RESEARCH

HIGHLIGHTS

- The Brisbane CBD vacancy rate increased to 7.9% as at July 2012, up from 6.2% six months earlier. Despite the strong net absorption of 36,916m² over the period the new supply of 82,737m² outweighed this, resulting in the vacancy increase. Despite lower expected new supply over the short term, the vacancy is expected to increase over the next 18 months as tenant demand is softer and the State Government contracts.
- Increased backfill space plus direct and sub-lease vacancy created by both private sector and State Government contraction have impacted short term rental growth prospects. Both prime and secondary effective rents are expected to fall approximately 5% over the year to June 2013. The Prime market is expected to recover that ground over the following year, while secondary space is expected to take longer to return to positive rental growth.
- The investment market for the Brisbane CBD has recorded total transactions of $905 million in 2012 to date, which represents the highest level of activity since the peak of 2007. Investor interest has continued to build with purchasers seeking exposure to the Brisbane market, however this demand has not yet converted to major yield falls.

Table 1
Brisbane CBD Office Market Indicators as at July 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	1,027,642	7.1	77,689	113,498	700	24.5	7.10 – 8.10
Secondary	1,122,155	8.6	13,093	-3,552	555	27.0	8.25 – 9.60
Total	**2,149,797**	**7.9**	**90,782**	**109,946**			

Source: Knight Frank/PCA

SUPPLY & DEVELOPMENT ACTIVITY

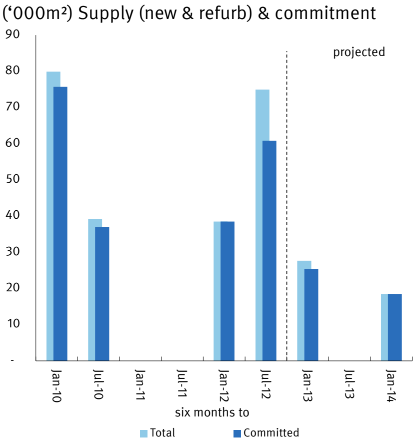
The first half of 2012 recorded relatively high supply additions for the Brisbane CBD market of 82,737m². Predominantly this arose from the completion of 111 Eagle Street (64,000m²) and the return to the market of refurbished space at 150 Charlotte Street (10,980m²) and 313 Adelaide St (7,846m²).

For the remainder of 2012 new supply will be limited to the completion of 145 Ann Street, an A grade building of 27,960m². This building is presently 92% committed with two floors remaining for lease. With the low rise floors ready for occupation the first tenant, GHD commenced moving into the property in September 2012, while construction work continues on the upper levels. Beyond 145 Ann Street the only other CBD project currently under construction is 55 Elizabeth Street. This building is fully pre-committed by the ATO with expected completion in mid-2013.

Further construction activity and new supply for the Brisbane CBD remains unconfirmed at this time. While there are a number of properties with development approval and seeking pre-commitment to commence, at this stage no project has received the level of commitment required to trigger construction. The exception is 180 Ann Street, where the developer Daisho is moving forward with plans to construct the building, not requiring any pre-commitment to commence construction.

Confidence surrounding the level of further private sector development has been impacted by the relative lack of tenants seeking to pre-commit to space and also the lack of urgency which these tenants are now displaying in the market. With delivery risk front of mind for many tenants, there is limited appetite to be the first to commit to a project, particularly where more than one commitment will be required to trigger construction. In August, Grocon announced that they had reached Heads of Agreement with Freehills to take the top three levels of 480 Queen St, however further commitments will be required to advance the project.

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



Source: Knight Frank

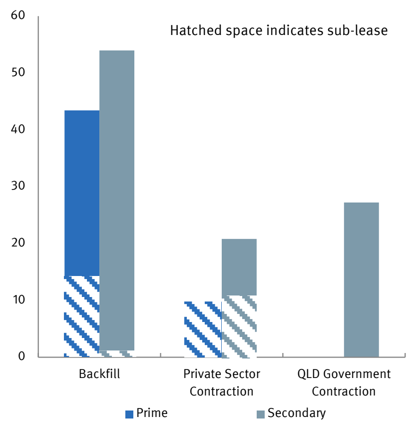
In addition, the State Government announced their intention to commit to circa 60,000m² within a purpose built tower at 1 William Street in the second half of 2016. Should this project continue to advance it is likely to take the place of one of the currently mooted projects, given the size of the building and the likely underlying demand in the market.

