RESEARCH

Knight Frank

BRISBANE CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2018

HIGHLIGHTS

Leasing sentiment continues to strengthen with a number of larger requirements recently determined. Larger tenant activity has added to the grass roots improvement which has been in place for some time.

While the prime (11.1%) and secondary (19.3%) vacancy rates are divergent there has been effective rental growth in both. The secondary uplift was tied to face rent increases arising from capital investment.

Investor interest, particularly from offshore buyers, has further increased over the course of 2018. Offshore buyers, with 78% of transactions by value over the past year, are dominant.

KEY FINDINGS

Total vacancy improved to **14.6% in July 2018 from 16.1%** in January. This improvement is expected to continue, with vacancy **below 13% at year's** end.

Prime and secondary effective rents grew by **5.1% and 4.5% y-o-y** respectively to July 2018; and growth will continue into 2019.

The longer term supply pipeline continues to take shape while **steady supply additions are forecast 2019-2022 resulting in a 4% stock increase over four years.**

Yields have **continued to tighten** across both prime and secondary as the improving tenant market has **given purchasers new confidence in Brisbane.**

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

Population growth at five year highs, a strong pipeline of major project and infrastructure investment focussed on the CBD, and improving economic activity are all boosting tenant and investor demand.

Economic indicators supporting demand growth

Queensland's economic growth remains positive with the most recent State Final Demand indicating annual growth of 3.4% in the year to June 2018. Forecasts for Queensland GSP are 3.0% for FY18 which is above the national average of 2.7% and expected to be the first time in three years where the QLD economic growth will outpace the national average.

Mining & energy, tourism and education are growth sectors, supported by a lower AUD and higher global growth. While recent state-based data is not yet available, national growth in the Mining & Energy sector is forecast by Oxford Economics to grow by 6.9% in FY18 and a further 7.3% in FY19.

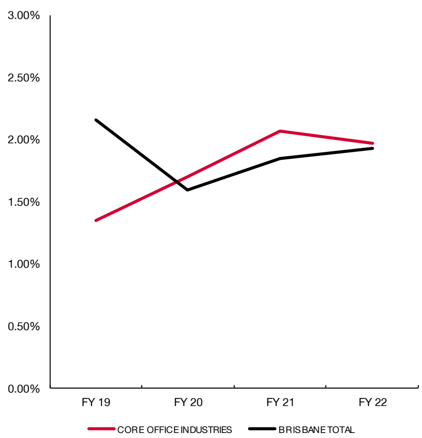
Population growth for Queensland is sitting at 1.7% and five year highs as at December 2017. This is being boosted by net interstate migration at 10 year highs along with solid net offshore migration and natural increase. In 2016-17 data Brisbane had the highest net internal migration gain of any of the capital cities at 12,000 people and net interstate migration has been accelerating in anecdotal data since that time.

Additionally there are a number of city-shaping infrastructure and major projects underway across Brisbane which will boost public transport, entertainment/dining facilities and enhance liveability.

Employment forecasts supportive of accelerating tenant growth

As shown in Figure 1 the Brisbane region is forecast to see accelerating annual growth in the core office employment sectors. From 1.35% y-o-y in FY19 the growth is set to accelerate to 2.07% y-o-y in FY21 before stabilising. This is supportive of steady acceleration in office demand. Brisbane is forecast to show 4.51% total employment growth during FY18 and while this is expected to moderate over the next four years, white collar employment growth is expected to outpace total employment.

FIGURE 1
Brisbane Employment Growth
% annual growth in employment—Brisbane



Source: Oxford Economics/Knight Frank Research

TABLE 1
Brisbane CBD Office Market Indicators as at July 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	1,272,103	11.1	24,881	18,303	750	34.5	5.25—6.25
Secondary	971,220	19.3	-31,005	-54,705	585	39.0	6.00—7.50
Total	**2,243,323**	**14.6**	**-6,124**	**-36,402**			

Source: Knight Frank Research/PCA *assumed WALE 4-6 years prime, 2-5 years secondary

TENANT DEMAND & ABSORPTION

Large tenant moves shape the market

Recent tenant activity has been dominated by some of Brisbane's biggest private sector tenants determining their future accommodation needs. The largest of these is Suncorp which has recently committed to 39,600sqm at 80 Ann St with completion of the building due in 2021/22.

Other large tenants that have finalised future office space during 2018 include:

- Telstra (19,557sqm—recommitted),
- QSuper (17,000sqm—relocating to Brisbane Square 2022),
- Department of Veteran's Affairs (6,414sqm—moving to 480 Queen St late 2018),
- Westpac (c6,000sqm—relocating to 123 Eagle St Q3 2019) and
- WeWork (7,500sqm new to the Brisbane market, opening in 192 Ann St October 2018).

These large negotiations, although many relate to future occupation, have resulted in banking/finance dominating lease commitments in 2018 to date (Fig 2). Professional services accounted for 22% and are generally the most active private sector tenants in the Brisbane CBD.

While there has been a great deal of market attention on the actions of larger tenants, which also has been transformational in boosting market confidence, the majority of activity remains for smaller tenants. Over the past year, 72% of the number of deals done, for relocations, have been for tenants <500sqm. This underlies the grass roots level boost in activity and demand, fuelling A and B grade markets.

With a number of large tenants recently finalising their accommodation needs the market's attention has turned towards the next major opportunities and whether these may trigger further development activity. The State Government has an active 25,000sqm brief in the market and larger corporates with 2020+ expiries such as Rio Tinto and IAG are beginning their accommodation considerations.

