

- Demand has improved with quality fitted-out space leasing well
- 2022 will be a medium-term peak of supply with 74,000sqm delivered
- Pace of sales has slowed as the market adapts to changing funding costs



Brisbane Near City Office

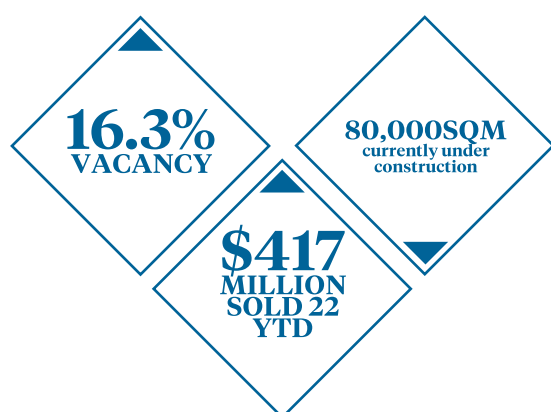
Market Report, June 2022

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HIGHEST NEW SUPPLY ADDITIONS SINCE 2010

With five buildings to be completed in 2022 the focus is on new supply take-up and absorption of backfill space. Recent deals have shown a preference for prime space, particularly with a quality fitout



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“The pace of sales transactions has slowed as buyers navigate the changing debt environment. Transactions under negotiation now will provide direction on yield movement.”

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The Key Insights

Net absorption improved through 2021 as tenants' confidence to act grew as the economic recovery remained robust. The return of larger tenants will see net absorption continue to grow over 2022, supported by relocations to new supply.

Prime and secondary gross face rents have increased modestly with prime gross face rents increasing for high quality fitted out space. Increases to incentives have limited the growth in effective rents with prime and secondary gross effective rents up 0.2% and 0.4% respectively over the year.

New supply for 2022 at 74,000sqm is expected to be the peak for the medium term. While pre-commitment activity is set to continue this year, fuelled by tenant demand for newer, high quality space to implement new fitout and work practices, the level of construction starts is expected to be lower.

Transaction turnover grew in late 2021 and into the start of 2022 with Milton Green at \$426.5m the largest recent transaction. As inflationary concerns took hold and the cash rate has been lifted by the RBA there has been a lull in market activity with sales taking longer to conclude than previously anticipated.

Brisbane Near City Office Market Indicators—April 2022

GRADE	TOTAL STOCK SQM [^]	VACANCY RATE % [^]	ANNUAL NET ABSORPTION SQM [^]	ANNUAL NET ADDITIONS SQM [^]	AVERAGE GROSS FACE RENT \$/SQM	AVERAGE INCENTIVE %	EFFECTIVE RENTAL GROWTH % YOY (gross)	AVERAGE CORE MARKET YIELD % [*]
Prime	636,822	15.9	7,729	27,100	612	43	0.2%	5.70%
Secondary	607,973	16.8	13,611	-5,619	480	41	0.4%	7.10%
Total	1,244,795	16.3	21,340	21,481				

Source: Knight Frank Research/PCA [^] as at 1 January 2022 PCA Data ^{*} assuming WALE 5.0 years

TENANTS DRAWN TO NEW STOCK

Growth metrics remain high as inflationary concerns accelerate interest rate increases

Economic indicators have continued to surprise on the upside as the recovery from the disruptions of COVID-19 have consolidated into 2022. GDP growth of 3.3% in the year to March 2022 and national unemployment of 3.9% (May 22) both continue to highlight the resilience of the Australian economy. Queensland has also fared well with current unemployment of 4.0% and 408,000 jobs created since employment fell in May 2020.

