RESEARCH

MARCH 2012

BRISBANE CBD

Office Market Report

Knight Frank

HIGHLIGHTS

- The Brisbane market has continued to surprise on the upside with net absorption of 54,032m² (PCA) in the six months to January 2012 ensuring that the vacancy rate fell from 7.4% to 6.2%, despite supply additions of 39,400m² in the second half of 2011. The addition of 102,580m² during 2012 is expected to break this trend and see a temporary increase in the vacancy rate.
- As the amount of immediately available space reduced, there was a surge in market rental levels with gross effective rents increasing by 11.4% for prime and 17.2% for secondary over the 12 months to Q1 2012. While increasing face rents were a factor (3.7% prime & 8.6% secondary) most of the improvement came from sustained erosion in incentive levels late 2011 and into 2012.
- The investment market has continued to improve with demand for both prime and secondary properties. Value-add investors have joined the market, seeking exposure to the expected upside. At this stage transactions remain relatively slow to conclude with yields steady/marginally firming despite the improving rental growth outlook.

Table 1
Brisbane CBD Office Market Indicators as at March 2012

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	952,644	3.8	50,253	38,500	700	20.5	7.15 – 8.10
Secondary	1,118,596	8.1	41,887	-10,275	560	21.5	8.25 – 9.60
Total	**2,071,240**	**6.2**	**92,140**	**28,228**			

Source: Knight Frank/PCA ^ as at January 2012

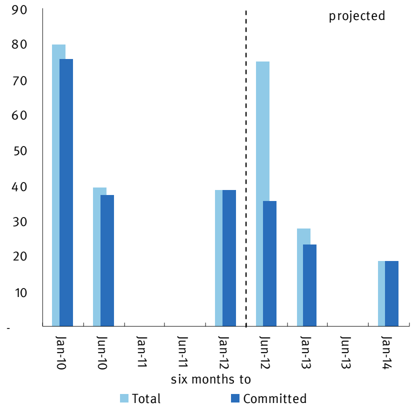
SUPPLY & DEVELOPMENT ACTIVITY

The level of new supply within the Brisbane CBD market is on an upswing after the hiatus which occurred following the completion of 140 Elizabeth Street in late 2009. The DEXUS developed 123 Albert Street was officially completed in August 2011 and the final 2.5 floors were leased in early 2012 bringing the property to full occupation.

Of the three buildings currently under construction, the first to be completed is 111 Eagle Street with anticipated completion in April/May 2012, adding some 64,000m² of premium accommodation to the market. Confirmed commitments have taken the building to 52% occupancy, however we understand there are additional space negotiations underway. The most recently announced major commitment was XStrata Coal, which has taken two levels (2,300m²). Further resources tenants such as Arrow Energy are also mooted to be interested in space within the building.

The refurbishment of 150 Charlotte Street is expected to be completed mid-2012 with two floors leased to the Queensland Government. A previously mooted commitment by Rio Tinto to the whole of the building is understood to have not proceeded, with the remaining space offered for lease at $575/m² gross face. In the second half of 2012 the completion of 145 Ann Street will add a further 27,960m² of A grade accommodation to the market. The building currently has four floors remaining for lease. The three tenants which committed early to the project – GHD, CUA and Grant Thornton have all increased the amount of space leased from their initial commitment.

Figure 1
Brisbane CBD Supply
('000m²) Supply (new & refurb) & commitment



Source: Knight Frank

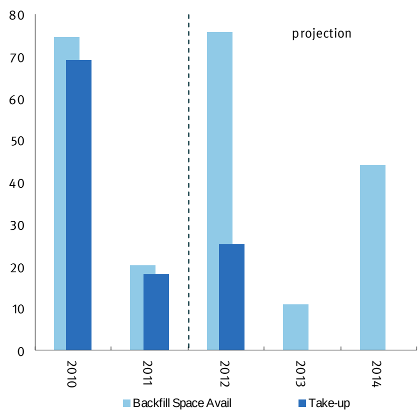
With near term supply relatively well committed, the next round of development is now taking form. The Regent development remains in active marketing, seeking a pre-commitment to commence construction. The proposed Grocon development (480 Queen St), which ran second for the Suncorp requirement of 32,000m² is also marketing, seeking a level of commitment which would trigger construction of the 61,500m² proposed building. It also remains a back-up option for Suncorp should its initial choice (Southpoint at SouthBank) not proceed. The developer of 30 Albert Street is also seeking a pre-commitment (and potentially a pre-sale) to commence, with little excavation required and a relatively smaller building allowing for the potential completion in 2014.

