%**	**15.6%**

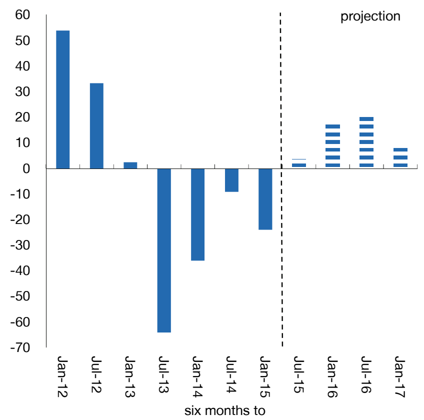
Source: Knight Frank/PCA

In contrast, the secondary market has continued to weaken, with the total vacancy increasing to 20.5% up from 17.3% in January 2014. B Grade, which accounts for the vast majority of secondary accommodation, has continued to suffer and has the highest vacancy rate at 23.0%.

Net Absorption

The Brisbane CBD recorded negative net absorption of –33,140m^2 over the course of 2014, with the second half of 2014 in particular showing high negative net absorption of –23,989m^2. Much of this negative figure can be attributed to specific tenant relocations with Ventyx (6,085m^2) and Bank of Queensland (7,957m^2) moving from the CBD to the Fringe market. In addition Boeing's relocation and contraction from 363 Adelaide Street (14,700m^2) into 7,459m^2 of space in 150 Charlotte Street contributed to the decline in net absorption for this period as Boeing only took occupancy mid-year, despite the deal being agreed in early 2013.

FIGURE 1
Brisbane CBD Net Absorption
('000m^2) per 6 month period



Source: Knight Frank/PCA

Even though a considerable portion of the negative net absorption can be attributed to specific tenant relocations, it also highlighted a lack of underlying growth within the market to counterbalance these negative influences.

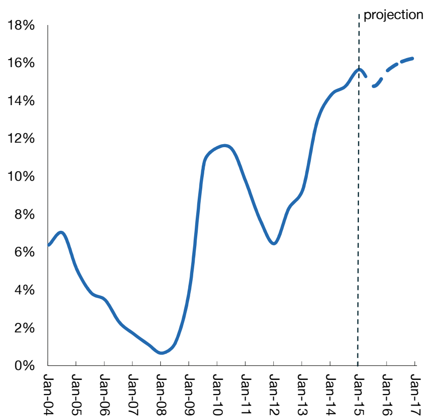
While the first half of 2015 is also expected to be impacted by one-off negative influences (ie Suncorp's relocation from the 16,435m^2 310 Ann Street to 123 Albert Street and their existing space in Brisbane Square) there are continued signs of improving market activity. This is expected to offset the contractions and result in some positive net absorption.

Vacancy

The vacancy rate is likely to dip slightly by mid-2015 to 14.8%, before increasing again under the weight of new supply, with the total vacancy expected to be back to current levels in January 2016.

The vacancy is expected to peak in January 2017 at 16.3% following the addition of 1 William Street. Thereafter no supply, combined with the expected high withdrawals will see the vacancy rate make significant improvement throughout 2017 and 2018.

FIGURE 2
Brisbane CBD Vacancy
% total vacancy

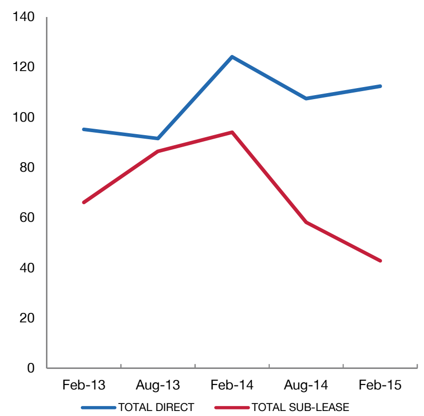


Source: Knight Frank/PCA

Knight Frank has continued to track the major backfill and contraction space and this has begun to show positive signs with the available sub-lease space decreasing by 50,000m^2 over the past 12 months, supporting the view that tenant demand has begun to improve.

Backfill space is expected to increase in late 2015 and into 2016 as tenants relocate into the new CBD buildings. This backfill space will be concentrated in prime buildings such as Waterfront Place, Riverside Centre and 240 Queen Street and will be a combination of direct and sub-lease space.

