RESEARCH

MAY 2012

CANBERRA OFFICE

Market Overview

Knight Frank

HIGHLIGHTS

- The Canberra office market is in the midst of a drawn out period of uncertainty. Given its high reliance on the Public Sector, Government's recent announcement to bring the Federal Budget back to surplus has put pressure on employment and efficiency dividends which affect demand for office space. Unfortunately this is unlikely to be any clearer after the Federal Election as the Coalition has also flagged a reduction in public service jobs.
- The positive for the office market however has been the switch to strong demand led supply additions. Net absorption has shown robust levels over the past two years and given most new supply is significantly pre committed this will keep A Grade Canberra vacancies from increasing again above their current rate.
- The two tier market has been evident for some time due to the NABERS ratings requirement by the Public Sector. This is likely to continue putting pressure on Secondary owners to upgrade their facilities; however the emergence in demand for fitted out space has shown Government to be more lean than green in recent times. Face rents have seen little movement and are unlikely to grow in the next two years, however pressure will be on economic rents with incentives likely to remain at their current level for Civic at 11% for A Grade and 15% for Secondary for the short term.

CANBERRA MARKET OVERVIEW

Table 1
Canberra Commercial Market Indicators as at April 2012

Market	Total Stock (m²)^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²)^	Average Gross Face Rent ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
A Grade							
Civic (city)	259,074	7.6	6,776	0	415	11	7.25 – 7.75
Parliamentary Precinct	174,963	3.5	6,778	6,024	422	13	7.25 – 7.75
Town Centres	198,700	0	0	0	376	12	7.75 – 8.50
Airport	157,851	31.4	-218	12,287	372	17	n/a
Secondary							
Civic (city)	404,494	10.9	18,276	-16,087	373	15	8.50 – 9.50
Parliamentary Precinct	175,691	5.0	-942	3,880	378	15	8.50 – 9.50
Town Centres	282,227	13.6	15,191	-17,157	310	20	9.50 – 10.50
Total Market#	2,208,091	10.6	64,096	1,802			

Core Market Yield:	The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc).
Parliamentary Precinct:	Includes Barton, Parkes and Forrest office precincts
Town Centres:	Includes the Phillip, Tuggeranong and Belconnen office precincts

Source: Knight Frank/PCA ^ as at Jan 2012 #Includes additional sub markets as well as above major listed markets

SUPPLY & DEVELOPMENT ACTIVITY

New supply of stock across Canberra has recently slowed after strong growth during 2007 and 2010. During this period we saw over 675,000m² of stock enter the market growing the total stock level by more than 30%. More recently though the completion of new stock has reduced with the last 12 months showing new supply additions of 48,172m² or net additions of just 1,802m². This slowdown in supply has aided the reduction of vacancies which significantly increased in 2010 off the back of high speculative completions.

Currently there are a number of large new buildings under construction in both Civic and the Parliamentary Precinct. During the first half of 2012 supply levels will be low with 17,838 m² to complete, which primarily represents refurbished stock completions at 10 and 12 Mort Street.

The second half of the year however will result in 94,000m² coming online. This includes the fully committed ASIO HQ 40,000m² in Parkes, ISPT's 4 National Circuit, Barton development of 30,000m² with partial commitment and the 90% committed Nishi, 25 Edinburgh Avenue, Civic.

Other major projects which are currently under construction and have certainty in entering the market over the next few years include Department of Human Services committed 6 Cowlishaw Street, Tuggeranong and St Johns Ambulance site Forrest as well as the partially PwC committed 28 Sydney Avenue, Forrest.

Civic has a high level of mooted supply; these projects are unlikely to proceed in the short to medium term due to the uncertainty in the economic and political environment. This mixed sentiment will continue through until the next Federal Election as employment growth (or losses) in both the Public and Private sectors continue to hamper confidence levels.

MOOTED PROJECTS UNLIKELY TO PROCEED GIVEN UNCERTAINTY IN THE ECONOMIC AND POLITICAL ENVIRONMENT

Given this uncertainty a "wait and see" attitude is likely to be the safest solution. With current A Grade vacancy of 11.7% throughout the region there is space availability. However, if space requirements do outstrip supply this will benefit the rental market. There are also multiple larger offerings at the Airport that could cater to any prospective growth in demand.