Backfill & Contraction Space

The level of backfill space has increased over the course of 2012 in line with the higher new supply and associated tenant relocations. This will also be boosted by a number of tenants relocating to new construction in the Near City (ie Urban Utilities 8,350m² and Macquarie 3,031m²) in early 2013.

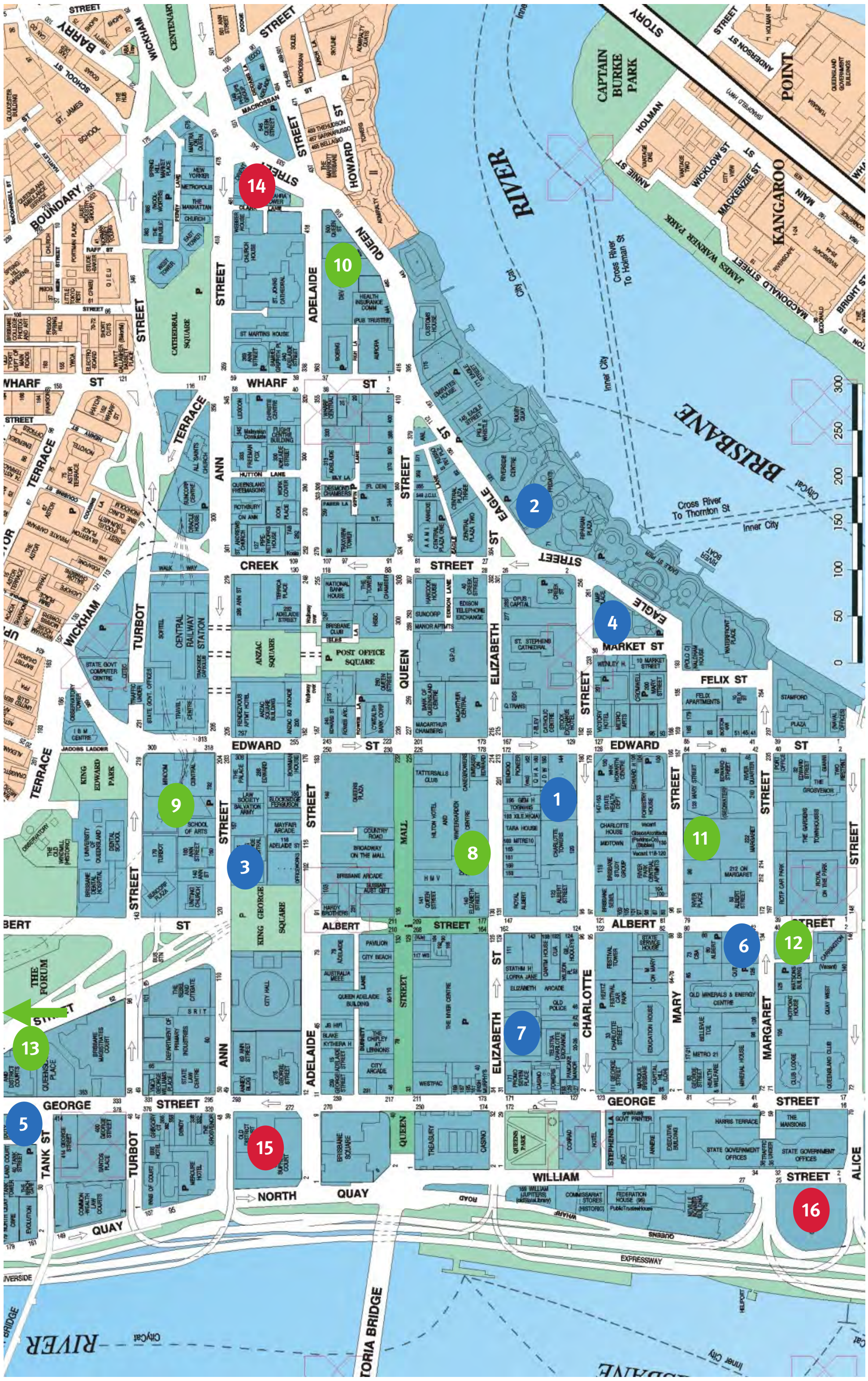
Due to a reduction in public service numbers, further space will come to the market as the State Government moves from leased accommodation on expiry. To date Knight Frank has identified 27,200m² of space which will be vacated late 2012 – early 2013 by the State, with more expected to emerge over coming months. In addition there is approx 30,500m² of private sector contraction space identified in the short term (20,000m² of which is sub-lease space).

