RESEARCH

BRISBANE CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2015

HIGHLIGHTS

Tenant demand has continued to firm with tenants now more likely to relocate to new premises. This activity is boosting sentiment, however the vacancy level will increase due to new supply.

Incentives have continued to creep higher while face rents have steadied, with prime face rents increasing slightly. Effective rents have continued to stagnate and tenants have the upper hand.

Despite relatively few sales, demand, particularly for prime office, has continued to build. Yields are firming under the weight of funds and reacting to the spread to Sydney and Melbourne yields.

KEY FINDINGS

Total Vacancy was 15.0% as at July 2015, down from 15.6% in January**.** For this cycle the **peak is expected to be above 17% in early 2017**

Prime and secondary effective rents softened by 1.3% p.a and 1.2% p.a respectively

Tenants, attracted by **the deals on offer,** have the ability to lower their accommodation costs and this is **boosting mobility**

Yields remain under **downward pressure**, particularly as the **spread to Sydney** average prime yields is now **105 bps**

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SUPPLY & DEVELOPMENT

Total vacancy reduced in the first half of 2015, however with new supply imminent the vacancy is expected to increase until early 2017. Withdrawal of obsolete stock will provide some mitigation particularly in 2016 & 2017

The quantum of stock in the Brisbane CBD market reduced by 35,000m² over the six months to July 2015. There was no additional supply, either in new stock or refurbished accommodation, over the first half of the year. However, after a hiatus of two years, supply of new office accommodation will return to the Brisbane CBD market in the second half of 2015. Three major office buildings will be delivered to the market over the next 12-18 months, totalling 188,000m².

The first, which will reach completion in November 2015, is 180 Ann Street, being developed by the Daisho Group. The building will contain 57,465m² and is 18% pre-committed to the Commonwealth Bank of Australia, with tenant interest growing as completion is imminent.

This will be followed by the completion of 480 Queen Street (55,561m²) in March 2016. This project, developed by Grocon and onsold to DEXUS Property Group/DWPF, is currently 92% pre-committed. 1 William St, a 74,853m² building fully leased by the Queensland Government, is expected to be delivered mid-late 2016.

The pipeline for additional development is low with the majority of development sites targeted to the hotel and residential market. However there is likely to be a need for new development by 2019 and some developers have begun to explore potential opportunities such as The Shayher Group's George St proposal, which is likely to be the next project.

Stock Withdrawal

Withdrawals over the past six months totalled 34,710m² with 16,094m² of this permanent withdrawals and the remaining 18,616m² temporarily withdrawn for refurbishment. Withdrawn for a full building refurbishment was the 15,816m² 310 Ann St, formerly occupied by Suncorp. Additionally two floors were withdrawn for refurbishment (2,800m²) in Riverside Centre, 123 Eagle St.

Permanently withdrawn from the office market was 363 Adelaide St (14,700m²) and 171-175 Elizabeth St (1,394m² office component). The building at 363 Adelaide St has been purchased by Valparaiso Capital with vacant possession and will be converted into student accommodation. 171-175 Elizabeth St, formerly owned by the Irish Club, has a DA lodged for a residential development.

Stock withdrawals are expected to continue to grow with potential withdrawals in the second half of 2015 including 240 Margaret St (3,750m²), 205 North Quay (3,318m²), 30 Herschel St (2,563m²) and 443 Queen St (5,560m²). The size and quantum of buildings to be withdrawn will increase again in 2016 and 2017, largely driven by the Queens Wharf project with at least a further 100,000m² of stock to be withdrawn in 2016 & 2017. The Queens Wharf project will directly result in the withdrawal of 80 George St, 100 George St and 75 William St, totalling 57,656m² to create the site.