MAJOR OFFICE SUPPLY

1 10 & 12 Mort Street^ # - 15,438 m^2
GPT Wholesale Office Fund - Q2 2012

2 3-7 Molonglo Drive, Airport - 34,000m²
Capital Airport Group - near complete, awaiting commitment

3 ASIO HQ, Constitution Ave, Parkes - 40,000m² [ASIO]
Federal Govt - Q4 2012 - 100% committed

4 4 National Circuit West, Barton - 18,000m² [AGD~]
ISPT - Q3 2012 - 44% committed

5 4 National Circuit East, Barton - 11,600m²
ISPT - Q3 2012 - uncommitted

6 Nishi^ - 21,000m² [Dept of Climate Change, Clayton Utz]
Molonglo Group - Q4 2012 - 90% committed

7 St John's Ambulance site, Forrest - 9,630m² [DHS*]
Doma Group - Q4 2012 - 100% committed

8 Blk 10 Sect.16, Cowlishaw St, Tuggeranong - 26,000m² [DHS*]
Amalgamated Group - Q4 2013 - 100% committed

9 28 Sydney Ave, Forrest - 12,500m² [PwC]
BDC ACT - Q2 2013 - 40% committed

10 1 Canberra Ave, Forrest - 24,500m²
Willemsen Group - Q3 2015 seeking pre-commit

11 Vernon North - Building 4, London Circuit^ - 25,000m²
Leighton/Mirvac JV - 2016+ seeking pre-commit

12 45 Furzer St, Phillip - 22,000m²
Doma Group - 2015+ seeking pre-commit

13 Signature Building 2, London Circuit^ - 16,000m²
Leighton/Mirvac JV - 2016+ seeking pre-commit

14 26-28 Antill St, Dickson (ex ACT Tab bldg) - 8,000m²
Amalgamated Group - 2015+ seeking pre-commit

15 Anzac Park East, Parkes # - 12,534m²
Federal Govt - mooted

16 Landmark Building, London Circuit^ - 50,000m²
Leighton/Mirvac JV - mooted

17 Section 96^ - 37,500m²
QIC - 2016+

18 Vernon South - Building 3, London Circuit^ - 25,000m²
Leighton/Mirvac JV - mooted

19 71 Constitution Ave, Campbell - 10,000m²
Hindmarsh Group - 2017+

20 23 National Ct, Barton - 14,500m²
Federal Govt - mooted

21 Section 4^ - 50,000m²
ACT Government - 2017+

22 Myuna Complex, Northbourne Ave^ -52,000m²
Walker Group - 2015+

23 44 Macquarie St, Barton - 20,000m^2 mixed use
Doma/Morris Group - 2015+

Under Construction/Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates
Major tenant precommitment in brackets
Major refurbishment
^ Civic precinct
* DHS Dept of Human Services
~ AGD Attorney General Department
Office NLA quoted

Map source: ACT Planning and Land Authority (ACTMAPi)

TENANT DEMAND & RENTAL LEVELS

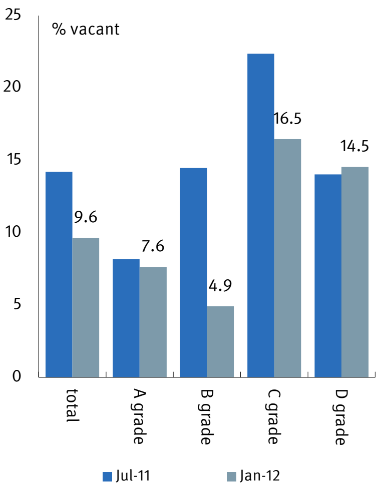
Demand for space across the Canberra total market has been reasonably robust over the past two years. During the 2011 calendar year net take up recorded was 64,096 m² which is a slight improvement on the 2010 result of 61,891m². During 2010 however Canberra witnessed a sharp increase in stock hence the overarching increase in vacancy rates to 14.1% in July 2010. The total Canberra market has seen its third consecutive decrease since this time resulting in a 10.6% vacancy as at January 2012.