Figure 2
Brisbane CBD Backfill & Contraction
('000m²) available space identified as at Sept 12



Source: Knight Frank

MAJOR OFFICE SUPPLY



1	#150 Charlotte St – 10,980m² [Fed Govt] CIMB– June 2012 - 20% committed
2	111 Eagle St – 64,000m² [ANZ/E&Y/Arrow] GPT– June 2012 - 82% committed
3	145 Ann St – 27,960m² [CUA/GHD]-Leighton/CPA – Q3 2012 - 92% committed.
4	^10 Eagle St - 7,414m² Direct & Sub-lease CPA *Arrow Energy/Stanwell* – 2012/2013
5	#420 George St – 6,500m² Nielson Properties – Q2 2013.
6	^ 60 Albert St - 6,010m² LaSalle Funds Mgt *Arrow Energy* - June 2013
7	55 Elizabeth St -18,517m² [ATO] Grocon/Credit Suisse – Q3 2013 – 100% committed
8	The Regent Development – 50,000m² ISPT – 2015+
9	180 Ann St – 57,000m² Daisho – Q3 2015
10	480 Queen St – 61,500m² - [Freehills] Grocon – 2015+ - 8% HOA only.
11	111 Mary St– 35,000m² Billbergia/ AMP SPP3 – 2015+
12	30 Albert St – 25,850m² Marquette Property (option) – 2015+
13	Transit Centre Stage II – 70,000m² GPT/APPF – tba
14	550 Queen St – tba Consolidated Properties - tba
15	Former Magistrates Court Site State Govt - Offered for Tender – mixed use 2015+
16	1 William St, 60,000 - 75,000m² [State Govt]- Expressions of Interest Sought – late 2016 – 100% committed

Under Construction / Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

As at September 2012, excluding strata buildings.
Major Refurbishment / entire building available
^ Sub-lease space >5,000m² contiguous.
Sub-Lessor indicated in *italics*
Major pre-commits in brackets
Avail Office NLA Quoted
Source of Map: Knight Frank

TENANT DEMAND & RENTS

Tenant demand across the Brisbane CBD has softened since the first quarter of 2012, after a particularly strong start to the year. Initially manifesting through a cessation of additional project space demand, since the end of the financial year there is an emerging trend of a lack of tenant confidence and downsizing.

As indicated above as at September 2012, Knight Frank has identified some 57,780m² of space coming to the market (20,560m² as sub-lease and the remaining 37,220m² on a direct basis) as a result of downsizing across the government and private sectors. Following a change of State Government in March 2012, the new administration has launched a reduction in public service numbers, with in the order of 14,000 full time positions removed during the first six months of Government. To date this has resulted in the 27,000m² of space identified as being vacated during late 2012 and early 2013. It is expected that this figure will grow further.

At the same time the private sector , particularly (but not limited to) engineering and resources firms associated with the coal industry, have been contracting as they seek to rein in costs. This sector also includes current or former government owned corporations such as QR and QRN. With 2/3rds of this space offered as sub-lease accommodation, this may be quickly re-absorbed if trading conditions improve for these companies.