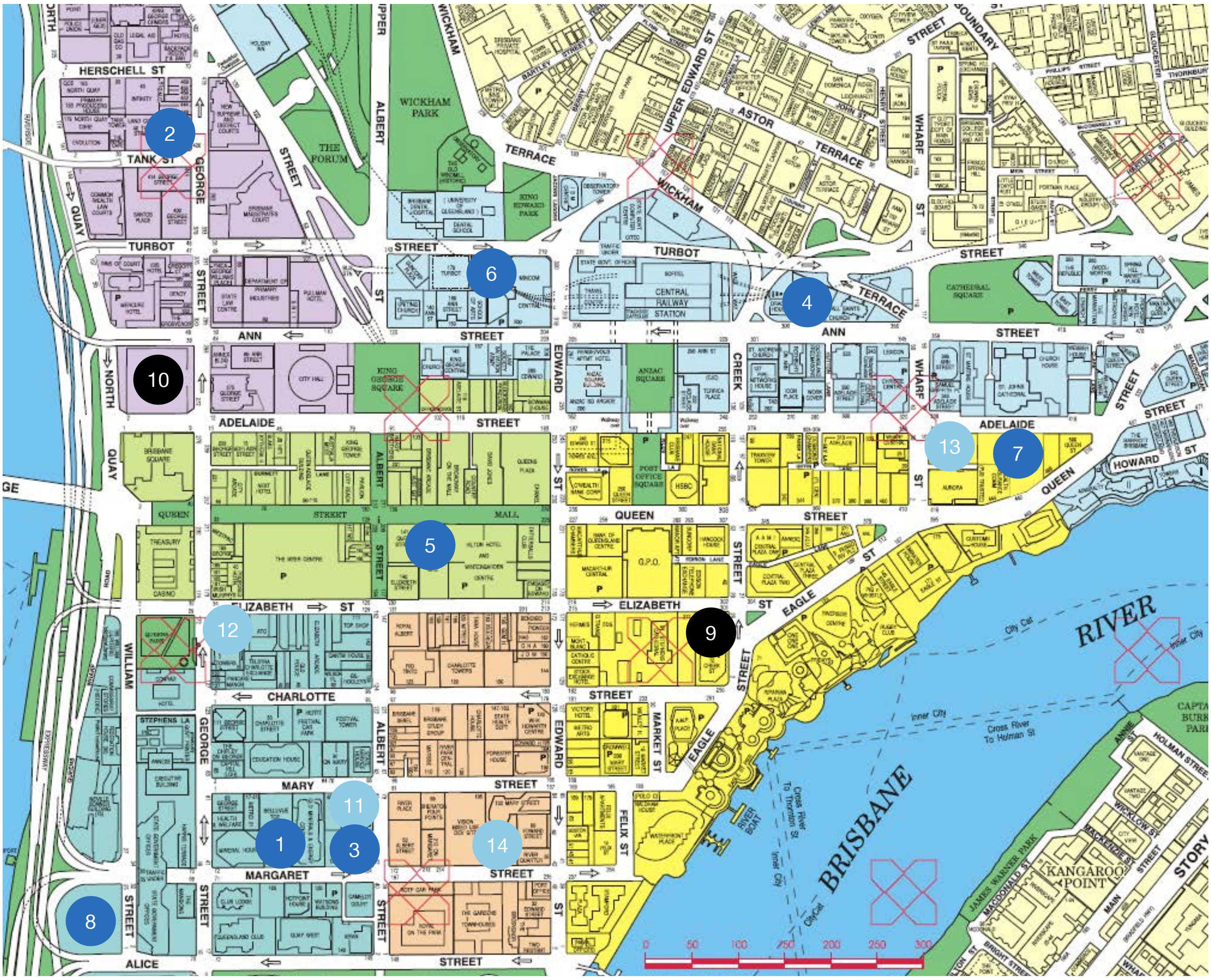
TABLE 1

Brisbane CBD Office Market Indicators as at July 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	1,065,573	11.7	-22,327	-18,616	697	36.5	6.15—7.35
Secondary	1,092,717	18.2	-18,385	-22,194	545	39.3	7.85—9.60
Total	**2,158,290**	**15.0**	**-40,712**	**-40,810**			

Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY



1 — #126 Margaret St—5,718m²
Investec Prop Opportunity Fund
Q1 2013—20% committed

2 — #420 George St—6,129m²
Forza Capital
Q2 2013—21% committed

3 — ^60 Albert St—c14,000m²
DWPF — Q1 2015 — *Arrow/Worley Parsons/Rowland*

4 — #310 Ann St—16,500m²
Pidgeon Family—Q1 2015

5 — 155 Queen St— c2,500m²
ISPT—Q4 2015

6 — 180 Ann St— 57,465m² [CBA]
Daisho — Q4 2015—18% committed

7 — 480 Queen St—55,561m² [BHP/ PwC/ Freehills] —92% committed
Grocon (DEXUS/DWPF) — Q1 2016

8 — 1 William St—74,853m² [State Govt]
Cbus Property/ISPT—Q3 2016
100% committed

9 — 12 Creek St Annex—6,297m² of GFA
DEXUS Property Group/DWPF—tba

10 — 300 George St—46,895m² NLA
Shayher Group—tba

11 — 80 Albert St—9,118m²
Frasers Hospitality—withdrawn Q1 2014
Hotel Conversion

12 — 171 George St—8,260m² office NLA
Toga Far East Hotels—withdrawn Q4 2014—Hotel Conversion