Aiding this reduction in vacancy has been the limited net supply additions to the market; Civic has shown 18 months of vacancy reductions off the back of limited supply and strong absorption. This has resulted in total Civic vacancies at 9.6% and sharper in the A Grade market at 7.6%. The Parliamentary Precinct has shown some increase in vacancy due to speculative supply and only partially committed additions during 2008 to 2010. Currently across the A Grade Parliamentary Precinct vacancy is 3.5% down from 4.5% last period while the Total market results are 4.3% for January 2012 down from 4.8% last July.

The strong take up levels over this past few years have been in line with the absorption of new developments. The sensible requirement to have significant pre-commitment before development commences has aided in vacancy levels contracting. While there are multiple mooted developments, the current trend of demand leading supply is likely to continue through the medium term. The recent announcement of the Federal Budget aiming to return to surplus next year will ensure that any large Public Sector commitments announced will be at a modest expense with the Government showing itself to be "more lean than green".

GOVERNMENT; MORE LEAN THAN GREEN.

Figure 1
Vacancy by Grade
Canberra Civic (%)



Source: Property Council Australia

The total market vacancy for Civic has fallen considerably over the past year, currently just 9.6%, down from 13.3% in July 2011. B and C Grade resulted in a strong reduction in vacancy to 4.9% and 16.5% respectively. A Grade stock has also reduced to 7.6% with limited large space options now available.

Tenant Demand

The speculatively developed 21,000m² Nishi at 25 Edinburgh Avenue is now 90% committed with tenants including Department of Climate Change and Energy Efficiency and Clayton Utz. Other major developments have also enjoyed robust absorption including the St Johns Ambulance site in Forrest and 6 Cowlishaw Street, Tuggeranong both committed to The Department of Human Services, as well as 28 Sydney Avenue, Forrest partially pre-committed to PwC.

Tenant demand has been hampered by the announcement of over 1,500 Federal job losses early in the year and the subsequent 4,200 cuts during 2012/13, according to the latest Federal Budget.

Confidence is down and tenants are looking to save funds where possible, hence the emergence of the popularity in fitted out space. Tenants are looking to stock which does not require further capital expenditure and owners, particularly of new stock, will need to consider factoring in fit out costs as part of incentives to aid in reducing letting up periods over the next 12 to 18 months. This is putting further pressure on incentives to remain in the market longer term.

Anticipated Vacancy Levels

While A Grade market vacancies are trending slightly above the total market results for Canberra this period, we expect this will change over the next couple of years. Currently the Total A Grade vacancy rate is 11.7% ahead of the Total Canberra 10.6% due to strong vacancies in the Airport, Deakin and Kingston precincts. Looking ahead, with new supply reasonably strongly committed we expect that A Grade vacancies to contract to 9.6% in January 2014 before compressing below 8% in 2015 and beyond.

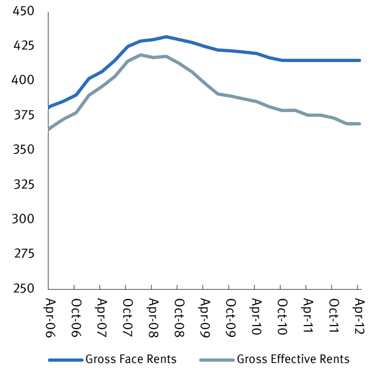
Backfill will be a greater issue for the Secondary market with The Attorney General's Department ceasing some leases in older buildings in Barton when they relocate opposite their major tenancy to 4 National Circuit. Clayton Utz will be vacating space at 40 Marcus Clarke Street when they move into Nishi. As a result, Secondary vacancy levels are expected to trend upwards from their current 9.8% to 12.5% by July 2013 and as high as 14.1% in July 2014.

Overall, total forecast vacancy is expected to stay within the 10% to 12% range. White collar employment growth is expected to be minimal but there is an element of unknown given the political risk associated with the Canberra market at the moment. The key for keeping vacancy levels in check is the continuation of demand led supply additions and withdrawal of older stock as vacated.

Rental Levels

Incentives have been increasing in most office markets across Australia, with Canberra no exception. While Gross Face rents have remained relatively static over the past three years, incentives have been on the increase; resulting in strong declines in Gross Effective rental rates. Currently, A Grade Civic Gross Face rents average $415/m², the same rate for the past 18 months. Incentives however have grown from sub 3% in 2008 to their current high of 11% resulting in Gross Effective rents reducing an average of 3.0% per annum over the last four years. The emphasis by owners of new stock should be on providing higher, flexible incentives given capital funding constraints to combat prolonged vacancy.

