RESEARCH

BRISBANE FRINGE OVERVIEW

STRONG PRIME TAKE-UP BRINGS CONFIDENCE
NOVEMBER 2018

COMPETITIVE WITH CBD | PRIME RENTS INCREASING | YIELDS CONTINUE TO FALL

KEY FINDINGS

A return to **positive net absorption** will drive a **fall in total vacancy, forecast at 13.8%** as at January 2019.

Prime effective rents grew by **4.4%** in the year to October 2018, however **secondary** effective rents remain **stable.**

25 King St, Bowen Hills has recently completed construction and there are now **no Fringe buildings under construction**, although there are **two major refurbishment projects** which will provide new supply in 2019.

Yields have **continued to tighten** across both prime and secondary as both **improving tenant demand** and the market-wide **appetite for investments** heightens competition.

Major Brisbane Projects:

- Cross River Rail $5.3b
- Brisbane Metro c$1.0b
- M1 Upgrade $1.0b
- Second Runway $1.4b
- Queens Wharf c$3.0b
- Herston Quarter $1.1b
- Howard Smith Wharves $200m

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ECONOMIC OVERVIEW

Supported by global and national economic growth, the Queensland economy remains on an expansive trend. This is flowing through to the Fringe market given its exposure to engineering, energy and education users.

Economic growth continues to accelerate in Queensland

Queensland's economic growth is on a positive trend with the most recent State Final Demand indicating annual growth of 3.4% in the year to June 2018. Estimates for Queensland GSP are 3.2% for FY18 which is above the national average of 2.9% and will be the first time in three years that QLD economic growth will outpace the national average.

Mining & energy, tourism and education are growth sectors, supported by a lower AUD and sustained global growth. The AUD has depreciated by 10% from the start of 2018 and while it has not yet made a foray below US70c the Reserve Bank appears comfortable at these, or lower, levels.

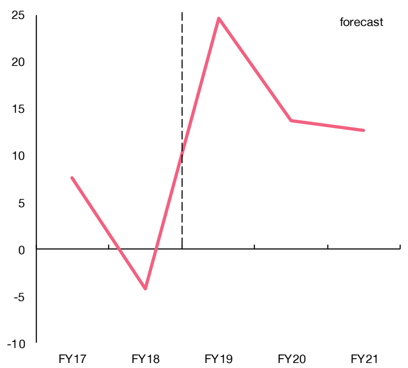
International visitor numbers into Queensland surpassed 2.73 million persons in the year to July 2018, up 4% in the last year and some 45% since the high AUD curtailed visitation in 2011 (TRA) . The lower dollar is also fuelling greater spending with international visitor expenditure in Queensland up by 8.1% in the year. Education is also a key draw for international guests with 7% of visitors here for the purpose of education with a corresponding significant length of stay.

The commodity sector has continued to show sustained improvement over the past year with increasing volumes and prices benefitting companies with still-lean cost structures following the contractions post-2012. The national mining sector recorded profit growth of 19% in the year to June 2018, building on the 67% increase of the year before (ABS). The Fringe market remains preferred by a number of engineering/consulting firms with WSP Brinkerhoff and Aurecon recently returning to Fringe locations from the CBD.

Employment boost in FY19

Forecasts of employment from the core office space industries show that FY 2019 will feature strong employment growth of 25,000 persons across Brisbane (Oxford Economics). This supports the forecast return to positive net absorption.

FIGURE 1
Brisbane Core Office Industries
'000 person annual increase in employment



Source: Oxford Economics/Knight Frank Research

TABLE 1
Brisbane Fringe Office Market Indicators as at October 2018

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	649,495	14.5	-25,580	-10,228	573	37.0	6.13
Secondary	539,071	14.5	-4,617	-20,848	463	39.0	7.67
Total	**1,188,566**	**14.5**	**-30,197**	**-31,076**			

Source: Knight Frank Research/PCA ^ as at July 2018 *assumed WALE 4-6 years prime, 2-5 years secondary

TENANT DEMAND & ABSORPTION

Engineering and IT dominate recent large tenant commitments

There has been noticeably higher tenant activity across the Fringe during 2018. As shown in Figure 2, leases negotiated in 2018 to date for tenants 1,000 sqm+ have been dominated by tenants from the Engineering and IT sectors, traditionally high users of Fringe office space. Given the relative lack of new stock, there has been increased activity in existing buildings.