13 — 363 Adelaide St—14,700m²
Valparaiso Capital —withdrawn Q1 2015
Student Accommodation Conversion

14 — 240 Margaret St—3,750m²
Aspial Corporation—withdrawal Q3 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 August 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

Although activity is on the increase, the growth of tenants has remained subdued during the first half of 2015. Therefore while the vacancy rate has reduced over the past six months, this reduction has not been as great as expected, and was solely due to reductions in the total stock base of the CBD. The total vacancy is now sitting at 15.0%, down from 15.6% at the start of the year, but still higher than the rate a year ago.

TABLE 2
Brisbane CBD—Vacancy Rates

Precinct	Jul 14	Jul 15
Premium	14.2%	9.3%
A Grade	10.5%	12.3%
Prime	**11.2%**	**11.7%**
B Grade	19.9%	19.2%
C Grade	11.7%	15.0%
D Grade	16.8%	16.5%
Secondary	**18.2%**	**18.2%**
Totals	**14.7%**	**15.0%**

Source: Knight Frank Research/PCA

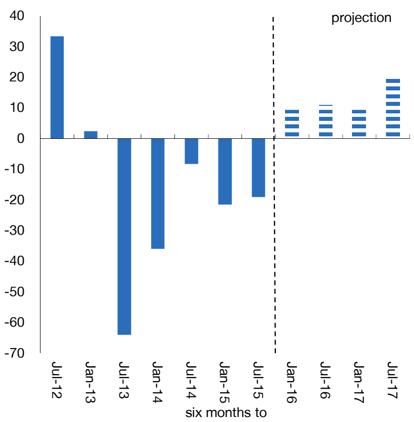
The prime market vacancy rate was 11.7%, up marginally from 11.2% a year earlier. The prime market is on the cusp of major new additions to supply which will see relocations of unprecedented levels in this market. This will create both risks and opportunities for prime building owners.

The secondary market has shown some improvement for the first time in three years, with vacancy falling from 20.5% to 18.2% over the past six months. Modest positive net absorption has combined with stock withdrawal to achieve this result.

Net Absorption

The Brisbane CBD recorded negative net absorption of –19,160m² over the first half of 2015, taking the annual net absorption to –40,712m². In a departure from recent market conditions the secondary market recorded positive net absorption of 8,360m² in the first half of 2015. This is due to take-up from tenants such as education providers and smaller businesses active within the market. Additionally the buildings withdrawn for change of use were already recorded as fully vacant, so their removal from the survey did not impact on the net absorption levels, which measures the total occupied stock.

FIGURE 1
Brisbane CBD Net Absorption
('000m²) per 6 month period



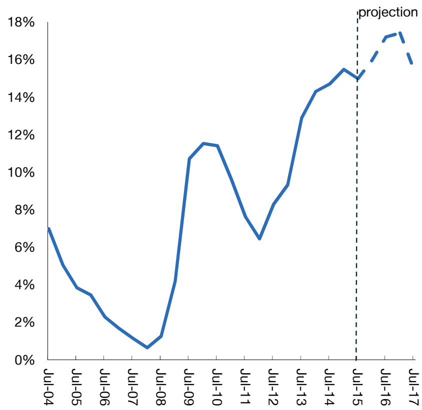
Source: Knight Frank Research/PCA

The prime market recorded negative net absorption of 27,520m² over the past six months, reversing recent trends where the prime market has been the stronger. The premium market recorded negative net absorption of 2,834m² with gaps beginning to appear in the older riverside premium buildings.

The A Grade market net absorption fell by 24,686m² over the first half of 2015. This was influenced by the withdrawal for refurbishment of the 15,816m² 310 Ann Street; which had previously been registered as fully leased, despite Suncorp relocating from the building late 2014/early 2015.

Outside of this, the remaining negative net absorption has largely arisen from sub-lease space which was already being marketed, now becoming formally vacant as per the PCA definitions, such as space marketed by Worley Parsons and URS.

FIGURE 2
Brisbane CBD Vacancy
% total vacancy



Source: Knight Frank Research/PCA

Vacancy

The vacancy rate is expected to steadily increase from this point as the new supply additions over the next 18 months will outweigh the level of take-up in the market. From the current point of 15.0%, the total vacancy is expected to breach 17% by mid-2016 and remain elevated for the remainder of 2016 before beginning to recover in 2017.