The Daisho development at 180 Ann Street is proceeding without a pre-commitment and the 57,000m² building has a targeted completion date of Q1 2015. Given the current demand profile for the CBD it is expected that at least two, and potentially three, buildings will be completed in the 2014 – 2016 period.

Backfill Space

With a greater level of tenant relocation expected in 2012 there is a corresponding increase in the level of anticipated backfill space which will come to the market. This encompasses the identified relocations into the new buildings of 111 Eagle St and 145 Ann St. There is also additional space from Rio Tinto, which has been slow to release backfill space to the market, still grappling with potential future requirements. Of the circa 75,500m² backfill space identified so far for 2012, 33% is already committed.

Figure 2
Brisbane CBD Identified Backfill Space
('000m²) from tenant moves 2,500m²+



Source: Knight Frank

www.knightfrank.com

1 123 Albert St – 38,500m² [Rio Tinto]
DEXUS - August 2011 – 100% committed

2 111 Eagle St – 64,000m² [ANZ/E&Y]
GPT– Q1 2012. 52% committed

3 145 Ann St – 27,960m² [CUA/GHD]-
Leighton/CPA – Q3 2012 - 80%
committed.

4 # 150 Charlotte St – 10,980m² [Qld Govt]
Walker Corp – Q2 2012 - 20% committed

5 # 313 Adelaide St – 9,662m² [Main Rds]
F.A Pidgeon & Son – Q2 2012 - 100%
committed