Table 2
Brisbane CBD – Vacancy Rates
Vacancy by building grade

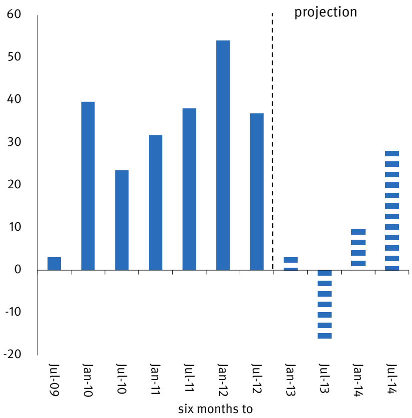
Precinct	Jul 2011	Jul 2012
Premium	3.9%	10.1%
A Grade	4.1%	6.3%
Prime	**4.0%**	**7.1%**
B Grade	10.9%	8.2%
C Grade	6.9%	7.9%
D Grade	10.5%	16.3%
Secondary	**10.0%**	**8.6%**
Total	**7.4%**	**7.9%**

Source: PCA

Net Absorption

Net absorption was high for the first half of 2012 at 36,916m² as tenant take-up, particularly in the first quarter of the year, was extremely strong. Coupled with the record levels in the previous six months of 53,867m², the annual net absorption of 90,783m² is roughly 2.3 times above the 15 year average. However the recent slowdown in tenant activity means that the short term outlook is far more modest.

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



Source: PCA/Knight Frank

Given the relatively low enquiry levels and short term tenant contraction, it is expected that net absorption for the second half of 2012 will be negligible for the Brisbane CBD. With the majority of the identified contraction space expected to hit the market in the first half of 2013, negative net absorption is expected over that period.

At this stage only one period of negative net absorption is expected, with the underlying fundamentals of the market remaining positive. Given the expected stabilisation in Government occupancy and brighter medium term economic forecasts, office demand is expected to recover over the course of 2014.

Anticipated Vacancy Levels

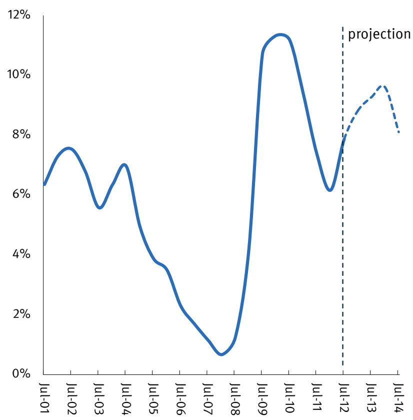
Despite the strong net absorption during the first half of 2012, the greater weight of new supply saw the vacancy rate increase from the lows of 6.2% at the start of the year to be 7.9%.

While supply additions will remain relatively low in the short term, the lower levels of demand will see vacancy steadily increase over the next 18 months. At this stage the vacancy rate is expected to remain below 10%, assuming recovery of demand in 2014.

VACANCY TO PEAK AT 9.6%

Peaking at 9.6% in late 2013/early 2014 the vacancy rate is expected to begin to fall again from that point as there is no new supply to come to the market during 2014 and into H1 2015. This lack of additional supply is expected to place a cap on the vacancy rate, with market softening largely limited to short term tenant weakness rather than oversupply.

Figure 4
Brisbane CBD Vacancy
% total vacancy



Source: PCA/Knight Frank

Tenant Demand

The reduction in general tenant demand has also been reflected in more modest demand for pre-commitment space. With Arrow Energy choosing 111 Eagle Street for its 14,800m² headquarters, the largest tenant within the market at this time is APLNG for 12,000m² in 2014 with one CBD option on the short list. Major CBD tenants actively seeking space within the market are KPMG with an 8,000m² requirement for 2015 and Peabody is testing the market for 5,000 – 7,000m². A number of legal firms such as MacGillivrays (2,000m²), Trilby Misso (4,500 – 6,000m² mid 2014) and Clarke & Kann (1,400m²) are in the market along with Marsh (2,500m²). Other tenants like VALE have shelved their expansion plans (they were seeking 8,000 – 10,000m² in line with a proposed major mine development) and are now seeking to sub-lease some of their existing space in the short term.

In contrast, the energy sector has continued to be active with Arrow Energy taking an additional 2,900m² in Waterfront Place for a short term to accommodate growth until the company relocates into 111 Eagle Street in 2013. It is also reported that Origin Energy is negotiating further expansion space, looking at 5,000 – 6,000m² of sub-lease space (Ernst & Young) also in Waterfront Place for a three to five year term.

