- *Net absorption has remained elevated due to tenant growth*
- *Limited new supply has assisted vacancy to reduce significantly*
- *Sales volume is low, vendors need to move to meet the market*

Knight Frank

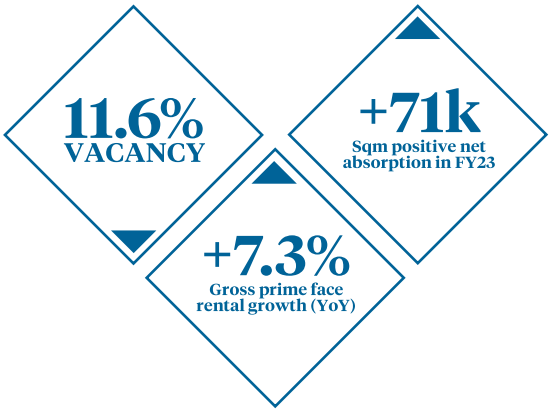
knightfrank.com/research

Brisbane CBD Office

Market Report, October 2023

STRONG RENTAL MARKET

Net absorption has remained strong at 71,000sqm in the past year, well ahead of southern cities. In contrast, sale transactions have remained scarce



"Vacancy is forecast to dip to 8.9% by July 2024 before increasing again due to new supply in 2025. The expected lack of new supply during 2026 + 2027 will assist the vacancy to fall below 10% again and mid-term stabilise between 8.7% and 9.5%."

The Key Insights

The pace of economic growth has slowed as the cash rate nears the peak level. Economic growth is forecast to remain resilient for Queensland with GSP growth of 3.2% in FY24 to be followed by 3.3% and 3.4% in in the following years (Oxford).

Total vacancy decreased from 12.9% in January 23 to 11.6% in July, with sustained strong net absorption and no new supply over H1 2023 (PCA).

There are two CBD assets under construction for delivery in late 2024 and mid-2025. With no new supply until late 2024 the vacancy rate has the ability to make further meaningful reductions, falling below 10% in 2024.

Prime face rent growth was 7.3% y/y with quality assets facing no push back from tenants on face rent increases. Prime gross face rents grew to $885/sqm with incentives slightly lower at 40%, although still covering the tenant's capital expenses.

Capital market activity has been subdued with assets going under contract but remaining in DD for a significant time. Prime yields have now softened 143bps from recent cyclical lows, with the potential for further softening.

Brisbane CBD Office Market Indicators—1 October 2023

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)	CORE MARKET YIELD %*
Prime	1,385,391	12.5%	52,534	32,478	885	40.0%	10.0%	6.75%
Secondary	971,271	10.4%	18,457	-13,613	722	41.5%	8.6%	7.70%
Total	**2,356,662**	**11.6%**	**71,000**	**18,865**				

Source: Knight Frank Research/PCA ^ as at 1 July 2023 *assuming WALE 5.0 years,

ECONOMIC GROWTH MODERATING AS EXPECTED

Cash rate tightening cycle is at or approaching its end point with a soft landing appearing possible

The necessary monetary policy response to combat inflation has now taken the target cash rate to 4.1%, with the past three RBA board meetings resulting in a 'hold' decision. The cash rate is generally considered to be at or near its peak level for this cycle. Data showing unexpected economic resilience or bubbly inflation will be the trigger for additional tightening at this point. Australia's cash rate target is lower than many other advanced economies with the US target of 5.25—5.5% 115 basis points higher currently. New Zealand (5.0%), Canada (5.0%) and the UK (5.25%) are similar with the Euro at 4.25% the closest to Australia. There has been an immediate currency impact due to this gap and if maintained this may shape patterns of capital flow.

Hopes remain that inflation has peaked with the latest quarterly data indicating 6.0% uplift to the June 23 Quarter. More recent and volatile, monthly data, although skewed towards products over services, has shown an increase from 4.9% in July to 5.2% in August. There is ongoing focus on services inflation, which reached a 20+ year high of 6.3% in the latest quarterly data and tends to be more sticky than goods inflation. Thus the speed that inflation returns to the target band of 2.5-3.0% remains debated. This will determine the length of time that the cash rate target will remain at peak levels and also if an uplift in the 'neutral' cash rate target is likely for this cycle.