Beyond that time the lack of new supply in the CBD, coupled with the expected recovering levels of net absorption and continued high obsolete stock withdrawal, vacancy is expected to show steady improvement through to 2019.

The Knight Frank series which has tracked major backfill and contraction space currently available since early 2013 has shown further improvement to August 2015 with sublease now 35,000m² (down by 22,500m² over the past year). Direct backfill and contraction space has also reduced to 102,700m², down by 4% over the year. However the level of sub-lease and backfill space is expected to increase across the CBD in the coming 18 months as the tenant relocations into new buildings take effect. At this stage the relocations to 180 Ann St and 480 Queen St will create in excess of 56,000m² of backfill space during late 2015 and the first half of 2016.

Tenant Demand

Tenant demand has remained on an upward trend over the course of 2015 with tenants now far more likely to relocate than a year ago. While enquiry levels are still patchy, the intent of tenants to move, rather than renegotiate in their current accommodation is far greater. This in part is a reflection of the higher business confidence levels, where companies do not see further downside in trading conditions, rather slow improvement. Balancing this activity is the fact that many tenants are taking similar amounts of space on relocation, rather than growing.

Another major influence on the propensity of tenants to relocate is the strong deals on offer. Particularly for tenants which signed a lease 5+ years ago with fixed reviews, their current rental levels would be well above market. When combined with the incentives on offer and more buildings undergoing refurbishment programmes, tenants can upgrade their accommodation and gain a new fitout with no capital outlay and little to no uplift in their annual rental levels.

Education and training tenants have continued to be active in the market, with several players new to the Brisbane market. Also active have been second and third tier professional firms, where there is some merger and consolidation activity. It is also expected that the public sector will become more active in the leasing market in the short term.

Rental Levels

Effective rental levels have stagnated over the past six months with both prime and secondary rents recording little to no change.

Prime gross face rents have increased by 1.0% over the past year to average $697/m² as the gradual lifting of prime face rents has continued. This has been more than balanced however by further increases in the average incentive levels. Prime incentives now average 36.5%, up from 35% a year ago. Overall average gross effective rents are now sitting at $443/m² which is 1.3% lower than in July 2014.

Prime effective rental levels are expected to remain stable on average until early 2017, as the market deals with the influx of new supply and tenant relocations it will engender. There is forecast effective rental growth of 3.0% over the year to July 2017, followed by improved levels of 4.5% in the year to July 2018. While the overall vacancy levels are expected to still be relatively high, the lack of expected new supply will support some rental growth, particularly at the premium and upper A Grade levels.

The secondary market has also been stabilising, however there are more owners now prepared to do deals with an incentive component of 40% or greater. Secondary gross face rents have been stable since the start of 2015 at an average of $545/m², although this represents an increase of 0.9% over the 12 months to July 2015. Incentives have continued to edge higher with the current average of 39.3% up slightly over the course of 2015 and up from 38% as at July 2014. As a result of this, the average gross effective rent fell by 1.2% p.a to July 2015.

Effective secondary rents are expected to remain static in the short term, not showing any significant improvement until late 2017 at the earliest, after which the sustained withdrawal of older stock is expected to begin to trigger some improvement in the market.

> "Tenants can upgrade their accommodation & gain a new fitout without uplift to their occupancy cost"

TABLE 3

Recent Leasing Activity Brisbane CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
295 Queen St	930	715 g	8	35+	SMS Solutions	Jul 16
180 Ann St	10,500	undis	11	undis	Commonwealth Bank^	Dec 15
410 Ann St	3,281	525 g	8	35+	IFAA	Dec 15
192 Ann St	6,300	585 g	10	30-35	Uniting Care	Oct 15
192 Ann St	3,300	595 g	10	30-35	Slater & Gordon	Sept 15
369 Ann St	1,400	495 g	7	25-30	Sage Institute	Jul 15
127 Creek St	790	550 g	6	30-35	Veolia Water	Jul 15
10 Eagle St	1,822	670 g	10	30-35	AEMO	Feb 15

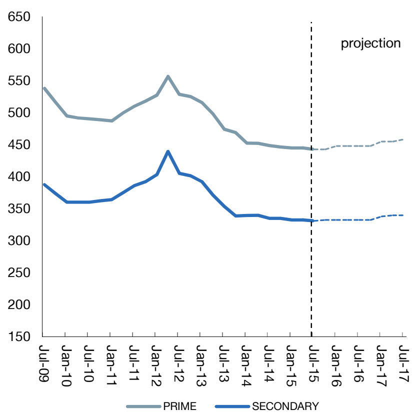
`estimated incentive calculated on a straight line basis g gross ^ pre-commitment