Rental Levels

The average market rent grew strongly in the first quarter of 2012, due to solid demand for the limited contiguous space. This was eased by the supply additions during June 2012 and then softened as the level of tenant demand decreased and some contraction space also began to enter the market.

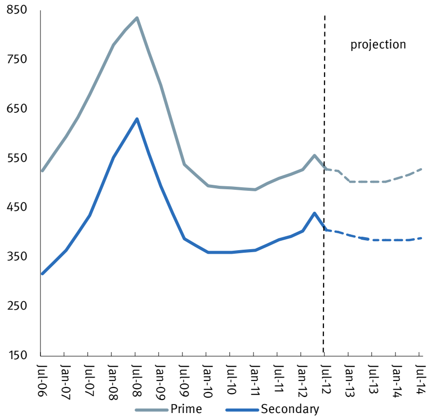
For the 12 months to July 2012 the prime effective rental growth was generated from the improving conditions during late 2011. The average gross face prime rentals grew by 2.9% to be $700/m² over the 12 months, while incentives fell slightly from 25.0% to 24.5% (after dipping as low as 20.5% in April 2012). This resulted in an average of $529/m² gross effective, which reflects effective rental growth of 3.6% over the year to July 2012.

In the short term, while the prime market is expected to be less impacted by tenant contraction, the new supply and associated level of backfill space will make the sector vulnerable to further discounting. At this stage the face rental rate of $700/m² gross is expected to be maintained in the short term, with a potential softening of $10 - $20/m² through mid-2013. In addition a further increase to average incentives is likely – with a peak of 26% during 2013. Overall prime gross effective rents are expected to soften by 4.6% over the year to July 2013, before recovering by 5.0% during the 12 months to July 2014 – bringing the market back to current levels. From mid-2014 the growth profile is expected to be stronger, averaging 6.5% p.a over the following two years.

Figure 5

Brisbane CBD Rents

$/m² p.a average gross effective rent



Source: Knight Frank

The average secondary effective rent grew by 5.0% over the year to July 2012, due to strong improvements late 2011/early 2012. With the amount of secondary space to become vacant in the next six months, the effective rents are forecast to fall 4.9% over the next year and thereafter remain flat until mid-2015.

Table 3

Recent Leasing Activity Brisbane CBD

Address	Grade	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Incentive (%)`	Lease Type	Tenant	Start Date
111 Eagle St	Premium	14,800	850 g	8	25+	Pre-commitment	Arrow Energy	Mar 13
150 Charlotte St	A	1,484	605 g	10	25+	Existing	DFAT	Nov 12
410 Ann St	B	3,600	535 g	8	25+	Existing	Jakobs	Aug 12
240 Queen St	A	2,042	685 g	8	25+	Existing	Sparke Helmore	Jun 12
1 Eagle St	Premium	2,900	undis	1	undis	Expansion	Arrow Energy	Jun 12
141 Queen St	B	1,634	550 g	7	25+	Existing	Dimension Data	Jun 12
200 Mary St	B	2,154	550 g	2	nil	Sub-lease	Harmony Gold/Newcrest	Jun 12
175 Eagle St	A	1,159	710 g	7	20-25	Existing	Cerner	Jun 12
175 Eagle St	A	1,159	710 g	7	20-25	Existing	ISIS	Jun 12
345 Queen St	A	1,645	665 g	5	25+	Existing	EMC	Jun 12
324 Queen St	B	1,554	595 g	8	25+	Existing	North QLD Bulk Ports	Apr 12
500 Queen St	B	2,400	550 g	5	25+	Existing	Pacific Aluminium	Apr 12
30 Makerston St	B	1,027	530 g	undis	20-25	Existing	Shine Lawyers	Mar 12

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

INVESTMENT ACTIVITY & YIELDS

Investor interest in the Brisbane CBD market has continued to build over the course of 2012. Investors, both institutional players and private investors have been active in the market, seeking greater exposure to the Brisbane market which has strong growth expectations over the medium term. In addition, offshore buyers such as Pramerica and CIMB have made significant purchases in the market and further demand exists from off-shore investors for both Brisbane CBD and Near City assets.

There have been 14 transactions across the Brisbane CBD commercial market (transactions over $3 million) for 2012 to date. This represents total turnover of $905 million, which is the highest total recorded since the standout year of 2007 ($2.13 billion).