The Urban Renewal precinct has seen the greatest activity with WSP Brinkerhoff relocating from the CBD into 5,685sqm of sub-lease space at 900 Ann St and DXC to consolidate from a number of locations into 4,700sqm at 100 Brookes St being the two largest relocations into the precinct. Additionally Macquarie Bank has expanded and re-signed over 4,301sqm at 825 Ann St.

The availability of modern, refurbished accommodation in Milton, particularly at Milton Green, has also spurred activity with Downer EDI (7,137sqm), Sandvik (2,931sqm), and AIA (1,466 sqm) all committing to the Origin backfill space.

Net Absorption & Outlook

Prime	FY18: -25,580sqm
Secondary	FY18: -4,617sqm

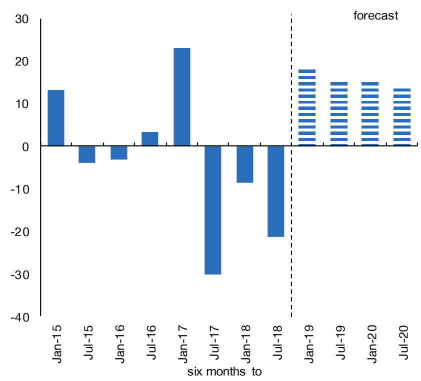
Source: Knight Frank Research/PCA

Net absorption will return to positive territory as tenant inflows return

After a recent run of negative net absorption, the Fringe market is forecast to return to positive net absorption in H2 2018. The recent negative net absorption was triggered by the withdrawal of buildings for redevelopment and the relocation of tenants from the Fringe into the CBD market (Origin, State Government, Tatts Group etc).

As the CBD leasing market began to improve from late 2017, the Fringe was experiencing soft leasing conditions. The resultant increase in Fringe incentives at the same time that CBD effective rental growth was accelerating caused the competitive dynamics between the two markets to change during 2018.

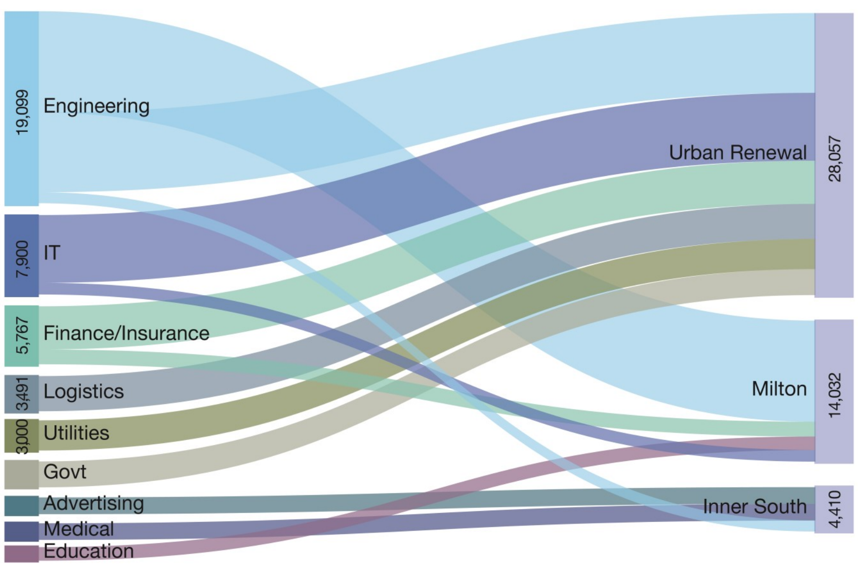
FIGURE 3
Brisbane Fringe Net Absorption
('000sqm) per 6 month period