6 #175 Eagle St - 9,280m² [QR National] –
Charter Hall – Q3 2012 – 48% committed

7 55 Elizabeth St -18,517m² [ATO]
Grocon – Q3 2013 – 100% committed

8 The Regent Development – 50,000m²
ISPT – 2014+

9 180 Ann St – 57,000m²
Daisho – Q1 2015

10 480 Queen St – 61,500m²
Grocon (contract) – 2015+

11 111 Mary St– 35,000m²
Billbergia/ AMP SPP3 – 2016+

12 Transit Centre Stage II – 70,000m²
GPT/APPF – tba

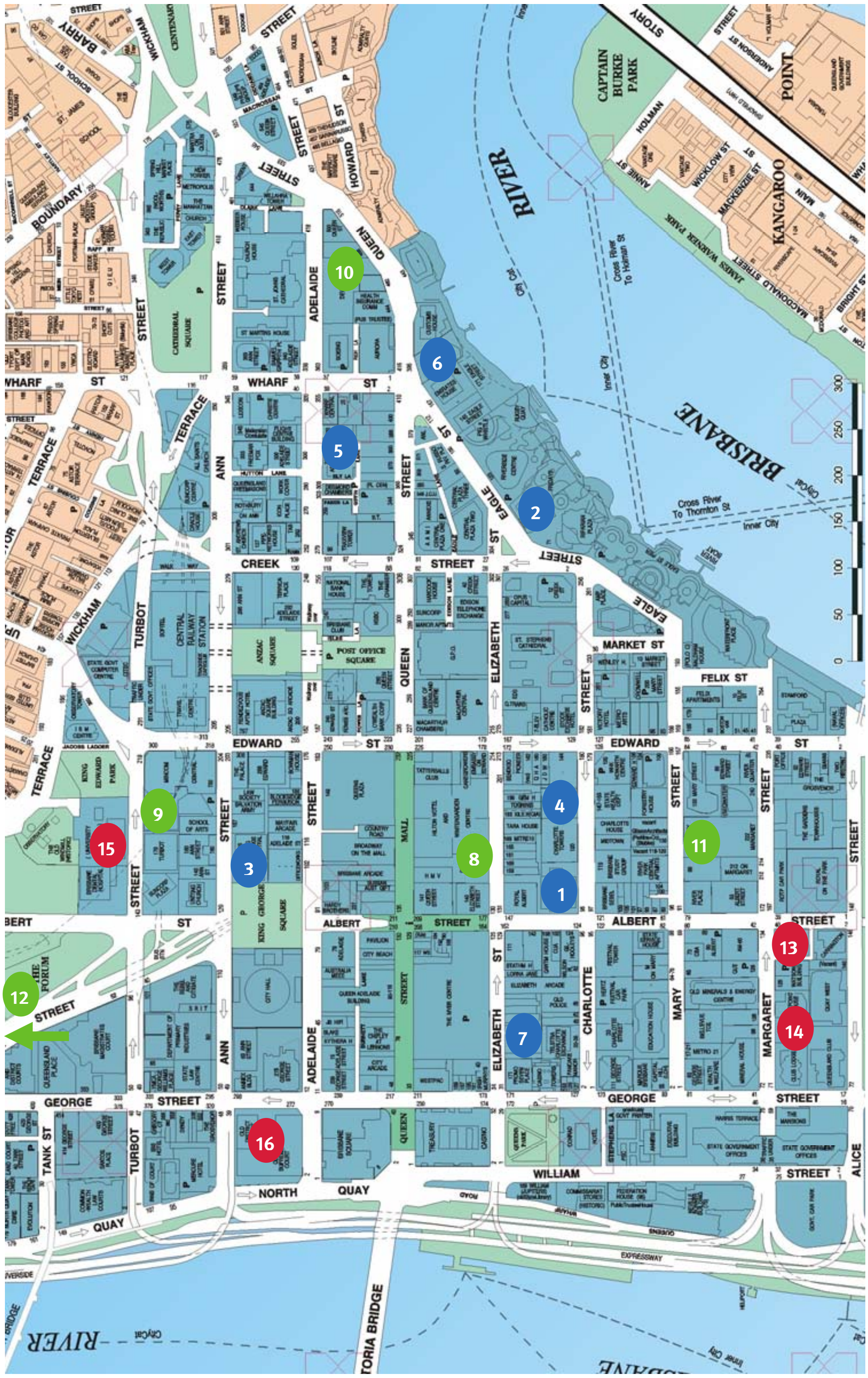
13 30 Albert St – 25,850m²
Marquette Property (option) – 2014+

14 111 Margaret St –25,000m²
Devine – 2015+

15 200 Turbot St - ~40,000m²
Leighton (option) – 2015+

16 Former Magistrates Court Site
State Govt - Offered for Tender – mixed
use 2015+

MAJOR OFFICE SUPPLY



Under Construction / Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

As at March 2012, excluding strata buildings.
Major Refurbishment.
Major pre-commits in brackets Office NLA Quoted
Source of Map: Knight Frank

TENANT DEMAND & RENTS

Tenant demand has continued to surprise on the upside within the Brisbane CBD market, recording the second highest level of six monthly net absorption, behind H2 2006. This brought the total vacancy down to 6.2%, a decrease of 3.2 percentage points over the 12 months to January 2012.

RESOURCES SECTOR DEMAND CONTINUED TO BOOST THE MARKET UPSIDE

Tenant demand has continued to be strong in the second and third tier expanding resources firms (200m² – 1,500m²) and also for project space (800m² – 2,500m²). Both of these tenant types have actively sought fitted out space. In recent months the presence of an existing useable fitout has gone from being beneficial (resulting in quicker leasing-up) to being a financial advantage (improvement in face rental and reduction in incentives) as the urgency of tenants to be in place quickly and with nil capital outlay has increased. While this type of demand has been concentrated in the secondary market, it has also been increasingly seen in the prime market.