Two of the city's best known buildings, colloquially known as the Blue Tower and the Gold Tower have sold in recent months. The Blue Tower, 12 Creek Street was purchased for $241.6 million by DEXUS with the listed trust taking 50% and the Wholesale DWPF the remaining stake. The sale by APGF reflected a core market yield of 7.64%. The building's slightly older "twin", the Gold Tower, 10 Eagle Street was purchased by Colonial Property Fund for $195 million in June 2012. This sale reflected a core market yield of 7.51%. The two A grade buildings are in a prime location close to the Brisbane River within the Financial precinct. Both buildings have a good mix of tenants with WALEs of 4.7 (12 Creek St) and 3.87 (10 Eagle St) which will facilitate the re-basing of the rental profile.

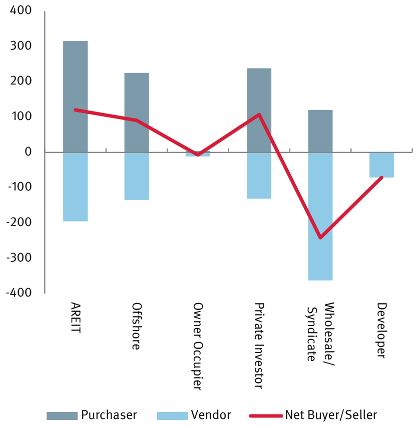
The other major sale of 2012 was the purchase by Pramerica Group of 215 Adelaide Street for $134.5 million. The B grade building was sold in tandem with a smaller heritage listed retail arcade and showed a core market yield of 8.90%.

INVESTORS SEEKING TO INCREASE THEIR EXPOSURE

These three larger sales reflect the current trend in the market for AREITs and Offshore buyers to dominate the net purchasing activity. As shown in Figure 6, for 2012 to date the wholesale/syndicate and developer categories continue to be net sellers of CBD property, with AREITs and offshore investors dominant purchasers.

Following a number of recent sales such as 40 Creek Street ($84.5 million), 500 Queen Street ($36 million) and 243 Edward Street ($37.25 million) private investors have increased their share of net purchasing activity in recent months, after being net sellers for most of the year.

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



Source: Knight Frank

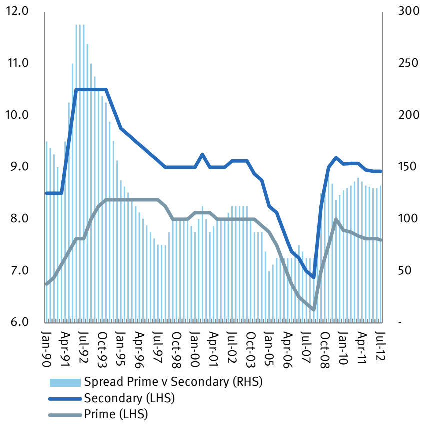
Table 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
40 Creek St	B	84.50	8.25^	12,986	6,507	6.1	Charter Hall Opp. 5	Private Investor	Sept 12
12 Creek St	A	241.60	7.64	32,227	7,497	4.7	APGF	DEXUS & DWPF	Sept 12
500 Queen St	B	36.00	9.00	7,145	5,038	4.2	Girdis Group	Great Western Corp	Aug 12
488 Queen St	B	20.00	n/a#	4,600	4,348	n/a	Girdis Group	MRL Capital	Aug 12
243 Edward St	C	37.25	8.93 ^	6,308	5,905	n/a	Albert Chung	Drivas Group	Jul 12
150 Charlotte St*	A	71.00	8.73	11,013	6,447	5.0	Walker Corporation	CIMB Trust Capital Advisors	Jun 12
10 Eagle St	A	195.00	7.51	28,098	6,940	3.9	Brookfield Aust	Commonwealth Property Office Fund	Jun 12
26 Wharf St	C	12.25	8.98	3,088	3,967	2.7	Harvest Property/ Denison Group	Private Investor	Mar 12
215 Adelaide St	B	134.50	8.90	29,780	4,516	4.1	GIC	Pramerica	Mar 12
379 Queen St	C	21.00	9.48	5,464	3,843	3.1	Private Investor	Kingsmede Pty Ltd	Mar 12

Source: Knight Frank ^ passing yield # sold 46% vacant *sold c80% vacant following the refurbishment, but with a 5 year rental guarantee from Walker Corp

Despite the increasing interest in Brisbane, yields have remained relatively steady, with competitive tension still lacking between purchasers. Prime core market yields have remained largely steady over the past six months, showing a median of 7.60% (range of 7.10% - 8.10%).