Source: Knight Frank Research/PCA

In the current high tenant mobility cycle it is expected that tenants will continue to cross markets, however the flow of tenants into the CBD from the Fringe in force during 2017 appears to have been arrested in 2018. While the migration of CBD tenants to newly constructed buildings remained strong (Aurizon, Aurecon, WSP) in 2018 there have also been CBD tenants committing to existing, largely prime, Fringe buildings (SunWater, Southern Cross Austereo, DXC and Aurizon into 100 Brookes St).

FIGURE 2
Tenant movement by Industry
Selected Fringe Deals 1,000sqm+ negotiated 2018 ytd Industry and Destination



Source: Knight Frank Research (size of line indicates area taken)

Fringe has good exposure to industries set to benefit from AUD depreciation

The solid employment forecasts, upside for commodity and energy related industries, and competitive deals on offer in quality Fringe accommodation is set to boost net absorption levels in the near term. While the CBD is set to remain strong competition for larger tenants, the Fringe market has gained traction in the past 6-9 months.

Net absorption is forecast to rebound to more than 18,000sqm in H2 2018 and then range between 13,500sqm and 16,000sqm in the following 18 months. With the availability of contiguous prime floors already diminishing, steady take-up will see pressure building in prime rents and potentially spur further construction starts.

SUPPLY & DEVELOPMENT

Vacancy Rate & Outlook

Prime	14.5% +250bps y-o-y	
Secondary	14.5% -230bps y-o-y	

Source: Knight Frank Research/PCA

Vacancy to fall from the mid -2018 peak of 14.5%

Influenced by the long-expected relocation of Origin from the Milton market, the Fringe vacancy increased to 14.5% as at July 2018. This increase in the first half of 2018 was influenced by negative net absorption in the market, rather than the level of new supply (900 Ann St), which was largely committed.

The Inner South remains the precinct with the lowest vacancy rate at 8.6%. The negative net absorption in the precinct over the past year was aligned with withdrawals of buildings for demolition and their tenants relocating into the CBD.

The Urban Renewal precinct recorded positive absorption of 17,612sqm in H1 2018, taking the overall vacancy to 13.7%. With the completion of 25 King St (43% occupied) and strong absorption of prime space in existing buildings, net absorption is set to remain positive for H2 2018, bringing further falls to the vacancy rate.

TABLE 2

Brisbane Fringe—Vacancy Rates

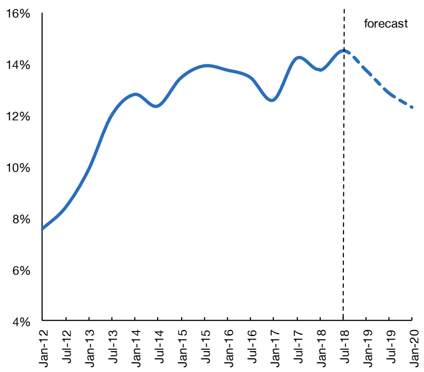
Precinct	Jul 17	Jul 18
A Grade	12.0%	14.5%
Prime	**12.0%**	**14.5%**
B Grade	15.9%	13.5%
C Grade	16.1%	14.6%
D Grade	60.9%	58.2%
Secondary	**16.8%**	**14.5%**
Milton	18.5%	23.6%
Urban Renewal	14.1%	13.7%
Spring Hill	18.4%	16.0%
Toowong	11.8%	11.2%
Inner South	9.6%	8.6%
Total	**14.2%**	**14.5%**

Source: Knight Frank Research/PCA

FIGURE 3

Brisbane Fringe Vacancy

% total vacancy



Source: Knight Frank Research/PCA

Given Origin's backfill space in 135 Coronation Drive, the Milton vacancy increased, as expected, reaching 23.6% in mid-2018. With a considerable lead time to plan for Origin's departure the landlords had implemented a strong placemaking strategy for the office park, rebranding as Milton Green, boosting retail amenity and shared spaces. This, combined with the strong building fabric (large floors of 1,400sqm+) has seen all available Origin backfill leased, with the Milton vacancy to reflect this improvement in the short term.