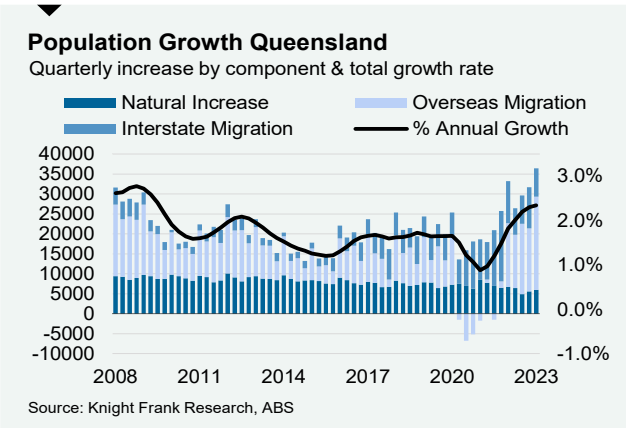
The Q2 2023 Australian GDP quarterly growth was +0.4%, in line with the (revised) prior quarter but lower than the last two quarters of 2022 at 0.7% per quarter. The FY 2023 annual GDP growth of 3.4% for Australia continues to show the expected moderation from the bounce-back peaks of 2021. For Queensland both the peaks and bounce backs (FY23 not yet finalised) shows greater volatility. Oxford Economics forecasts Australian GDP growth will moderate to 1.3% for FY24 before increasing to 2.23% in FY25. The forecasts are stronger for Queensland in the short term with GSP growth of 3.2% in FY24 to be followed by 3.3% and 3.4% in in the following years.

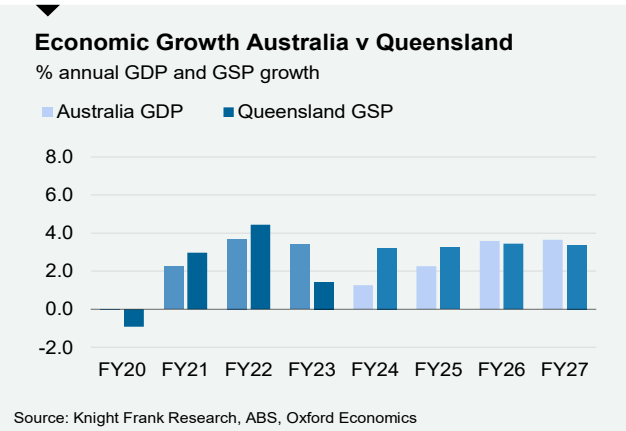
Employment conditions have remained buoyant with national unemployment sitting at a low 3.7% in August 2023. Queensland employment growth has also been strong with 55,270 jobs created in the past 12 months and unemployment remaining tight at 4.1%.

Population and infrastructure boosts will support ongoing activity

Queensland recorded 2.3% annual population growth to Q1-23, ahead of the national average of 2.2% which was boosted by accelerated net offshore migration. Queensland is on track to gain a larger share of offshore migration with a strong tertiary education offering and sustained employment growth. During 2015-2019 Queensland attracted, on average, 12.4% of national net offshore migration. Recently this has increased to 15% and Queensland, particularly Brisbane, is well placed to increase this allocation as the city matures. Net offshore migration was 57% of Queensland's annual growth. Queensland also benefits from consistent net interstate migration with annual inflow of 31,070 persons to Q1-23, well above average levels (24,723).

Population growth and construction required for the 2032 Olympics has resulted in a deep infrastructure spending programme for Brisbane. Cross River Rail is on track for delivery in 2025 and the City Deal has funded the Brisbane Metro programme with a 2024/2025 completion.





PROFESSIONAL SERVICES TENANTS ACTIVE

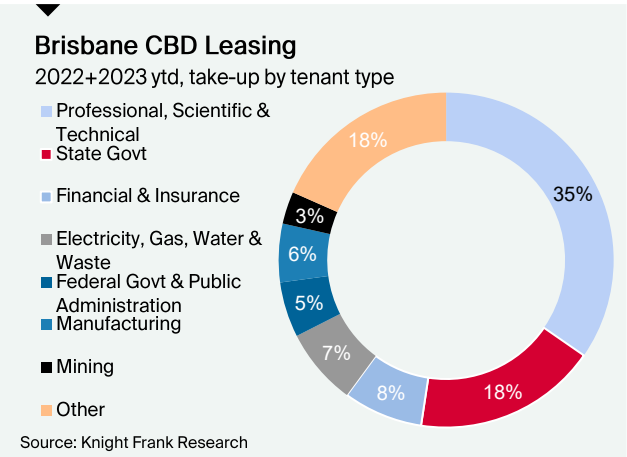
Leasing activity now driven by the larger corporates and Government requirements

The broadening of tenant demand has continued with the market no longer reliant on the SME sector for deal volume. Top and mid-tier professional firms are increasingly locking in future premises decisions and taking advantage of the relatively greater choice on offer now than there will be in the next two years. Government, particularly the State Government, has returned to the market taking leases to both service the growing population and also as part of an ongoing programme to upgrade their office accommodation (both grade and Green rating).