Figure 7
Brisbane CBD Yields & Risk Spread
% yield (LHS) & spread prime v secondary bps (RHS)



Source: Knight Frank

The core market yield for secondary property has also remained stable over the course of 2012. Some firming sentiment at the start of the year has since unwound with purchasers again needing to factor in leasing risk. The secondary core market yield range is currently 8.25% -9.60% with an average of 8.93%.

The average risk premium between prime and secondary properties is currently 132 basis points (bps), and while this is not materially different from the long term average of 125bps this reflects a period of stabilisation after the GFC. Pre-GFC this risk premium had fallen to an unsustainably low 50-60bps as secondary assets were being purchased with little regard to leasing risk. Following the impact of the GFC on both investors and financiers this gap blew out, maximising at 150bps. At this stage there is a case to be made that on a structural level, there is scope for the yield gap to close to circa 80 – 120bps with the average of 125bps impacted by the very soft market of the early 1990s. However in the short term the anticipated leasing conditions for secondary space will stall any wholesale narrowing of this risk premium.

OUTLOOK

After several strong years of performance, with net absorption of 223,872m² over the past three years (compared with 129,828m² for Sydney CBD and 224,635m² in Melbourne), the Brisbane CBD market has seen tenant demand slow from the second quarter of the year. This has been due to a combination of the slowing resources sector, particularly coal producers, general cost cutting by major corporates and the State Government downsizing.

As a result of this there is expected to be an increasing amount of sub-lease space offered to the market in the short term, and although not all tenants will vacate this space, it will have an impact on the net absorption and vacancy levels over the course of 2013. Should the resources market show improvement, then it can be expected that some of this space would be quickly re-absorbed by users. To date all of the sub-lease space identified is from the private sector; however as the State Government exhausts lease expiries to vacate they may also seek to put some sub-lease space on the market.

With 66% (48,000m²) of this identified contraction space located within secondary buildings, this market is expected to be the most impacted. In addition there is approx 54,000m² of secondary backfill space which has been identified as returning to the market from tenant moves to new buildings both within the CBD and the Near City.

The prime market is not completely spared any impacts from this changing market with approx 53,000m² of space (43,400m² backfill and 9,800m² contraction) to be offered to the market in the short term. However with the buildings under construction almost fully committed and no further completions expected until at least the second half of 2015, this lack of new stock is expected to insulate the prime market from any softness beyond the short term. As a result the effective rental for the prime market is expected to soften by no more than 5% and be back to current levels by mid-2014.

LITTLE NEW SUPPLY TILL 2015/2016 WILL LIMIT VACANCY

The softer market conditions are expected to see the vacancy rate continue to climb over the next 18 months, peaking in late 2013 at 9.6%. The lack of any new supply during CY 2014 and until the second half of 2015, is expected to limit further vacancy rate increases and facilitate a relatively rapid reduction back to 5-6% during 2015.

While the short term outlook for the Brisbane market engenders a degree of caution due to the rapid change seen in the market over the past few months, the longer term prospects still remain underpinned by a pipeline of capital investment in the state. Even given the recent reduction in feasibility studies for future resources projects, there was still $7.83 billion of private sector capital expenditure in the mining sector during Q2 2102.

LONGER TERM PROSPECTS REMAIN SOUND

The desire by investors both local and off-shore to gain exposure to this market has seen transaction activity within the CBD grow over the course of 2012, with sales in 2012 to date the highest seen since the stand out year of 2007. The recent weakness in the leasing market may impact on short term buying confidence; however those without sufficient exposure to the Brisbane market will still seek purchasing opportunities. As within any market, purchasers will need to analyse each building on its merits with some properties more vulnerable to the current contraction within the market than others.

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