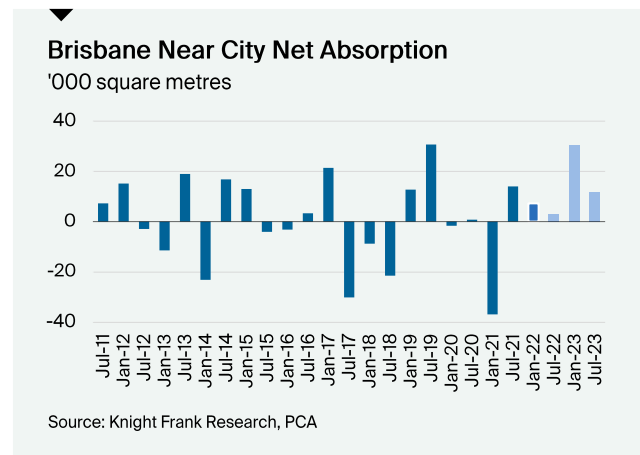
Globally, and increasingly locally, inflation triggered by supply chain disruptions and exacerbated by soaring energy costs (due to Russia's invasion of Ukraine) is appearing to be more entrenched than previously hoped. The highly accommodative monetary policy settings in place during the pandemic are no longer required and are being unwound faster than previously expected. This was led by the US and EU zones but has since become a factor in Australia as well.

Queensland has weathered the pandemic relatively well compared to the southern states with fewer lockdowns keeping businesses open and supporting retail spending. The combination of lifestyle factors and a more mobile office workforce has seen net interstate migration increase, with Queensland seeing record inflows of 50,162 persons for 2021, 83% of all interstate inflows, despite travel restrictions for much of the year. This will continue to spur infrastructure development and the Near City market will gain significant benefit from the new Cross River Rail stations at Woolloongabba and Exhibition Station and the concentration of investment and event locations for the Olympics in 2032.

Net absorption to increase over the remainder of 2022

Near City office net absorption improved through 2021 (+21,340sqm) after a substantial drop in 2020 (-36,048sqm) as sub-lease space was absorbed and tenants expanded.

Net absorption for H1 2022 is expected to be only modestly positive with market activity interrupted by flooding and a Federal election. Tied to new supply the net absorption is forecast to accelerate in H2, largely driven by ATO's relocation from a suburban location into the Near City. Recent market intel indicates space may be offered for sub-lease, potentially mitigating the positive impact. Serviced office operators, both existing and new are also expected to contribute to net absorption with a number of new sites proposed. The recent lease of Schneider Electric is an example of a tenant new to the Near City, relocating from Eagle Farm and into higher quality space to enhance amenity for workers.



Recent significant tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	FACE RENT \$/SQM	INCENTIVE	TERM YRS	START DATE
Schneider Electric	470 St Paul's Tce	UR	1,538	710 g	40%+	5	Aug 22
Tech Mahindra	15 Green Square Close	UR	1,443	670 g	40%+~	5	Aug 22
Clough	825 Ann St ^	UR	3,296	635 g	40%+~	6	Aug 22
Sun Cable	900 Ann St	UR	1,830	675 g	30-35~	5	May 22
Alstom Transport	159 Coronation Dr	Milton	1,424	570 g	40%+	5	Jan 22
Endeavour College	230 Brunswick St	UR	2,280	575 g	40%	10	Jan 22
AGPal	56 Edmondstone St	UR	2,020	445 n	40%+	10	Dec 21

^space had been marketed for sub-lease although new direct deals agreed, Clough took first one floor and then expanded the commitment ~existing high quality fitout

FEASIBILITY IMPACTING SUPPLY PIPELINE

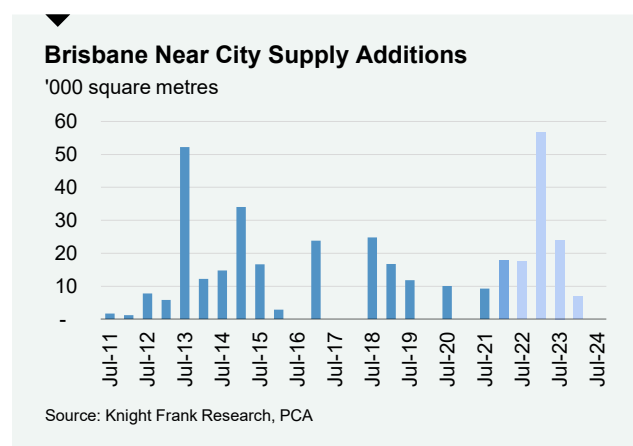
Supply should peak this year for the medium term with completions of 56,700sqm remaining in 2022

Construction completions of 27,100sqm in 2021 will be eclipsed by an expected 74,000sqm in 2022. The vast majority of this is to be delivered in the second half of this year with only 470 St Paul's Terrace, Fortitude Valley reaching completion during 2022 to date. The 17,544sqm project, achieving PC in March 2022, is understood to be c70% committed with leasing activity accelerating as tenants had the opportunity to view the finished product.