FIGURE 3
Brisbane CBD Backfill & Contraction
('000m^2) remaining available 2013-2015



Source: Knight Frank

Tenant Demand

Tenant demand has continued to improve steadily if modestly over the second half of 2014 and into 2015. Enquiry levels remain subject to fluctuation on a week to week basis with tenants' confidence easily shaken by external events such as changes of Government or poor economic news. However the tenants which do come to the market with a serious brief are now more likely to relocate than to re-commit to their existing accommodation than was the case a year ago.

The opportunity to both upgrade their location and obtain a new fit-out is an attractive proposition to tenants and fuelling this increased relocation activity. In some cases such as McInnes Wilson, the landlords have retained an existing tenant in the building however on a higher floor and refurbished space.

The education and training sector has been particularly active in the leasing market, boosted by both the lower AUD which improves demand from offshore students and increased funding from federal and state government programmes. Recent relocations in this space have included Pragmatic Training (1,406m²), Impact English (1,128m²), Imperial College (595m²), Karstens (952m²), The Language Pod (562m²) and Queensland International Institute (580m²) with further activity expected in this sector in the short term.

Aside from the major pre-commitments by professional firms to new buildings such as 480 Queen Street, there has also been increasing leasing activity from both the legal and accounting sector due to a number of take-overs and consolidations in that sector.

Rental Levels

Effective rental levels have found their low-point for this cycle with only modest falls recorded over the past 12 months. As the level of available sub-lease has continued to fall, this has assisted to place a floor under the rental levels.

Prime gross face rents have increased by 2.2% over the past year to average $695/m² as the claw-back on face rents has continued to gain momentum. However incentives have also increased to average 36%, resulting in an overall fall to gross effective rents of 1.6% from April 2014.

Prime effective rental levels are expected to remain largely stable to April 2016 (up 1.5%) with modest growth of 3.1% forecast for the year to April 2017 to herald the first material improvement to effective rents since 2012.

"Average effective rentals have found their low-point for this cycle"

A similar pattern has emerged for the secondary market with slight improvement in the gross face rentals more than offset by a further increase to average incentives. Face secondary rents averaged $545/m² as at April 2015 which was a 1.9% increase over the past year. However with incentives now averaging 39%, the gross effective rent softened by 2.1% over the 12 month period. Secondary rents are expected to plateau from this point with little to no major improvement expected until late 2016/ early 2017.

TABLE 3

Recent Leasing Activity Brisbane CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
480 Queen St	2,800	undis	10	undis	DLA Piper^	PC
180 Ann St	10,500	undis	11	undis	Commonwealth Bank^	Dec 15
175 Eagle St	1,150	695 g	8	35+	Fisher Adams Kelly	Aug 15
239 George St	2,619	570 g	8	35+	City Beach	Jul 15
295 Ann St	2,422	585 g	8	30-35	ABS	Jun 15
69 Ann St	3,600	625 g	10	30-35	Remserv	Jun 15
295 Ann St	2,480	565 g	10	25-30	Manpower	May 15
295 Ann St	1,233	385 g	5.5	-	Davidson Recruitment#	Mar 15
143 Turbot St	1,406	520 g	7	30-35	Pragmatic Training	Feb 15
379 Queen St	1,128	475 g	7	35+	Impact English	Jan 15
400 George St	1,457	430 g	4	-	Central Petroleum#	Oct 14

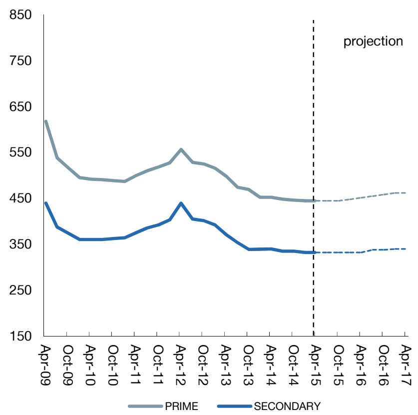
`estimated incentive calculated on a straight line basis g gross ^ pre-commitment # sub-lease

Source: Knight Frank

FIGURE 4

Brisbane CBD Rents

$/m² p.a average gross effective rent



Source: Knight Frank

INVESTMENT ACTIVITY & YIELDS

As the low interest rate environment persists, the demand across the investment market has continued to build with both local and offshore buyers seeking to expand their property portfolios. While 2014 was a record year for the Australian office investment market, recording $15.96 billion for transactions $10 million+, the Brisbane market's transaction levels were below 2013 levels. However 2013 was an exceptionally strong year due to the transaction of 1 William Street ($400m for 50%), 480 Queen Street ($543.9m) and a portfolio of Qld Government assets purchased by QIC Funds Management ($561.9m). Therefore the 2014 total transaction level of $1.69 billion was 40% below the $2.86 billion recorded in 2013.