For 2023 to date, 30% of leasing activity by area was in tenancies 10,000sqm +, a further 27% came from tenancies in the 5,000—10,000sqm range. This is representative of more widespread decision making from tenants of scale and greater pre-commitment activity.

Smaller tenants remain active, however the market is less dependent on their activity than was the case during 2020-2022 when smaller tenants made up 20%+ of the total area leased. More recent data for 2023 shows this proportion has shrunk to under 10%.

Boosted by pre-commitment activity, the Professional, Scientific & Technical tenants accounted for 35% of recent leasing activity. Three quarters of the professional services take-up was across the legal and accounting sectors with architect/engineering 15%. The combined Government sector/public administration sector was 23%, with the State Government particularly active with 18%.



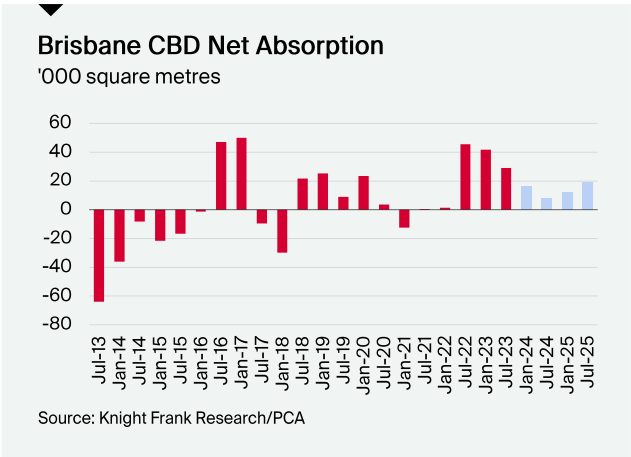
Smaller tenants may be becoming more conservative

After dominating market activity since 2019, smaller tenant activity may have peaked in first half of 2023. While still an active portion of the market the cost pressures of small business may be beginning to impact on the courage of these SME's to commit to new leases. This is in complete contrast to larger businesses where market-leading accommodation and appropriate green ratings are seen as essential parts of employee value proposition and retention.

Net absorption to remain positive due to underlying growth but risks from corporate downsizing remain

Net absorption in FY23 totalled 71,000sqm, continuing the sustained run of elevated net absorption, and being more than 2.5 times the 20 year average. This strength was in contrast to the major southern CBD markets where annual net absorption has been overwhelmingly negative.

While underlying demand for Brisbane CBD is forecast to remain sound though the medium term, the realities of a slowing economy and greater focus on costs cannot be ignored. Organic growth supporting population growth and extensive infrastructure and construction pipeline will continue to drive new demand and support positive net absorption. Moderating this is the potential for corporate downsizing through larger tenants releasing tranches of space on expiry or via sub-lease. To date there has been little significant downsizing in the Brisbane CBD, however it would be short sighted to believe that this market will remain immune.



VACANCY REDUCING DUE TO NET DEMAND

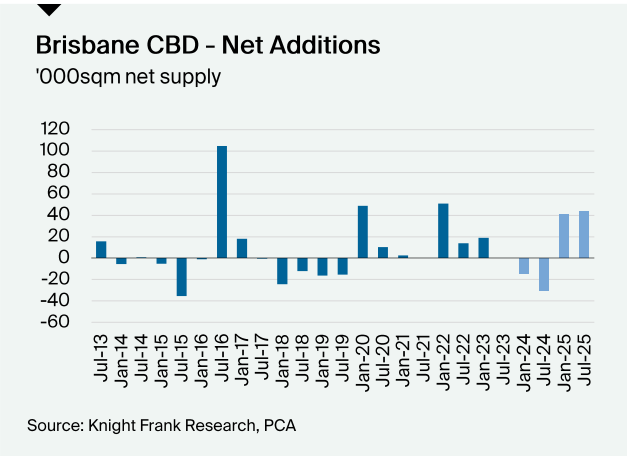
No new supply until late 2024 but additional options 2027+ are emerging

No stock was added or withdrawn in Brisbane CBD in H1 2023. The market has been without new supply since early 2022 and this pause will continue through to late 2024, allowing for a meaningful reduction in the vacancy rate.