The Fringe total vacancy is forecast to fall to c13.8% at the end of 2018, with the strongest improvement coming from the A grade market. The restrained supply additions over the short term will assist to convert improvement in net absorption directly into falls in total vacancy with rates of 12.0% - 12.5% to be in place by the end of 2019.

After a flurry of activity in 2018, the pipeline of major tenants seeking fringe space is slightly lower at this time with Optus (6,000 sqm), Parmalat (2,500 sqm) and IAG (5,500 sqm) all currently active within the market.

Delivery of only one new building in H2 2018

New supply in the Fringe has remained modest with the completion of 900 Ann St, Fortitude Valley (19,971 sqm) in the first half of the year complemented by the completion of 25 King St, Bowen Hills in November 2018.

The building at 25 King St, is the tallest engineered timber office building to be completed in Australia. The 14,963 sqm building is 44% pre-committed by Aurecon which is relocating from 32 Turbot St in the Brisbane CBD.

Following the recent completion of 25 King St, there is no new supply under construction in the Fringe, with near term supply to arise from refurbishment projects. Works have recently started on a major refurbishment at Valley Metro, 234 Wickham St, Fortitude Valley with the 8,924 sqm building to receive a new façade and equipment upgrades. This is expected to be complete by July 2019.

Refurbishment works are also expected to soon commence at 339 Coronation Dr, Milton with the 13,171 sqm building recently sold with vacant possession to a Singaporean institutional investor. This refurbished space is expected to be returned to the market in late 2019.

As demand is appearing to show steady acceleration it is expected that further new construction will commence in the Fringe during 2019/20. As shown in Table 3 there are a number of proposed developments which are awaiting pre-commitment to commence. At this stage only 11 Breakfast Creek Rd, Newstead has a major pre-commitment in place.

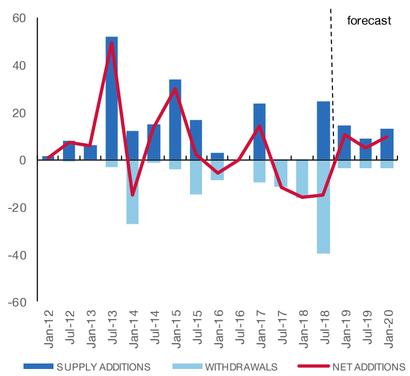
With the recent tightening of lending policies by the majority of commercial banks it is expected that significant pre-commitment hurdles will be required to progress construction. This will continue to limit the speed at which these proposed projects will be delivered to the market. The scaling back in size of some projects is still considered likely to progress them to construction within the short term.

Integrated neighbourhoods are what tenants want

As the requirements from tenants for more than just office space intensifies there are several pockets within the Fringe market well-placed to make the most of the trend towards integrated neighbourhoods and place-making.

With homogenous precincts no longer attractive to many occupants the mixing of residential, convenience retail, leisure/ entertainment facilities and shared open spaces is seen as vital to attract major corporate users. Lend Lease's Showground Hill and AMP/Sunsuper's Milton Green have actively curated their precincts while locations in South Brisbane and Newstead already have a vibrant mixture of uses on their doorstep.

FIGURE 5
Brisbane Fringe Supply
'000 sqm



Source: Knight Frank Research/PCA

"Positive net additions will return to the Fringe, however at modest levels short term."