Source: Knight Frank Research

FIGURE 3

Brisbane CBD Rents

$/m² p.a average gross effective rent



Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Investment demand has continued to build across the commercial markets of Australia under the weight of global capital inflows. This has seen yields firm and the level of competition for formally marketed assets build. As opposed to Sydney and Melbourne, Brisbane has seen relatively fewer CBD commercial sales during late 2014 and this first half of 2015 as few assets have come to the market.

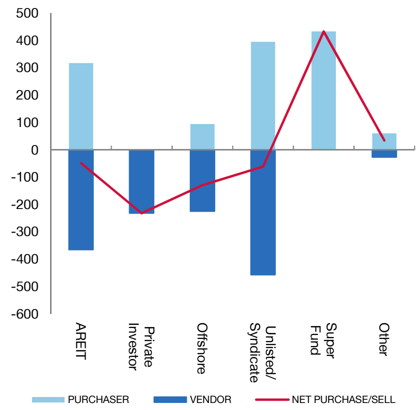
Over the 12 months to August 2015, the Brisbane CBD achieved $1.302 billion in office building sales in the $10+million market. This is roughly in line with the turnover achieved in the year prior, which was $1.282 billion. Purchasing activity over the past 12 months has been dominated by domestic funds with Super Funds (33%), Unlisted/Syndicate (30%) and AREITs (24%) dominating the landscape. Despite the strong purchasing activity both AREITs and the Unlisted/Syndicate sector remained net sellers of Brisbane office assets.

While offshore demand is high, in the past year their purchases were restricted to 300 Adelaide St ($47.5 million to Lei Shing Hong) and 363 Adelaide St ($47.5 million to Valparaiso Capital). Offshore purchasers, however, have been active in purchasing non-office CBD assets such as the Rendezvous Hotel at 103 George St for $29.50 million and the former Polo Club 193 Mary St for approximately $10 million, along with residential development sites like 30 Albert St and 240 Margaret St.

Recent major sales were dominated by the transactions of the Waterfront Place/ Eagle Street Pier complex for $635 million and the rejuvenated 215 Adelaide St for $224 million. After initially coming to the market in August 2014, the Waterfront Place office tower and adjoining Eagle Street Pier site have been contracted by DEXUS Property Group and DWPF for a combined $635 million. The asset is being sold by joint owners Stockland Trust and the Future Fund with a break-up of $592 million for the 59,448m² premium office tower and $43.0 million for the 6,258m² waterfront retail/restaurant precinct. Expected to settle in October 2015, the blended core market yield over the complex is 6.9%, with the retail component accounting for approx. 5% of the total income, although it has significant underlying value as a development site. The WALE at the time of sale was 4.2 years with increased mobility expected in the top tier tenants in the coming years.

The other recent significant sale was Challenger Life's purchase of 215 Adelaide St for $224 million, following their late 2014 acquisition of 53 Albert St for $209 million. The building was sold by offshore investor, Pramerica, which acquired the property in early 2012 for $134.5 million. The B grade 33 level building has 25,764m² in the office tower with 3,346m² of retail and office space in the adjoining Rowes & Rothwells building fronting Edward St. The property has undergone a major refurbishment of approx. $30 million which included a newly designed foyer and re-mixing of the retail component which now accounts for 16% of the asset's income. The property was 93% leased at the time of sale with a WALE of 4.3 years and reflected a blended core market yield of 7.03%.

FIGURE 4
Brisbane CBD Purchaser/Vendor
$ million sales ($10 million+) Year to August 2015



Source: Knight Frank Research

TABLE 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
1 Eagle St & Eagle Street Pier	P	635.00	6.90*	65,706*	9,664*	4.2	Stockland Group & Future Fund	DEXUS Property Group & DWPF	Oct 15
215 Adelaide St	A/B	224.00	7.03±	29,110	7,695	4.3	Pramerica	Challenger Life	Jul 15
24 Market St	B	6.50	9.78^	995	7,369	2.8	Private Investor	SV Partners	Jun 15
420 George St	B	22.00	n/a~	6,442	3,415	n/a	RNP	Forza Capital	Apr 15
10 Felix St	B	26.00	7.76	4,622	5,577	2.0	Canberra Raiders Leagues Club	AIMS Funds Management	Feb 15
363 Adelaide St ‡	B	47.50	VP	14,962	3,175	VP	Investa Property Group	Valparaiso Capital	Jan 15

*blended rate across the office and retail/site components ±blended rate across office and retail component ^ passing yield ~ sold largely vacant
‡ purchased for conversion to student accommodation Source: Knight Frank Research

Beyond these two larger transactions the only other office market sales in 2015 have been for smaller amounts and generally of a value-add or redevelopment nature.