Figure 2
A-Grade Civic Rents
($/m²) 2006-2012

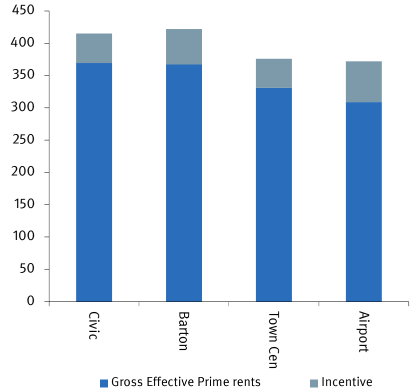


Source: Knight Frank

The Parliamentary Precinct has historically been a tight market and has demanded slightly higher A Grade rents. Currently averaging $422/m² there has been little change in the Face level for the past few years. Incentives however continue to play a strong part in this market growing for the fourth consecutive year to 13%. Secondary rents have fared much the same, with incentives having grown to 15%, the third year into double digit incentives.

With vacancy at a high in the Airport precinct, Face and more so Effective rents have been under downward pressure. Town Centre rents have stabilised for both A Grade and Secondary Face rents however incentives continue to grow, currently up to 20% in some Secondary assets.

Figure 3
A-Grade Gross Rents and Incentives
By region ($/m²) April 2012



Source: Knight Frank

Table 2
Recent Leasing Activity (New leases over 500m² and significant renewals over 1,000m²) Canberra

Address	Region	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Lease Type	Tenant	Start Date
28 Sydney Avenue	Forrest	5,700	U/D	10	Pre-lease	PwC	Jul-13
18 Canberra Avenue	Forrest	9,630	442g	15	Pre-lease	Dept Human Services	Nov-12
Nishi, 25 Edinburgh Avenue	Civic	1,950	535g	U/D	Pre-lease	Clayton Utz	Oct-12
121 Marcus Clarke Street	Civic	8,824	420g	10	New	Comcare	Jul-12
Garema Court	Civic	10,883	U/D	12	New	Dept Regional Australia, Local Govt, Arts & Sports	Apr-12
2-6 Shea Street	Phillip	1,570	320g	15	New	Aboriginal Hostels Limited	Apr-12
14 Childers Street	Civic	500	420g	10	New	Australian Securities & Investment Corporation	Mar-12
28 National Circuit	Forrest	2,000	U/D	5	New	Dept Finance & Deregulation	Mar-12
6 National Circuit	Barton	826	430g	7	New	Coal Association	Feb-12
121 Marcus Clarke Street	Civic	1,400	395g	7	New	JLL	Dec-11
221 London Circuit	Civic	762	382g	5	New	ACT Government	Nov-11
14 Childers Street	Civic	2,000	420g	7	New	BAE	Nov-11
70 Kent Street	Deakin	978	385g	5	U/D	Confidential	Oct-11
10 Richmond Avenue	Fairbairn	1,380	355g	10	New	Defence Force Recruiting	Sep-11
2 Shea Street	Phillip	934	330g	5	New	Eway	Sep-11
Cnr Akuna & Bunda Streets	Civic	2,940	433g	2	Sublease	DCCEE	Sep-11
14 Childers Street	Civic	481	395g	5	New	Australian Institute of Management	Aug-11
51 Allara Street	Civic	7,879	396g	10	Renewal	DRET	Jul-11
121 Marcus Clarke Street	Civic	1,427	420g	8	New	ARIA	Jul-11

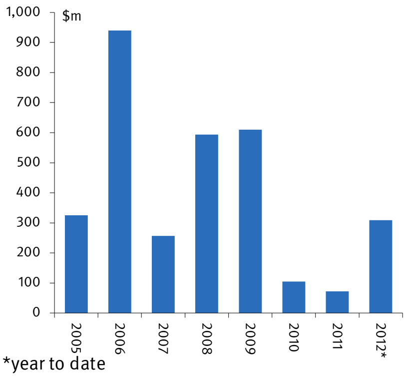
Source: Knight Frank g gross U/D refers undisclosed

INVESTMENT ACTIVITY & YIELDS

The last two years have witnessed subdued investment activity across Canberra with 2010 only recording $105million in investment and a reduced $72.2 million in 2011 spread across five transactions. The first quarter of 2012 however is showing good signs of growth for investment into the region, with $308.9 million transacting. Sales include the A Grade Civic property at 50 Marcus Clarke Street; selling for $225.89 million. The 40,861m² premises sold to CIMB Trust Capital from Walker Corporation on a yield of 7.36%. Reported also this year is the purchase of a 50% share of the Caroline Chisholm Centre at 57 Athlion Drive, Tuggeranong for $83 million. This purchase by Frasers Commercial Trust represented a core market yield of 8.83% on an A Grade asset.