Of the 2014 sales, the influence of offshore investors was stronger than ever with 45% of all transactions by value attributable to offshore purchasers. This is in contrast to the Australian office market as a whole where 40% of transaction value came from offshore buyers.

Despite the sustained demand for prime, core assets only two sales were recorded in this sphere during 2014. In April 2014, 70 Eagle Street was purchased by Pembroke Real Estate for $122.7 million, which reflected a core market yield of 6.25% on the asset which had a WALE of 8.4 years. The other major core sale was Challenger Life purchasing 53 Albert Street in December 2014 for $209.268 million. The modern building is fully occupied by the State Government on a recently re-negotiated lease with a WALE of 7.0 years, and the sale reflected a core market yield of 6.79%. Unusually it is understood that the purchaser will remain liable for the outstanding incentive component in relation to the building, largely rental abatement, which has an estimated present value of $25.4 million.

Outside of this, particularly in the latter half of 2014, remaining sales have been further up the yield curve as value add or development acquisitions. 300 Adelaide Street was purchased by Hong Kong based Lei Shing Hong for $47.5 million and the 13,140m² B grade building was circa 35% vacant at the time of sale. The sale reflected a core market yield of 8.93%, and with a relatively low improved rate of $3,615/m² the purchaser has the flexibility to hold or redevelop.

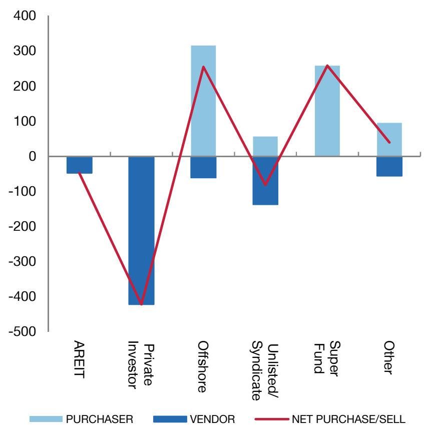
Another offshore group, Valparaiso Capital, has purchased 363 Adelaide Street for approx. $48 million for redevelopment into student accommodation. The 14,962m² building was sold with vacant possession and has large floorplates of approx. 1,000m² over its 14 office levels. This sale adds to 240 Margaret Street and 171 George Street as sales in 2014 where the buildings will be withdrawn from the office market for conversion or redevelopment.

After a flurry of sales in November and December 2014, sales activity to date during 2015 has been relatively slower with only two completed sales. However there is a high level of activity within the market for both on and off-market opportunities and the number of sales is expected to accelerate to the end of the financial year ie Waterfront Place, which has recently entered due diligence.

FIGURE 5

Brisbane CBD Purchaser/Vendor

$ million sales ($10 million+) Year to March 2015



Source: Knight Frank

TABLE 4

Recent Sales Activity Brisbane CBD

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
10 Felix St	B	26.0	7.76	4,622	5,577	2.0	Canberra Raiders Leagues Club	AIMS Funds Management	Feb 15
363 Adelaide St ‡	B	48.00	VP	14,962	3,208	VP	Investa Property Group	Valparaiso Capital	Jan 15
414 George St ±	A	30.00	9.14	4,989	6,013	2.4	Lend Lease Core Plus Fund	LaSalle Investment Management	Dec 14
53 Albert St	A	209.27*	6.79	19,059	10,980	7.0	Hatham Holdings	Challenger Life	Dec 14
60 Edward St~	A/B	61.09	7.93	10,725	5,696	2.5	AMP Capital	RACQ	Dec 14
300 Adelaide St	B	47.50	8.93	13,140	3,615	2.1#	Charter Hall Direct Property Fund	Lei Shing Hong Properties	Dec 14