The focus will shift to refurbished assets, the first being the withdrawal of 70 Eagle Street for refurbishment following the relocation of QSuper (make good works currently underway) to Brisbane Square. The scope and timing of refurbishment works have yet to be publicly released. Other whole building opportunities, which may be a major repositioning or a shorter lobby/amenity reworking, include 41 George St (29,960sqm), 150 Charlotte St (11,080sqm) and 140 Elizabeth St (9,908sqm).

Construction at 205 North Quay is expected to top out prior to the end of 2023. Completion of the fully pre-committed 42,700sqm building is expected late 2024. The premium development at 360 Queen Street is now 75% pre-committed with mid-2025 completion for joint venture partners Investa & Charter Hall. Waterfront North is targeting early 2028 completion and is c50% pre-committed.

Surging construction costs and extended development timeframes has made feasibility for additional tower starts significantly more difficult. However opportunities remain for new pre-commitments to trigger further development 2027+ with Santos (c15,000sqm) close to announcing their future office location and Conoco Phillips with an active brief for 12,000—20,000sqm in 2025-2028.



Vacancy rate to fall below 10% in the next 12 months

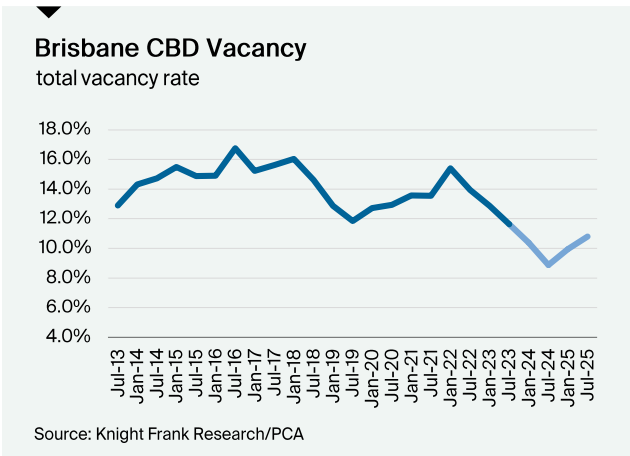
Total vacancy decreased to 11.6% in July 2023 from 12.9% as at January 2023. This decrease was driven by continued strong net absorption within a climate of no new supply additions. Total vacancy has now fallen from a recent peak of 15.4% in January 2022, thanks to this sustained demand.

While the quantum of net absorption is likely to reduce in the short term it will remain positive and combined with no supply this directly translates into further falls in the vacancy rate.