TABLE 3
Major Additions — Brisbane Fringe

Additions

Address	Precinct	NLA (m²)	% Leased	Major Tenant/s	Developer	Status	Date
900 Ann St, Fortitude Valley	Urban Renewal	18,791	100%	Aurizon /WSP	Consolidated Properties onsold to Charter Hall	Complete	Apr 18
K5, Showground Hill, 25 King St, Bowen Hills	Urban Renewal	14,963	44%	Aurecon	Lend Lease	Complete	Nov 18
234 Wickham St, Fortitude Valley	Urban Renewal	8,924	-	-	LaSalle Asia Opportunity Fund IV	Refurbishment	Jul 19
339 Coronation Dr, Milton	Milton	13,171	-	-	Singaporean Investor	Refurbishment	H2 2019
11 Breakfast Creek Rd, Newstead	Urban Renewal	27,510	16%	John Holland	Charter Hall Office Trust/ John Holland	Approved	STP
152 Wharf St, Spring Hill	Spring Hill	30,500	^	-	Wharf Investment Corporation	Approved	STP
36-52 Alfred St, Fortitude Valley	Urban Renewal	32,693	-	-	LaSalle Asia Opportunity Fund IV	Approved	STP
301 Wickham St, Fortitude Valley	Urban Renewal	35,000	-	-	Cornerstone Properties	Approved	STP
Jubilee Hotel, 470 St Paul's Tce, Fortitude Valley	Urban Renewal	18,800 GFA	-	-	JGL Properties	Approved	STP
358 Wickham St, Fortitude Valley	Urban Renewal	22,114	-	-	Prime Space/Grocon	Approved	STP
801 Ann St, Fortitude Valley	Urban Renewal	44,300	-	-	Walker Corporation	Approved	STP
895 Ann St, Fortitude Valley	Urban Renewal	c25,000	-	-	Consolidated Properties	Mooted	STP
CDOP 7, Milton	Milton	19,600	-	-	AMP/Sunsuper	Mooted	STP
K3, Showground Hill Bowen Hills	Urban Renewal	c25,000	-	-	Lend Lease	Mooted	STP

Source: Knight Frank Research ^reported 100% pre-commitment in place, however the timing remains unconfirmed.

RENTS & RECENT TRANSACTIONS

Rents, Incentives & Outlook

Prime Rents (g)	$574/sqm face 4.4% y-o-y $362/sqm eff 4.4% y-o-y	↗
Secondary Rents (g)	$464/sqm face 2.0% y-o-y $283/sqm eff 0.3% y-o-y	→
Incentives	P:37.0% S:39.0%	↘

Prime effective rents lifting due to greater demand

After lagging the CBD market, prime Fringe rents have shown improvement during the second half of 2018. A number of significant transactions (Table 4) has reduced the larger contiguous vacancies available and triggered a response in both face rents and incentives.

After peaking at 38% in April 2018, prime Fringe incentives have fallen to 37% and are expected to continue to gradually moderate, but remain aligned with CBD incentive movements. This has resulted in effective rental growth of 4.4% in the year to October 2018, the highest rate of growth in six years and breaking an extended period where prime rents were drifting. With little imminent supply and the rebalancing of demand between the CBD and Fringe, rental growth will be sustained, ranging between 3.7% and 4.5% y-o-y for the next three years.

In contrast, secondary rents have remained stable on an effective basis with secondary assets still having to compete on price to secure tenants. This weakness in rental growth is expected to remain in force until mid-2019 when the general sustained market improvement will flow through to c3.5% y-o-y growth for effective rents in the next two years.