‡ purchased for redevelopment as student accommodation ± purchased as part of a national portfolio, allocated price only
*purchaser will take on responsibilities for outstanding incentives (rental abatement) with an estimated PV of $25.4 million
~purchaser will owner occupy in the order of 4,000m² of space to be vacated in the building. # sold with circa 35% vacancy
Source: Knight Frank

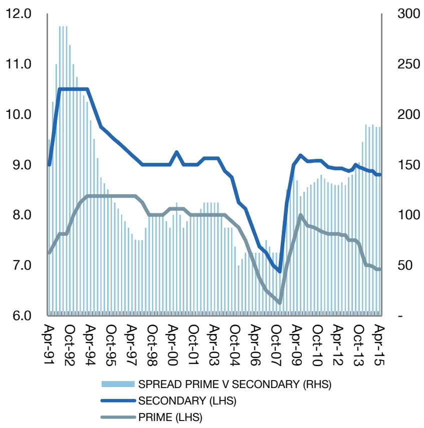
Demand for investment in Australian office assets has continued to build, however in recent months a greater proportion of this has been directed into the Melbourne and Sydney markets, particularly underscored by potential residential conversion and redevelopment in Sydney. As values continue to increase in the southern markets it is expected that additional purchasing activity will flow into the Brisbane market.

The sustained demand for investment and low interest rate environment has continued to place downward pressure on yields across all markets. Within the Brisbane CBD the average prime yields are currently 6.20% - 7.65% with a median of 6.93%. This represents firming of 28 basis points over the past year and 60 basis points over this firming cycle in the past two years. As investment opportunities reduce and recovery in the prime leasing market becomes entrenched, there is further scope for firming of the prime yield band, particularly at the upper yield range.

Secondary yields have also shown some firming activity, although have been lagging the prime market due to the weaker leasing market conditions. Average secondary yields currently range between 8.00% and 9.60%, with an average of 8.80%. This indicates firming of 10 basis points over the past year. Recent and current purchasing activity has been a mixture of investors seeking income driven investments and those with current or future redevelopment plans. There have now been four sales of existing commercial buildings for residential, student accommodation or hotel development, however to date there has not been enough pricing tension created to markedly shift yields.

However as shown in Figure 6 the spread between prime and secondary yields in the Brisbane CBD is currently relatively high at 187 basis points in contrast to a long term average of 129 basis points. As demand from yield-driven investors increases, it appears likely that this potential under-pricing in the secondary market will be eroded as the sector becomes priced more in line with the wider investment market than with local current leasing fundamentals.

FIGURE 6
Brisbane CBD Core Market Yields
% Yield LHS & Basis Point Spread RHS



Source: Knight Frank

363 Adelaide Street has been purchased by Valparaiso Capital for conversion to student accommodation. The sale, with vacant possession, showed an improved rate of $3,208/m²

Outlook

- Tenant confidence and demand is steadily building and 2015 is expected to see greater levels of tenant relocation and upgrading in the Brisbane CBD.
- The delivery of three new buildings over the next two years will provide a high level of backfill, largely within prime buildings which will boost activity in the A grade and high B grade buildings.
- Effective rents have now stabilised and are expected to remain at similar levels over the remainder of 2015. On average incentives are expected to remain at current levels although face rents may be increased across select buildings.
- Stock withdrawals will continue as obsolete stock is redeveloped or demolished in favour of residential or hotel accommodation. Post 2016 the development pipeline for office assets is low with a two year hiatus in completions expected.
- While the Brisbane markets only accounted for 11% of national office transactions by value during 2014 the market share is expected to increase over 2015 as demand spills over from the southern cities.
- Purchasing activity is expected to continue to broaden from simply core assets and become more active in the higher yielding value-add sector as investors chase return. Development or redevelopment potential will also be highly sought.
- Yield compression is expected across both the prime and secondary markets, however greater transaction levels are required to confirm this. With the secondary yields having been slow to move there is greater scope for short term compression in that market.
- Transaction activity across the Brisbane CBD market is expected to accelerate towards the end of the financial year.

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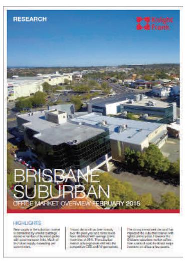

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