Table 2
Brisbane CBD – Vacancy Rates
Vacancy by building grade

Precinct	Jan 2011	Jan 2012
Premium	4.0%	2.7%
A Grade	5.5%	4.0%
Prime	**5.3%**	**3.8%**
B Grade	13.7%	7.5%
C Grade	8.6%	8.4%
D Grade	12.9%	16.1%
Secondary	**12.7%**	**8.1%**
Total	**9.4%**	**6.2%**

Source: PCA

Net Absorption

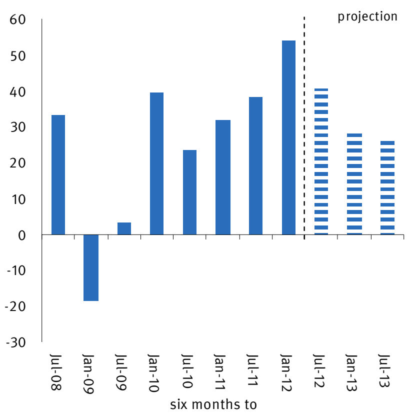
Table 3
Brisbane CBD – Net Absorption
Net absorption prime v secondary

Six months to	Prime m²	Secondary m²
Jan 2010	71,468	-30,528
Jul 2010	32,087	-4,572
Jan 2011	25,553	6,242
Jul 2011	11,457	26,651
Jan 2012	38,796	15,236
10 year Av.	**11,585**	**10,604**

Source: PCA

Strong tenant demand saw the Brisbane CBD record net absorption of 54,032m² over the six months to January 2012, taking the total for the 12 months to 92,140m². Boosted by 123 Albert Street, the net absorption was dominated by prime accommodation with 38,796m², ahead of secondary take-up at 15,236m² over the six month period. This reverses the trend seen in the six months to July 2011 where secondary accommodation dominated the net absorption levels as there was a lack of available prime accommodation and project tenants were soaking up the available cheaper, secondary space.

Figure 3
Brisbane CBD Net Absorption
('000m²) per 6 month period



Source: PCA/Knight Frank

Forecast net absorption is expected to remain above long term averages, but is expected to ease slightly from the most recent result which was increased by the delayed addition of 123 Albert Street into the official net absorption figures. Strong demand from start up and expanding resource-based companies is expected to boost net absorption in the first half of 2012. The larger professional firms which are relocating into new accommodation are generally upgrading and consolidating, with limited net space growth.

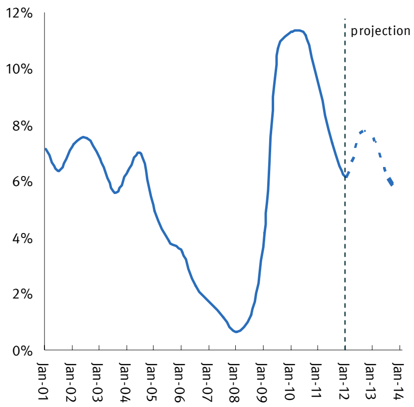
VACANCY RATE FELL TO 6.2%

From the second half of 2012 and throughout 2013 the net absorption is forecast to range between 25,000m² and 30,000m² per six month period. In 2014 the net absorption is expected to be impacted by the proposed major tenant relocations of Suncorp (23,000m²), Bank of Queensland (10,270m²) and potentially Boeing (c8,000m²) & QLD Health (13,300m²) which are expected to relocate out of the CBD and into the Near City/suburban market. Following this impact a further upswing in demand is forecast to be in place during 2015 and 2016.

Anticipated Vacancy Levels

Under the weight of impressive net absorption levels the vacancy rate has remained unaffected by the additional supply to the market during the second half of 2011, keeping the downward trend unbroken. The level of additional supply during 2012 is expected to result in the vacancy rate increasing moderately over the year to 7.7%, before trending downwards once again. With the lack of additional supply presently forecast for 2013 and 2014 this downward trend is anticipated to be strong and sustained, dipping below 4%, until anticipated completions in late 2014 and throughout 2015 reverses that momentum.

Figure 4
Brisbane CBD Vacancy
% total vacancy



Source: PCA/Knight Frank

Tenant Demand

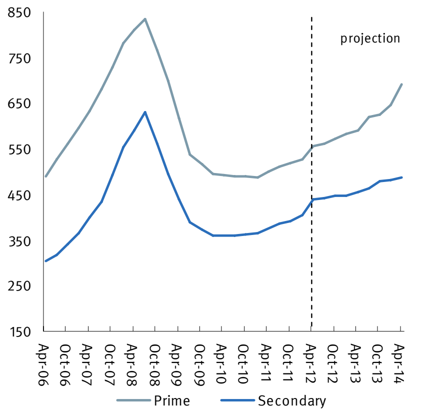
The largest current tenant requirements are resource sector based with BHP and Vale in the market for significant amounts of space in the medium term and Arrow Energy (8,000 – 14,000m²) and GVK/Hancock Coal (5,000 - 6,000m²) examples of tenants with more immediate accommodation needs. Smaller mining tenants such as Pacific Aluminium (2,000m²) are also seeking space. Professional tenants are not un-represented however, with Barry.Nilsson. Lawyers (2,300 – 3,000m²) and Herbert Greer (2,000m²) both in the market.