There are currently five major projects under construction with four of those currently slated to reach completion during 2022. The commitment level for the four 2022 completions is 74%, underpinned by the fully committed 152 Wharf St and strong pre-commitment levels in 31 Duncan St and 525 Boundary St. The remaining project under construction is speculative with 895 Ann St, Fortitude Valley (24,000sqm) due for completion mid-2023.

Pre-commitments to drive new starts with risk appetite for speculative development diminishing

It is expected that supply additions will slow in 2023 & 2024 with further starts to be limited to pre-committed projects. Demand from tenants to relocate to market-leading, fresh space to adopt new fitout and workplace practices will keep pre-commitments front of mind. Speculative starts may continue but will increasingly be limited to projects with a smaller scale. There is a significant pipeline of projects with development approval or an active development application but some of these may revert to residential schemes as that market strengthens.



SUPPLY

CONSTRUCTION:

- 152 Wharf St, Spring Hill (SH)—24,000sqm
100% committed [ATO] H2 2022
- 31 Duncan St, Fortitude Valley (UR)—21,000sqm
c60% committed [Urban Utilities] H2 2022
- 525 Boundary St, Spring Hill (SH)—5,484sqm (medical)
65% committed [Qld Fertility Group]. H2 2022
- The Greenhouse, West Village (IS)—6,250sqm H2 2022
- 895 Ann St, Fortitude Valley (UR)—24,000sqm.Mid-2023

DEVELOPMENT APPROVAL:

- South City Square, Woolloongabba (IS)—7,000sqm. 2024
- 358 Wickham St, Fortitude Valley (UR)—22,114sqm
- 458 Wickham St, Fortitude Valley (UR)—8,236sqm
- The Aviary Toowong (T)—24,265sqm
- 52 Alfred St, Fortitude Valley (UR)—32,693sqm
- 301 Wickham St, Fortitude Valley (UR)—35,000sqm
- 6 Little Cribb St, Milton (M)—29,870sqm
- 21-25 Morgan St, Fortitude Valley (UR)—18,825sqm
- 426-442 St Paul's Tce, Fortitude Valley (UR)—c40,000sqm
- 41-47 Brookes St, Fortitude Valley (UR)—14,964sqm
- 160-180 Breakfast Creek Rd, Newstead (UR)—18,910sqm
- 949 Ann St, Fortitude Valley (UR)—12,800sqm
- 58 Morgan St, Fortitude Valley (UR)—13,270sqm
- 11 Breakfast Creek Rd, Newstead (UR)—c25,000sqm
- 19 Eagle Tce, Petrie Terrace (M)—19,182sqm

DEVELOPMENT APPLICATION:

- 251 Wickham St, Fortitude Valley (UR)—15,882sqm
- 388 Brunswick St, Fortitude Valley (UR)—11,177sqm
- 63-67 McLachlan St, Fortitude Valley (UR)—6,845sqm
- 186 Wickham St, Fortitude Valley (UR)—28,500sqm
- 10 Edmondstone St, South Brisbane (IS)—9,385sqm (medical)

Projects 5,000sqm+ with active planning schemes. Excludes mooted and abandoned schemes, however not all of the above are actively marketing at this time.
UR—Urban Renewal, IS—Inner South, M—Milton, T—Toowong, SH—Spring Hill

GROSS FACE RENTS UP BUT INCENTIVES HIGH

Vacancy will remain elevated, due to supply additions

Total vacancy was 16.3% in January 2022, down from the recent high of 16.6% a year earlier but remaining elevated with net supply of 21,481sqm in the year largely balanced by net absorption. The introduction of new supply, dominated by 470 St Pauls Tce, Fortitude Valley, will see the vacancy rate increase to July 2022, potentially reaching 17.0%. Despite strong pre-leasing a number of tenants are moving from within the Urban Renewal precinct with tenants new to the Near City market being Spaces and Schneider Electric.