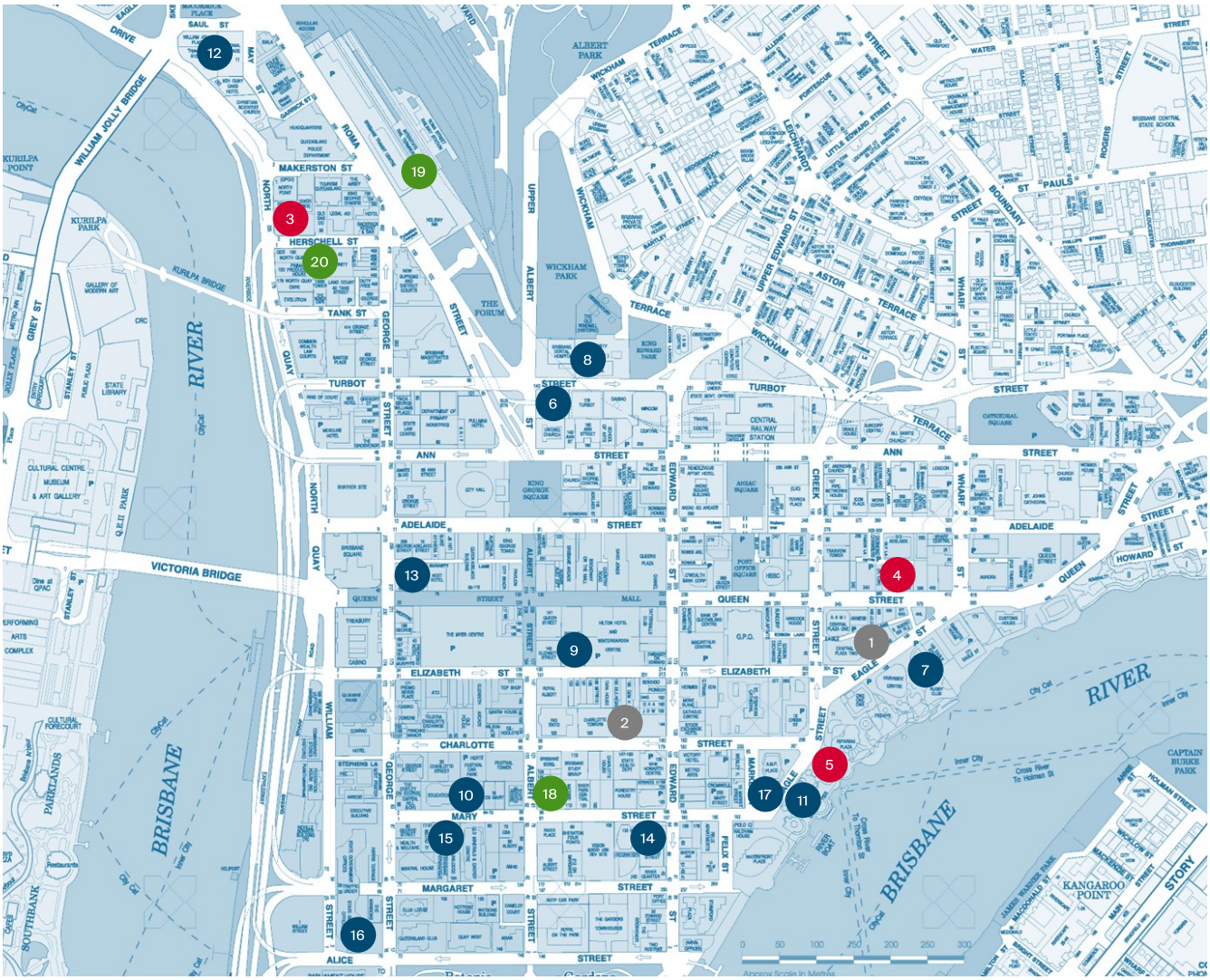
The vacancy is forecast to dip to 8.9% by July 2024 before increasing again in response to the new supply through 2025. An expected lack of new supply during 2026 + 2027 will assist the vacancy to fall below 10% again and mid-term stabilise between 8.7% and 9.5%.

The premium market is clearly the tightest with vacancy of just 4.4%, supporting strong rental growth for the limited space available. The A grade market has improved markedly, down to 15.8% as at July, from a peak of 19.7% in early 2022. This sector is expected to continue to tighten significantly as corporate and government tenants are active.

The best in class assets have already seen significant rental uplift as amenity and green credentials are highly sought. The B grade vacancy remains sub-10% for the second consecutive period as the market has a stable and refurbished stock base with steady demand.



MAJOR OFFICE SUPPLY



MAJOR REFURBISHMENTS

1. 70 EAGLE ST– 11,476 SQM
   MOOTED–2024
2. 150 CHARLOTTE ST–11,080SQM
   MOOTED 2025

UNDER CONSTRUCTION/ MAJOR PRE-COMMITMENT

3. 205 NORTH QUAY–43,700 SQM [SERVICES AUSTRALIA]
   CBUS 100% COMMITTED H2 2024
4. 360 QUEEN ST–46,700 SQM [BDO,HOPGOODGANIM, FREEHILLS, QIC]
   CHARTER HALL POF/ICPF – 75% COMMITTED - MID-2025
5. WATERFRONT PRECINCT NORTH TOWER–72,500 SQM [DELOITTE, MINTERELLISON, GADENS, COLLIERS] DEXUS - 48% COMMITTED. H1 2028

NB Dates are Knight Frank Research estimates
STC= timing is Subject to Commitment
Major tenant commitment in [brackets] net to NLA