Rental Levels

Tighter than expected market conditions, as demand was higher than anticipated, absorbed many of the full floors that were available, which had been a hindrance to rental growth. This led to a spurt in rental growth during late 2011 and into early 2012. While this was not at the 30% p.a growth recorded for prime Brisbane accommodation at the peak of the market in 2006, it was sharp enough to serve as a reminder that the Brisbane market can change direction very quickly, particularly when contiguous space begins to be the subject of competition between tenants.

For the 12 months to the end of Q1 2012 the prime effective rental growth was generated by a relatively rapid reduction in incentives. The average gross face prime rentals grew by 3.7% to be $700/m² over the year, at the same time average incentives fell from 26.0% down to 20.5%. This resulted in effective gross rental growth of 11.4% p.a. at an average gross effective rent of $557/m². With the prime vacancy rate at only 3.8% and only limited contiguous floors available for immediate occupation, pressure increased on rental levels. This pressure is expected to ease following the imminent completion of 111 Eagle Street which still has space available, and as the tenants relocate into the building, leaving generally prime space as backfill. Prime effective rental growth is expected to be 6.1% over the 12 months to Q1 2013, before accelerating again by 16.9% in the following year as the vacancies shrink.

Figure 5
Brisbane CBD Rents
$/m² p.a average gross effective rent



Source: Knight Frank

Secondary rental levels also increased sharply in late 2011/early 2012 , re-basing the market. Due to face gross rental growth of 8.6% p.a to $560/m² and falling incentives from 27.5% to 21.5% over the year to Q1 2012, the market recorded 17.2% effective rental growth. Increased availability due to backfill space from mid year will slow effective rental growth to 3.7% over the coming year.

Table 4
Recent Leasing Activity Brisbane CBD

Address	Grade	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Incentive (%)`	Lease Type	Tenant	Start Date
12 Creek St	A	6,000	650 g	12	20-25	Existing	BDO	Jan 13
145 Ann St	A	1,100	675 g	7	Undis	Pre-commitment	Mills Oakley Lawyers	Sept 12
111 Eagle St	Premium	2,300	Undis	7	Undis	Pre-commitment	XStrata Coal	Jun 12
123 Albert St	A	3,813	Undis	7	Undis	Existing	Qld Treasury	Apr 12
175 Eagle St	A	4,640	700 g	4	15	Existing	QR National	Mar 12
240 Queen St	A	1,000	550 g	10	Undis	Existing	Shadforth Financial Group	Jan 12
1 Eagle St	Premium	1,792	810 g	10	27	Existing	Pilot Chartered Accts	Dec 11
400 George St	A	1,457	650 g	10	Undis	Existing	Conrad & Gargett	Nov 11
80 Albert St	B	1,539	515 g	3	15 – 20	Expansion	Arrow Energy	Oct 11
123 Eagle St	Premium	1,134	780 g	10	25+	Existing	Piper Alderman	Sept 11
144 Edward St	B	2,037	600 g	6	Undis	Sitting Tenant	Unidel	Sept 11
120 Edward St	B	1,822	595 g	10	Undis	Existing	Norman Disney & Young	Sept 11
324 Queen St	B	1,472	595 g	10	15-20	Existing	Brookfield*	Sept 11

Source: Knight Frank *part owner `estimated incentive calculated on a straight line basis

INVESTMENT ACTIVITY & YIELDS

There has been sustained and increasing interest in the Brisbane CBD investment market over the past six months as the vacancy and rental growth prospects have continued to improve. However to date this has been slow to translate into transactions with private investors continuing to dominate the number of sales.