The largest Canberra sale for 2011 was Myuna Complex in June for $24 million. The complex includes five buildings on Northbourne Avenue and Mort Street representing a total current NLA of 24,390m² on a site area of 6,265m². The site has a DA for a commercial building, nine storeys along Mort Street and 11 storeys along Northbourne Avenue which will equate to approximately 52,000m². The property will also include four levels of basement parking with ground floor entrances, retail, atrium and conference facilities. The target NABERS rating is for 5 stars. It is unlikely that this project will commence until commitment is sourced and given the high level of Civic mooted projects this could be well beyond 2015.

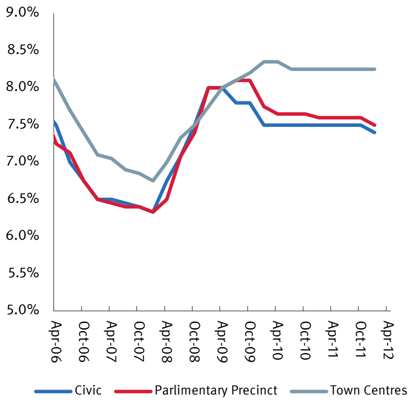
Figure 4
Canberra Office Investment Sales
Value of Transactions (over $10m)



*year to date
Source: Knight Frank

The underlying theme for investment over the past few years has been quality and WALE. The divide between A Grade and Secondary assets continues at their post GFC wide level with Civic Secondary yields ranging 8.50% to as high as 11.00%. Current interest in the market is for properties with current secure income and the potential to add value in the longer term; without this strong WALE, yields can be pushed out significantly. Growing in importance for the Canberra market over the past few years has been the NABERS rating; high requirement for Government tenants have put further weight to the divide in asset yields and pressure on owners of Secondary assets to upgrade their services.

Figure 5
Average A-grade Core Market Yields
Canberra Regions



Source: Knight Frank

Table 3
Recent Sales Activity Canberra

Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	Vendor	Purchaser	Sale Date
50 Marcus Clarke Street, Civic	A	225.89	7.36	40,861	5,528	Walker Corporation	CIMB Trust Capital	Mar-12
Caroline Chisholm Centre, 57 Athlion Drive, Tuggeranong^	A	83.00	8.83	40,244 (20,122)	4,125	Record Realty Trust	Frasers Commercial Trust	Feb-12
CWA Building, 17 Moore Street, Civic	C	19.00	10.66	6,291	3,020	Macquarie Bank	CorVal Property Trust No.2	Sep-11
Lionel Murphy Building 50 Blackall Street, Barton	B	13.50	11.70	5,003	2,698	MAB Funds Management	Morris Property Group	Aug-11
202-212 City Walk, Civic	C	10.00	9.00	1,950	5,128	GE Capital Real Estate	Canberra Labor Club Group	Aug-11
Myuna Complex, Northbourne Ave, Civic*	Dev Site	24.00	N/A	6,265*	3,831*	Stockland Corporation	Walker Corporation	Jun-11

Source: Knight Frank *site and $/m² site ^50% share

OUTLOOK

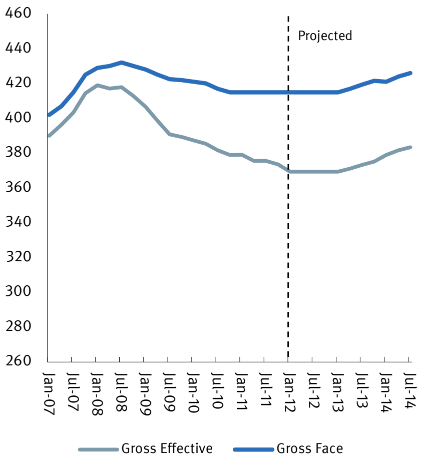
Over the past three years there has been an emergence of a two tier market between A Grade and Secondary stock. We expect this will continue through the medium term. While WALE continues to be important to any investor there is growing importance to sustainability indicators such as NABERS given the high level of Public sector occupation. Rents reflect this divergence with A Grade stock maintaining their current levels while Secondary stock has witnessed some downward pressure on both Face and Effective rents.