DEVELOPMENT APPROVED

6. 343 ALBERT ST–50,160 SQM
   CHC 5%/GIC 95% TIMING STC
7. 135 EAGLE ST– C35,000 SQM GFA
   GPT. TIMING TBC
8. 200 TURBOT ST–66,079 SQM GFA
   MIRVAC. TIMING STC
9. 150 ELIZABETH ST–51,000 SQM GFA
   ISPT– TIMING STC. NEW DA LODGED
10. 62 MARY ST- 38,000 SQM
    QIC–TIMING STC
11. WATERFRONT PRECINCT SOUTH TOWER–60,000 GFA SQM
    TIMING STC
12. 309 NORTH QUAY–C55,000 SQM
    CHARTER HALL. APPROVED (BOTH SCHEMES)
13. 60 QUEEN ST–26,592 SQM
    CHARTER HALL. APPROVED
14. 133 MARY ST ANNEX–12,226 SQM
    ARA. TIMING TBC/UNLIKELY
15. 25 MARY ST–45,587 SQM
    BELLEVUE TCE PROPERTIES. APPROVED
16. 2 ALICE ST C26,000 SQM
    DESINATION BRISBANE – MASTERPLAN APPROVED
17. GOLD TOWER ANNEX–5,710 SQM
    MARQUETTE PROPERTY. TIMING UNLIKELY

DEVELOPMENT APPLICATION/MOOTED/ EARLY FEASIBILITY

18. ALBERT STREET CROSS RIVER RAIL STATION AIRSPACE–C45,000 SQM DEVELOPMENT APPLICATION
19. ROMA STREET CROSS RIVER RAIL STATION AIRSPACE–MOOTED
20. 33 HERSCHEL ST–15,000SQM GFA
    CAPRICORN ASSET MGT–DEVELOPMENT APPLICATION

RENTAL GROWTH STRONG

Prime market is tightening quickly, particularly for best in class assets, fuelling rental growth

Prime face rent growth has remained elevated as the premium and upper A market tightens quickly within a climate of limited new supply. Prime gross face rent has increased by 7.3% to $885/sqm in the 12 months to October 23. Prime incentives now average 40%, falling over the quarter.

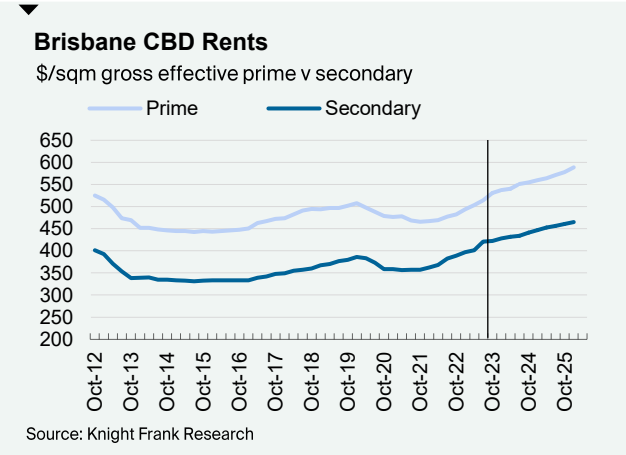
Premium rents remain the major driver of prime rental growth, although the gap between the pace of rental growth is closing as the A grade market tightens. On an annual basis premium face rental growth of 8.2% is still outpacing A grade at 6.4%. The low premium vacancy will spur further premium rental growth, albeit a psychological barrier of $1,000/sqm has been breached. As leasing activity picks up in the full and multi-floor A grade sector, higher rents have been achieved as tenants are willing to pay a higher rent for a better tenant experience. In the future the limited availability of multi-floor space will vie with an increasing mandate from corporates to contain costs.

Face rents will grow strongly for the rest of 2023 before slowing into 2024 as companies take a more conservative approach. Prime gross face rents will increase 2.8% to October 2024 and a further 4.2% to October 25. Longer term momentum remains upbeat with a forecast average uplift of gross face rents of 4.8% p.a over the coming five years. Incentives will tighten further but stabilise at 38.5%-40% over the next 5 years. Incentives remain essential to cover the capital costs of fitout and re-location for tenants so will remain elevated.

Secondary rental growth sustained to date, but incentives are sticky

Sustained secondary demand has rewarded the refurbishment investment from owners and has continued to push gross face rents higher, reaching $722/sqm as at October 2023. This represents an annual increase of 8.6% over the year. Incentives are stable at 41.5% and are expected to remain a central part of the secondary market.