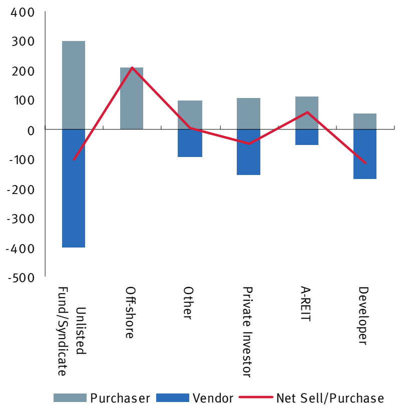
The largest CBD sale of the past six months was the $109.95 million purchase of 333 Ann Street by Growthpoint in December 2011. Growthpoint have been active within the Brisbane market acquiring some $307 million of Near City and suburban office properties during 2010 and 2011, however this is their first foray into the CBD market. The A grade building was constructed in 2008 and while fully leased the building is over-rented to some extent which is reflected in the passing yield of 9.12% compared to the core market yield of 8.20%. This was the largest prime sale of the second half of 2011 and with only secondary properties transacting in the CBD during 2012 to date, remains the largest sale since the transactions of 55 Elizabeth Street ($169.5 million in May 2011) and Waterfront Place, 1 Eagle Street (50% transferred for $216.4 million in May 2011). While other prime properties, such as 300 Queen Street have been openly marketed, no transaction has emerged to date.

In the first quarter of 2012 there has been an increase in CBD assets offered to the market, both formally and informally. This is a reflection of continued need by some owners to recycle funds and also the perception that the Brisbane market and asset prices are on the improve. CBD assets currently being offered to the market include 12 Creek Street, 40 Creek Street and 144 Edward Street.

OFF-SHORE INVESTORS WERE THE STRONGEST NET BUYERS

Overall purchasing activity within the Brisbane CBD over the 12 months to March 2012 has been dominated by unlisted funds/syndicates and off-shore buyers with 56% of transactions by combined value, even though they have not featured in recent purchasing activity within the market. Over the past 12 months the strongest net buyer of property has been from off-shore interests from two separate sales as they seek exposure to the resources based economic upside inherent within the Brisbane market at this time.

Figure 6
Brisbane CBD Purchaser/Vendor
$ million sales over $3million yr to March 2012



Source: Knight Frank

Despite the strong purchasing activity the unlisted fund/syndicate sector were net sellers in the Brisbane CBD market over the previous 12 months. Sellers such as Becton/Blackrock and Domaine SEQ Growth Fund were divesting assets as part of a larger financial restructure.

Private Investors remained active market participants with five purchases, however were overall net sellers in the market by total transaction value due to the divestment of assets such as 229 Elizabeth St, purchased by the Catholic Church for $51 million.

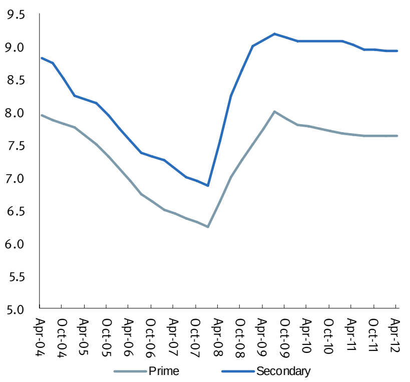
Table 5
Recent Sales Activity Brisbane CBD

Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
379 Queen St	C	21.00	9.48	5,464	3,843	3.1	Private Investor	Kingsmede Pty Ltd	Mar 12
20 Wharf St	n/a*	11.31	8.33^	2,277	4,967	25.0	NEXTDC Limited	Private Investor	Jan 12
369 Ann St	B	36.25	10.04 ^	6,646	5,454	3.8	Becton Office Fund/ Blackrock Trust	Private Investor	Jan 12
333 Ann St	A	109.95	8.20	16,467	6,677	4.0	Domaine SEQ Growth Fund	Growthpoint	Dec 11
126 Margaret St	B	19.50	10.19^	5,690	3,427	1.4	Receivers & Managers (Record Funds Mgt)	Investec Property Opportunity Fund 2	Sept 11
229 Elizabeth St	B	51.00	n/a	8,405	6,068	n/a	Private Investor	Roman Catholic Archdiocese Bris.	Aug 11

Source: Knight Frank *fully fitted out as a data centre ^ passing yield

Yields have remained relatively steady, lacking any significant competition between purchasers to drive any major tightening in yields. However as the prospects for rental growth improves there has been a slight downward pressure on yields and increasing appetite for risk. Prime core market yields have remained largely steady over the past six months to range between 7.15% - 8.10 %. In the current environment the passing yield has remained a major factor for purchasers, with financiers seeking a large buffer between passing income and interest cover. However more purchasers are now considering the medium to long term upside in purchase analysis with a greater focus on the 3-5 year income horizon than has been seen in recent years.