TABLE 4

Recent Leasing Activity Brisbane Fringe

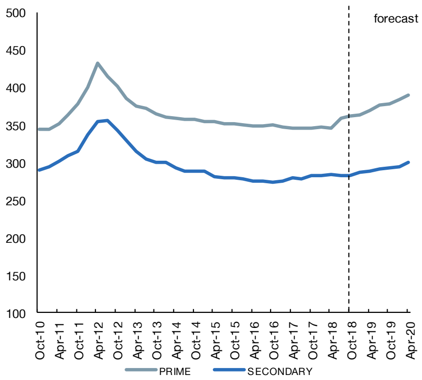
Address	NLA m²	Face Rent	Term yrs	Incentive (%)`	Tenant	Start Date
135 Coronation Dr, Milton	2,931	597 g	10	30-35	Sandvik	Jul 19
515 St Pauls Tce Fortitude Valley	3,000	575 g	10	35-40	SunWater	May 19
135 Coronation Dr, Milton	7,137	588 g	8	35-40	Downer EDI Services	Q2 2019
135 Coronation Dr, Milton	1,466	597 g	5	35-40	AIA	Feb 19
825 Ann St, Fortitude Valley	4,301	600 g	6	30-35	Macquarie Bank	Feb 19
900 Ann St, Fortitude Valley	5,685	625 g	7	40+	WSP Brinkerhoff	Jan 19
147 Coronation Dr, Milton	1,344	535 g	6	35-40	QTAC	Sep 18
520 Wickham St, Fortitude Valley	2,254	600 g	5	40+	RPS Group	Jul 18

Source: Knight Frank Research
`est. incentive calculated on a straight line basis g gross n net

FIGURE 6

Brisbane Fringe Rents

$/m² p.a average gross effective rent



Source: Knight Frank Research

TABLE 5

Recent Sales Activity Brisbane Fringe

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
100 Skyring Tce, Newstead	A	250.00	5.79	24,665	10,136	7.5	Charter Hall DOF & POF	Growthpoint Properties Australia (REIT)	contract
825 Ann St, Fortitude Valley#	A	169.50	6.25	19,115	8,867	4.9	Hines Global REIT	Centuria Metropolitan REIT	Oct 18
100 Brookes St, Fortitude Valley#	A	86.50	6.25	9,602	9,009	5.1	Hines Global REIT	Centuria Metropolitan REIT	Oct 18
339 Coronation Dr, Milton	B	40.25	VP	13,180	3,054	n/a	151 Property	Singaporean Institutional Investor	Sep 18
2 King St, Bowen Hills	A	170.00	5.48	16,341	10,403	6.0	The Impact Group	Heitman/Abacus Funds Mgt	Aug 18
130 Commercial Rd, Newstead	B	19.04	7.21	4,258	4,473	2.6	Private Investor	Primewest Funds Mgt	May 18

Source: Knight Frank Research ^ passing yield property under contract with settlement expected Dec 2018 # part of a national portfolio, allocated pricing & analysis

INVESTMENT ACTIVITY & YIELDS

Domestic funds have largely outbid offshore buyers on the limited opportunities

Transaction activity in the Fringe has been lower over 2018 to date, compared with the extremely strong activity in 2017. As shown in Figure 8, total 2018 transactions to date stand at $558 million. However this will be boosted with the finalisation of the transaction at 100 Skyring Tce, Newstead for $250 million, expected in December 2018.

With 100 Skyring Tce under contract to Growthpoint Property Aust, a domestic REIT, this continues the recent trend of domestic funds outbidding offshore buyers in the Fringe. In 2017 offshore buyers accounted for 46% of sales, but for 2018 this may slip to 15%.

While unlisted funds and wholesale groups have remained the dominant purchaser type, REITs have increased their exposure in the Fringe this year with the higher yields attractive to listed entities. The 2018 REIT activity also included Centuria Metro REIT's purchase of the Hines Global REIT portfolio, which included two Fringe assets.

Offshore buying activity during 2018 has been a mix of core assets (50% of 2 King St, Bowen Hills) and value-add (339 Coronation Drive, Milton)

Current Yields & Outlook

Prime	5.50% - 6.75% -53bps y-o-y	↘
Secondary	7.10% - 8.25% -42bps y-o-y	↘

Assumed WALE Prime: 4-6 yrs, Secondary: 2-5 yrs

Prime yields continue to tighten across the Fringe

Fringe prime yields have remained firmly on a tightening cycle, with median yields down 53 basis points over the past year. This ranges from 5.50% for modern, large scale assets through to 6.75% for prime, but older, assets of a lesser scale than sought by major institutional funds.