Incentives will remain a large part of the rental landscape while total vacancies trend above 10%. We expect that A Grade incentives will contract only marginally next year to 10% with some further tightening possible as A Grade vacancy levels fall further. This will have an improved effect on A Grade Gross Effective rents thereafter.

Figure 6

A-Grade Gross Rents

Civic Average ($/m²)



Source: Knight Frank

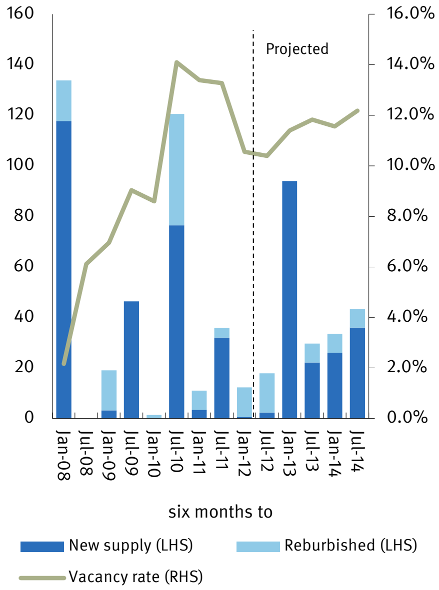
Face rents however, are unlikely to have large upward growth over the next three years. Some limited growth in 2013 and beyond is anticipated however this will stem from the limited demand likely for large contiguous spaces. With no new (speculative) supply, there will be little space available for business expansion or relocation to A Grade stock. Once this occurs there will be a knock on effect to the incentive levels and we will see the contraction of incentives resulting in the gap between Face and Effective rents begin to reduce as we saw prior to 2008. Alternatively, increases to average Face rents may emerge from the increased Economic rents demanded from new premises; these may ensure high incentives remain in the market longer term.

With the growing importance of NABERS ratings, owners of Secondary stock will be faced with a decision of whether to upgrade or try and lease an asset in an environment of high Secondary vacancy. A further setback for these owners is the Government's announcement not to honour the $1 billion tax break for green initiatives (retro fit and refurbish) due to commence 1st July. The improvement in the Secondary market will strongly lag the A Grade market and as such incentives will maintain their current high for the medium term. Hence the defined division of this two tier market.

Figure 7

Vacancy Rate vs Gross Supply

Total Canberra Region (000s m²)



Source: PCA/Knight Frank

Efficiency savings have become an increasing issue for property owners and developers as Government has increased the efficiency dividends to 1.5% late last year to aid in reducing costs to meet surplus. While there was speculation of further increases, this has not transpired holding at 1.5% for the next two years as announced in the Federal Budget. This increase further emphasises the Public Sector's appetite for fitted out premises and cheaper accommodation alternatives. Should there be a change in Government, these measures could remain in place or other cost saving initiatives implemented through reduced employment numbers flowing through to contracted space requirements.

CHANGE IN FEDERAL GOVERNMENT COULD RESULT IN A FURTHER REDUCTION IN EMPLOYMENT NUMBERS, REDUCING SPACE REQUIREMENTS.

Despite supply additions over the next two years, vacancy levels are expected to contract slightly. Current Total Canberra Region vacancy sits at 10.6%, we expect this will compress slightly to 10.4% before increasing in January 2013 to 11.4%. After this period vacancy will continue upwards peaking at 12.2% in July 2014. The Prime market will fare a little better with vacancy sub 10% by January 2014. Backfill will become an increasing issue post 2014 particularly for the Secondary market where vacancy will grow to a high of 14.1% in July 2014.

The next few years for the Canberra market remain uncertain; the announcement of the Federal Budget has not made the way ahead for Canberra any clearer. Regardless, the halt to speculative supply to the market is moving in the right direction, however any prospects of rental growth or yield compression is unlikely in the short term.

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