Despite relatively few transactions across the CBD market, the pressure on yields has continued to see firming across the market. This is being fuelled by the steady and sustained yield contractions in the major investment markets of Sydney and Melbourne. As the yields firm in markets competing with Brisbane, if an arbitrage develops then there will be additional investment and new yield parameters set in the Brisbane market. The awarding of the Queens Wharf project (a 6ha infill site for an integrated resort development) to Echo Entertainment, Chow Tai Fook and Far East Consortium has increased Brisbane's visibility offshore and as such is increasingly seen as the next logical avenue for major investment into the Australian markets.

The average prime yields are currently 6.15% - 7.35% with a median of 6.75%. This represents firming of 25 basis points (bps) over the past year and 85 basis points during the current firming cycle of the past three years. With a margin of 104 and 70 bps over current prime average yields for Sydney and Melbourne respectively, the Brisbane prime market provides a viable alternative. This spread is above the 10 year average of 83 bps for Sydney and 36 bps for Melbourne.

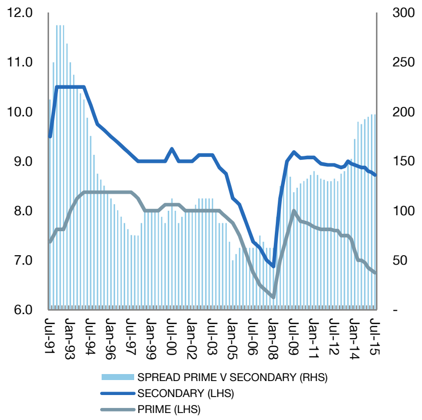
Secondary yields have also firmed slightly over the past year as yields for solid, well leased B grade buildings have firmed in line with the greater investment demand. However the upper yield range has remained stable as there has been no change in pricing for secondary assets with high leasing exposure. The current yield range for the secondary CBD is 7.85% to 9.60%, reflecting an average of 8.73%. The spread between prime and secondary yields has increased slightly over the past six months to sit at 197.5 basis points, well above the long term average of 130 bps.

Investment demand is expected to remain high in the short term with a mix of off-market and formal campaigns to see additional sales in H2 2015.

FIGURE 5

Brisbane CBD Core Market Yields

% Yield LHS & Basis Point Spread RHS



Source: Knight Frank Research

215 Adelaide Street was purchased by Challenger Life for $224 million which reflected a core market yield of 7.03% blended across the office tower and adjoining retail building.

Outlook

- Leasing activity is experiencing an upswing with new tenants to the market in the education sector and increased likelihood of tenants to relocate and upgrade due to the deals on offer.
- The delivery of three new buildings over the next two years will take the total vacancy to a new high and engender a period of high relocations and backfill space across the premium, A and upper B grade markets.
- Effective rents continue to stabilise with little to no change from the start of 2015. Face rents have some upward pressure however this is balanced by higher incentives. To be competitive landlords increasingly have to demonstrate both investment in the building and also market-meeting incentives.
- Stock withdrawals will increase in importance with steady withdrawals for the remainder of 2015 and then increasing into 2016 & 2017. While there are many potential candidates for withdrawal the relatively high book values of some of these assets may defer withdrawal.
- Purchasing activity has been lower than the southern states over 2015 to date with few formal campaigns. The sustained yield tightening is expected to bring further assets to the market and demand from private Asian investors will continue to drive off-market activity.
- Yields will continue to experience downward pressure under the weight of funds and sustained low interest rate environment. Recent share market volatility in China is likely to fuel greater capital outflows from the region into the relatively more stable Australian markets. This will particularly be the case for assets which are relatively insulated from the leasing market until 2018.

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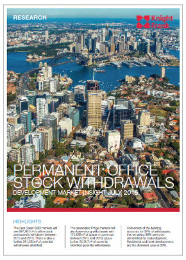

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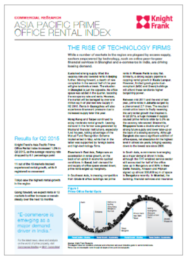

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