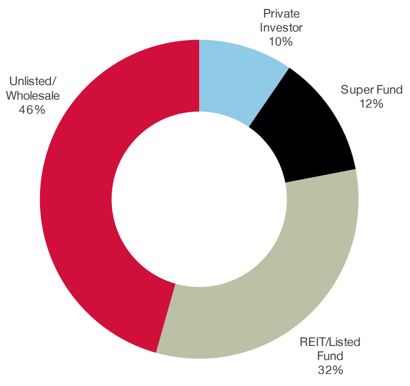
The risk margin between prime Fringe and CBD assets remains low at 43 basis points, with the margin narrowing over the past six months. Illustrated by Figure 9 the margin between the CBD and Fringe markets fell to 38 bps in late 2017 due to the delay in yield contraction within the CBD until the leasing market recovery was evident in early 2018.

Since the development surge in the Fringe market, 2006—2010 when total stock grew by 43%, the yield gap to the CBD has been lower, averaging 61 basis points compared with the long term average yield gap of 81 bps. This re-rating of the market emerged as the size of assets and quality of tenants increased. This trend has been reinforced by the level of demand for office assets in Brisbane with demand flowing over from the CBD and into the Fringe market.

Despite indications of increases in the global cost of debt, the sustained high level of equity seeking investment is set to continue to place downward pressure on yields for the remainder of 2018 and into 2019. With the Fringe leasing market showing improvement, albeit slower than the CBD, the continued yield firming trend is a factor of both weight of funds and improving confidence in the market. The relatively restricted supply pipeline remains a positive for sustained rental growth in the longer term.

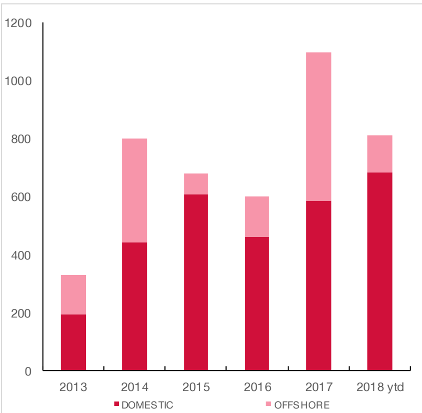
Secondary yields have also tightened over the past year, down by 42bps. With the residential development market cooling there has been less demand for secondary low rise office buildings with the expectation of conversion to development sites. However the continued development of the geographically limited Fringe precincts means that land rich assets remains well sought after by the market.

FIGURE 7
Brisbane Fringe Purchaser Profile
2017 + 2018 ytd



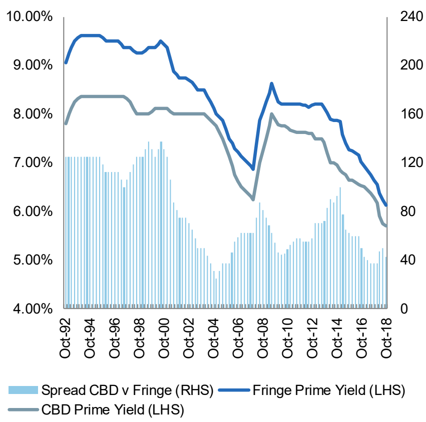
Source: Knight Frank Research

FIGURE 8
Brisbane Fringe Sales Volume
$million by source of funds



Source: Knight Frank Research (includes 100 Skyring Tce in 2018 data)

FIGURE 9
Brisbane Fringe Core Market Yield
% Prime CBD & Fringe Yield LHS & Spread RHS



Source: Knight Frank Research

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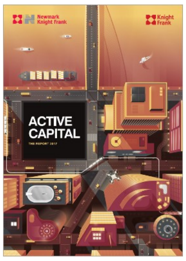

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