Figure 7
Brisbane CBD Yields
% median core market yield prime and secondary



Source: Knight Frank

The core market yields for secondary properties has also remained quite stable with some minor firming at the upper yield range as investors become more confident about the leasing environment for secondary space. Secondary core market yields currently range between 8.25% - 9.60% showing a firming of 15 basis points since the start of 2011. Despite a relatively steady yield environment the capital value of these assets has been recovering in line with rental recovery and improved occupancy levels. Private investors remain strong purchasers of these assets, although value-add funds such as the Investec Property Opportunity Fund 2 have also entered the market.

OUTLOOK

The Brisbane CBD market has benefited from sustained high levels of tenant demand, which has seen the vacancy rate fall over the past six months, despite net supply additions of 31,554m² over that period. The speed at which available space was taken up by tenants, and the acceleration of rental growth was a salient reminder of how quickly the Brisbane market can change. Much of the growth in the market has come, and is expected to continue to arise from, resources based companies or their direct service providers. These companies may either be expanding/consolidating main head office functions or seeking project space (typically encompassing 100 – 150 seats for 2-5 years).

With the buildings under construction showing a relatively high level of pre-commitment of 68% (excluding the refurbishment project of 150 Charlotte Street) the market's attention is turning to the next round of construction. Larger potential requirements from tenants such as BHP and Vale, along with the expectation that other tenants such as Queensland Gas, Santos and Arrow Energy will continue to follow an expansionary path, has stimulated developer interest for the delivery of new product in 2015+. At this stage the only confirmed project is Daisho's 180 Ann Street which will commence on a speculative basis for delivery in early 2015. Several other projects remain in marketing phase seeking a pre-commitment level which will trigger construction.

Despite the strengthening tenant demand and market rental growth, the addition of 102,780m² of space (91,900m² new and 10,880m² refurbished) will have an impact on the market over the remainder of 2012. While it is not anticipated that the market will lose any of its recent gains, the rate of effective rental growth is expected to slow as this space, and the associated backfill space from tenant relocations is absorbed by the market.

To date this backfill space has already been the subject of steady interest. For example the space being left by two tenants relocating into 111 Eagle Street; Gadens 4,678m² over two buildings is 78% leased, and Norton Rose 4,640m² within 175 Eagle Street has been fully committed by QRNational.

RENTAL MARKET HEADING TO A PINCH POINT IN EARLY/MID 2014

The average prime rental growth is expected to slow from the 11.4% growth seen in the year to Q1 2012 to 6.1% in the following year, before recovering to 16.9% p.a growth (12 months to Q1 2014) as the market heads towards a pinch point in early to mid 2014. After a period of digestion from late 2014, due to the expected major tenant relocations out of the city and the first of the new building completions, the market growth is expected to accelerate again from mid/late 2015.

Secondary rents have recovered strongly under the weight of demand from project, processing and technical based tenants which have absorbed large tracts of fitted-out secondary space. After the standout average effective rental growth of 17.2% over the year to Q1 2012 the greater availability of backfill space with suitable fitout is expected to take some of the heat out of this market. The average secondary effective rent is expected to show annual growth of 3.7% and 6.6% to Q1 2013 and Q1 2014 respectively.

Investor interest has steadily built for the Brisbane market, with larger wholesale or off-shore entities seeking prime, core product exposure to the market with its perceived upside. In addition value-add institutional investors have increased their activity, competing with private investors for some second tier assets. Despite the improving rental growth parameters, yields have firmed only marginally, handcuffed by the continual tightness in financial markets which has resulted in lengthy sales processes and minimal competitive pressure between purchasers.

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