The surge in new supply in the second half of 2022 is set to push the vacancy rate further, towards or slightly above 18.0% into 2023 which is expected to form the vacancy high-point for this cycle. Underlying tenant demand and the potential for accelerated removal of obsolescent office stock will assist to bring the vacancy rate back down below 16% by mid-2024.

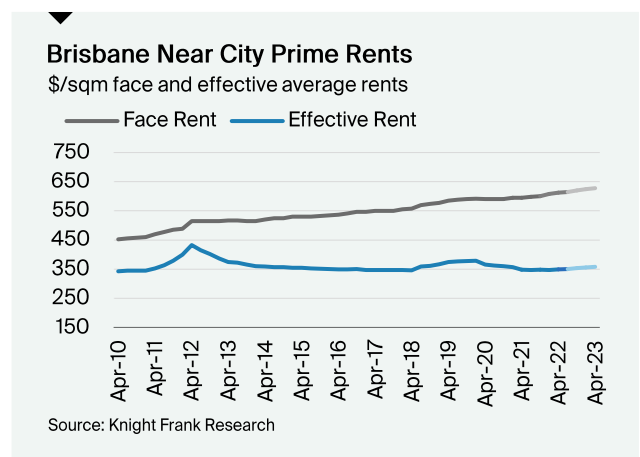
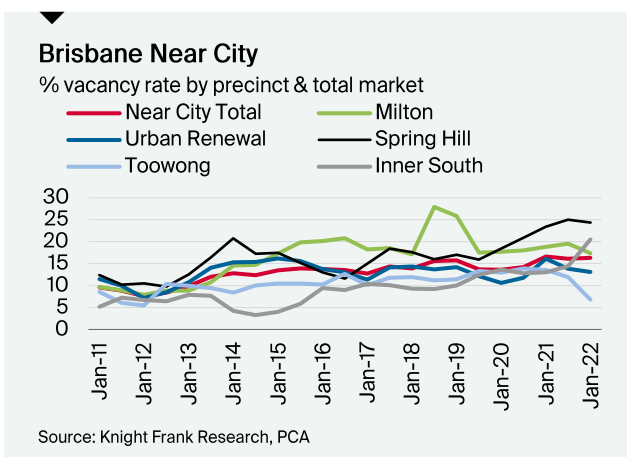
The vacancy rate is highest in Spring Hill at 24.3% although the Inner South saw vacancy breach the 20% barrier in the most recent results (20.5%). This was spurred by recent speculative supply and with a further completion of 6,250sqm in 2022 will remain high, although improving quickly with quality space sought. Vacancy fell in Urban Renewal to 13.1% to January 2022 due to positive net absorption although supply will see that number grow mid-year. With the majority of recent and future supply delivered in the Urban Renewal precinct and a high level of tenant mobility within that precinct, vacancy is set to grow even though the new supply will provide an overall benefit enhancing market scale of the precinct.

Prime effective growth soft even as gross face rents push to new highs on fitted space

Prime gross effective rents have increased only marginally over the past year (+0.2%) after falling by 7.9% since the start of 2020. While face rental growth has continued to be achievable in the market, particularly for tranches of prime fitted-out space, this has not kept up with cost escalation in the wider economy. There is also increasing divergence in face rents achieved across the prime grade buildings with new or near new space, with a quality fitout, putting a gap on the rest of the market. While face rents have been able to be lifted by landlords, sustained high incentives have limited effective rental growth. Landlords who have been able to leverage existing fitout, plus provide a market incentive, have both dominated recent take-up and been able to push face rents higher.

Prime rents remain exposed to the uplift in vacancy as the recent supply is digested and further completions flow through the market. Increasing to 15.9% in January 2022 and likely to increase further to the end of the year, the prime vacancy will remain elevated and continue to engender high levels of competition for larger tenants. This will keep incentives elevated although gross face rents will continue to appreciate, in part driven by cost recovery by landlords.

Secondary vacancy did reduce in 2021, sitting at 16.8% in January 2022 with refurbished assets or those with higher parking ratios seeing good activity. Overall secondary gross face rents are higher by 2.1% over the past year, however incentives have softened slightly to 41% on average.