The prevalence of spec fitouts in secondary space, while partly controlling costs if done in bulk, also underwrites total incentives in the secondary market. Secondary face rental growth will remain elevated through the remainder of 2023 but is close to reaching an affordability ceiling for increasingly conservative SMEs. Growth will moderate in early 2024 to the more normal range of 2.8%—3.5% p.a over the next five years.



Recent significant tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	FACE RENT $/ SQM	INCENTIVE	TERM YRS	START DATE
Jellinbah Resources	66 Eagle St	Financial	1,100	825 g	40+	7	Apr 24
PKF	66 Eagle St	Financial	1,433	815 g	40+	7	Nov 23
CPB Lawyers	300 George St	North Qtr	1,961	915 g	40+	9	Nov 23
Wood Group	123 Albert St	Midtown	4,032	855 g	40+	5	Jan 24
State Government	123 Albert St	Midtown	4,539	830 g	40+	5	Jul 23
QBE	300 George St	North Qtr	1,366	815 g	40+	7	Mar 23

u/d—undisclosed

TRANSACTION VOLUMES STILL LOW

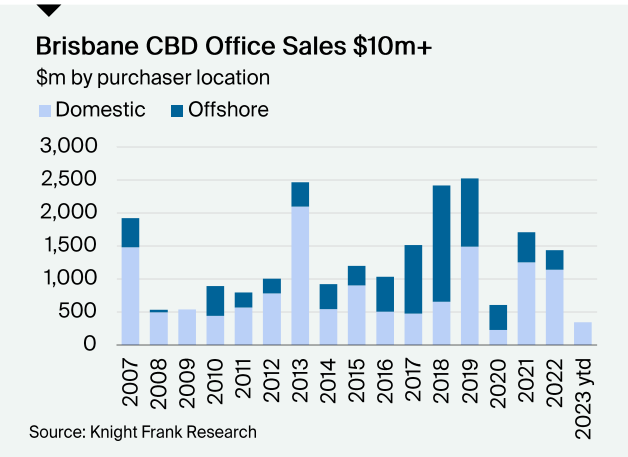
After a flurry of sales early 2023 the pace of transactions slowed

A strong start to 2023 when two $100 million+ assets traded in January and February has not been sustained, with limited transactions since.

The gap between vendor and purchaser expectations has remained with the cost of new commercial debt and equity causing an ongoing disconnect between existing book values and purchase offers. Purchasers do expect a discount to book value, with book values being reduced gradually, and are prepared to remain on the sidelines if this is not the case.

While book values are adjusting and vendors now more realistic than in 2022, formal campaigns have still been slow to translate into sales. Of the 11 on-market campaigns in 2023 only two have resulted in completed sales. A further three are understood to be in due diligence being 240 Queen St, 241 Adelaide St and 55 Elizabeth St, which would add c$520 million in transaction volumes if completed.

Assets such as 120 Edward St, with the campaign only recently closed, remain in negotiation with buyers to secure a contract. However the majority of other assets have been withdrawn from formal offer. Long DD periods and contracts falling over does indicate that capital raising for these purchases has been difficult. With REITS largely out of the market, retail and wholesale syndicators have been successful in placing assets under contract but sometimes struggled to raise funds in a timely manner. This has not been isolated to Brisbane and is reflective of the level of return investors expect from property when fixed income returns have significantly increased in line with long term bonds.



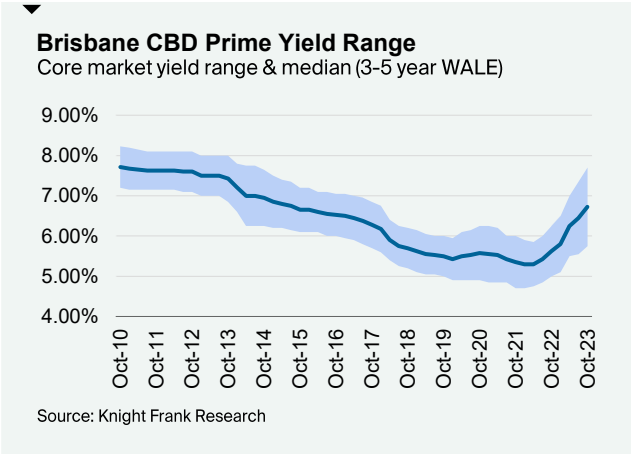
Domestic buyers have remained dominant in Brisbane CBD

Acquisitions which have occurred in 2023 have all been to domestic buyers. Offshore entities have remained engaged, attracted by the strong leasing demand and rental growth profile of Brisbane, but have not yet acted. Higher redemption requests and hedging risk have kept these buyers overwhelmingly cautious. The strength of the USD and relatively stronger economic growth remains a draw for funds to flow into Australia.