CAPITAL MARKET LANDSCAPE CHANGING

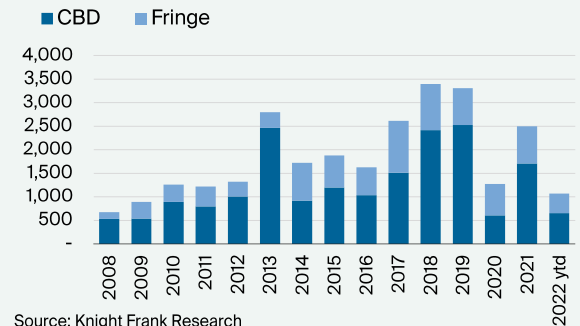
The pace of asset sales has slowed as buyers manage changing funding environment

Transactions of \$417 million have been recorded in 2022 ytd after a strong finish to 2021 saw a total of \$793 million exchanged. Activity in 2022 has been dominated by 31 Duncan St, purchased by a JV between Charter Hall and PSP. While the final price will depend on the metrics achieved in the remaining office leasing deals for the building, it has been given a placeholder value of c\$370 million.

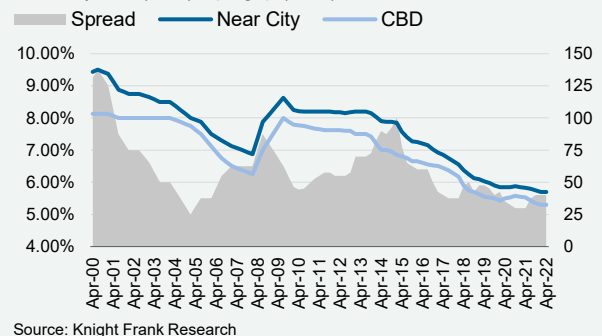
A number of assets ranging from institutional grade offerings to smaller secondary buildings have been formally offered to the market in recent months. This includes the Valley Metro complex, Energex House, 1 Breakfast Creek Rd, Green Square South, HQ South and 159 Coronation Drive. While some of these are in DD or transacting imminently the majority have seen the sale campaign take longer than previously expected.

The changing metrics across the global economic outlook and debt markets has slowed the pace of sales as buyers come to term with increased funding and hedging costs for overseas buyers. With limited transactions formalised since the interest rate growth cycle began it is difficult to pinpoint the immediate impact on yields. As at April 2022 the yield environment was considered stable with buyers active in the market, albeit with a weather eye on the future. Prime Near City median yields at 5.7% were 40bps above the CBD as the margin unwound the contraction of 2020 when CBD sales were more limited. As sales data flows through it is expected to show an increase in prime median yields of 30-50bps.

Brisbane CBD & Near City Sales \$10m+
\$m office sales by market



Near City v CBD Prime office yields
median yields (LHS), bps gap (RHS)



Recent significant sales

PROPERTY	PRICE \$M	CORE MARKET YIELD %	NLA SQM	\$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
49 Doggett St, Newstead	22.84	4.98	2,561	8,920	5.0	Secure Zone Pty Ltd	Private Developer	Apr 22
31 Duncan St, Fortitude Valley#	Tbc	Tbc	25,725	-	-	Charter Hall/PSP	Tribune Properties	Feb 22
Milton Green, 147 Coronation Dr, Milton	426.53	c6.0	50,330	8,475	2.9	Shayher Group	Sunsuper/Dexus Wholesale Property	Dec 21
56 Edmonstone St, Bowen Hills^	101.50	5.87	12,427	12,427	6.5	RAM DPF Fund	Charter Hall Long WALE REIT	Dec 21
200 Creek St, Spring Hill	41.00	5.20~	7,710	5,318	2.4	Forza 200 Creek Fund	Sentinel Regional Office Trust	Dec 21

fund through with the final price to be determined at PC dependent on leasing metrics achieved. Settlement of land and works to date of \$122m Feb 22. ^ property was sold c40% leased with the vendor providing a 5 year rental guarantee on the remainder; this is reflected in the analysis ~passing yield

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.



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