Transacted early in 2023, 333 Ann St was a A/B grade asset purchased by the newly listed RAM Diversified Property Fund for $141.1 million with an equivalent yield of 6.59%. In February the A grade 70 Eagle St was purchased by a private investor for $110 million. The well located asset has been vacated by QSuper and the purchase reflected an improved rate of $9,585/sqm.

Since those early 2023 sales the transactions which have finalised have been sub-$50 million. 247 Adelaide St was the smaller of two adjoining assets offered to the market by Charter Hall/Abacus JV and was purchased by BWC Properties, a private investor/developer for $15.4 million. 33 Queen Street was purchased by Mackwell Group for $37.6 million reflecting a core market yield of 7.0% across the heritage and modern buildings.

The most recent completed sale was the off-market purchase of 333 Adelaide St for $41.8 million. The secondary asset was purchased by Stadia Capital on behalf of a private investor at a yield of 7.84%.



Yield softening has continued through 2023, and pressure remains due to limited transactions

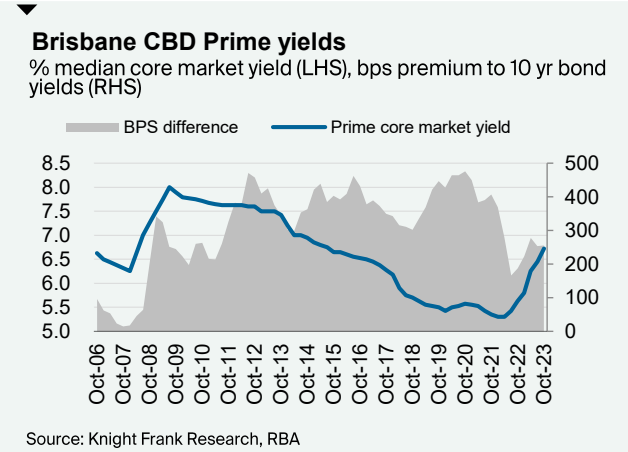
Monetary policy tightening cycle in Australia and globally is widely accepted to be in its final stages. Most central banks will only increase again if there is substantial data showing that inflation is resurgent. While this does bring a degree of comfort and certainty to purchasers, the underlying cost of funds is not expected to retreat in the short term.

Long term bond rates increased through the middle of 2023 trading above 4% since July. This is reflective of both an increased view that cash rates may remain higher for longer than previously expected and also the quantum of long dated fixed interest bonds available to the market. There has also been increasing debate as to whether the "neutral" rate has increased from the post-GFC extended lows. All of these factors indicate the yield softening trend to be being ongoing.

There has not been a significant prime investment sold in Brisbane since the 50% sale of 53 Albert St at just under 6% in October 2022. The anticipated transactions of 240 Queen St and 55 Elizabeth St will provide some much-needed market guidance. Prime yields are judged to range 5.75% - 7.70% with a median of 6.75% for the Brisbane CBD. The range is widening with large core assets judged to be less impacted than those with income risk exposure. This reflects softening of 28bps in Q3 and average softening of 143 bps since the lowpoint of early 2022.

Median core market secondary yields have also continued to soften over the past quarter to range 7.15% —8.24% as at October. The transactions that have occurred, and deals within extended DD, also reflect a broadening yield band.

"Long term bond yields have been trading above 4% since July. Stabilising at that level has intensified the pressure on yields."



Recent significant sales

PROPERTY	PRICE $M	CORE MARKET YIELD %	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
333 Adelaide St	41.8	7.84	7,499	5,567	4.5	Stadia Capital (for a private investor)	Icon Constructions	Aug 23
33 Queen St	37.6	7.00	5,590	6,726	2.7	Mackwell Group	Abacus Group	Jul 23
247 Adelaide St^	16.5	6.83	3,034	5,438	1.0	BWC Properties	Charter Hall REIT/ Abacus Group	Jun 23
70 Eagle St	110.0	n/a	11,476	9,585	0.8	Hancock Properties	Pembroke RE	Feb 23
333 Ann St	141.1	6.59	16,301	8,658	3.6	RAM Diversified Property Fund	Growthpoint Prop Gp	Jan 23

^ includes income support

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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