Net Absorption & Outlook

Prime	FY18: 24,881sqm
Secondary	FY18: -31,005sqm

Source: Knight Frank Research/PCA

Net absorption boosted by inward tenant flow and upgrading

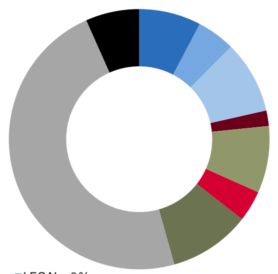
Net absorption in the first half of 2018 was 21,739sqm, a welcome return to positive net absorption after negative results in both of the previous two six month periods. While this figure was dominated by prime net absorption, accounting for 19,003sqm of the total, there was also positive net absorption from the secondary market (largely B grade buildings) with 2,736sqm. This was the first positive net absorption recorded for the secondary market since H1 2015 and reflects the success of many secondary building improvement works and speculative suite construction, drawing tenants to those buildings.

Net absorption in H1 2018 was impacted by a number of larger tenant movements although the long-awaited relocation of Origin into the CBD (16,250sqm) was balanced by space left by Aurizon's (16,520sqm) relocation to a new building in the Fringe. Tenancies new to the CBD included some 8,000sqm of space taken by the State Government (from Woolloongabba), Cross River Rail Authority (3,026sqm) and a new serviced office venture by Christie Corporate (3,500sqm). However this does not fully account for net absorption, this indicates a solid level of growth across smaller and medium sized tenants as has been anecdotally recorded from the A and B grade leasing activity.

This underlying improvement to tenant demand is expected to continue through the second half of 2018, however the overall net absorption is expected to be slightly lower at c15,000sqm as the balance of larger tenant movements between the Fringe and CBD changes. Outflows from the CBD (Aurecon, WSP) at c14,000sqm will not outweigh inflows and new businesses (Allianz, WeWork, The Hub) at c19,450sqm to the CBD but will limit the net absorption upside for the remainder of the year.

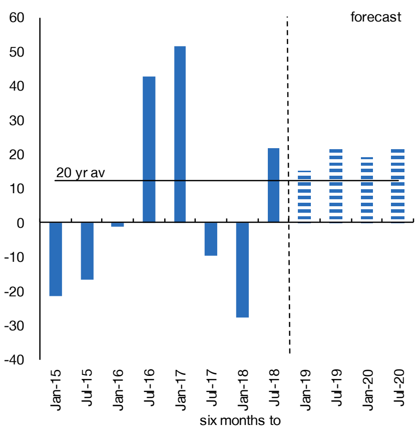
Net absorption is currently benefitting from the likely one-off, uplift from coworking/serviced office providers as the sector establishes in Brisbane. Longer term, forecast employment growth across key white collar industries provides the basis for steady net absorption in the medium term, at levels above the long term average.

FIGURE 2
Tenant activity by industry
Deals negotiated 2018 ytd by NLA taken



Source: Knight Frank Research (relocations only)

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



Source: Knight Frank Research/PCA

SUPPLY & DEVELOPMENT

Net supply to remain negative until H2 2019

The withdrawal of secondary buildings for future redevelopment was the only change to stock levels for the Brisbane CBD during the first half of 2018. With net withdrawals of 12,063sqm this was the third consecutive period of stock reductions within the CBD.

The withdrawal of 12,063sqm was across four buildings spanning 360—380 Queen St and was a combination of C (76%) and D (24%) grade stock. While there is currently no firm start date for the construction of the proposed new tower for the site, the existing buildings have been emptied of tenants and will remain off-line until demolished.

This trend of stock withdrawals will remain in force for the remainder of 2018 and into 2019. This will continue to support market recovery with the dual benefit of the continued withdrawal of secondary stock and net absorption translating directly into vacancy rate reduction with no new supply.

The next major withdrawals, currently expected before the end of 2018, will be spurred by resumptions for the Cross River Rail project. The largest is the Roma Street Transit Centre with a combined area of 29,521sqm from the East and West towers. With one tower substantially vacant and the remainder in the process of having tenants relocate but most likely remain in the CBD, this will benefit market indicators.

TABLE 2

Brisbane CBD—Vacancy Rates

Precinct	Jan 18	Jul 18
Premium	12.0%	9.5%
A Grade	12.8%	11.7%
Prime	**12.6%**	**11.1%**
B Grade	22.0%	20.8%
C Grade	16.6%	15.3%
D Grade	17.4%	13.7%
Secondary	**20.6%**	**19.3%**
Totals	**16.1%**	**14.6%**

Source: Knight Frank Research/PCA

Supply increasing from H2 2019 with the long-term pipeline building

The confirmation that Suncorp has selected 80 Ann St as their future headquarters has triggered construction with the 60,243sqm building to be completed in late 2021/22. This adds to the two projects currently under construction at 300 George St and 20 Creek St. The speculatively developed 300 George St (47,000sqm), part of the Shayher Group's W hotel complex, is expected to complete in Q3 2019. A smaller boutique project, 20 Creek St (7,200sqm), undertaken by Dexus, is in the early stages of construction with completion expected late 2019.

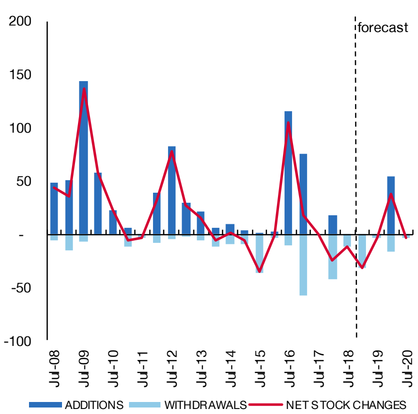
Beyond these projects, as shown on Page 5, there is a longer term pipeline emerging for both refurbished and new accommodation. However given the complexity of some of the larger projects they are considered 2025+ options only.

Potential full building refurbishments include the refurbishment/expansion at Mid-Town Centre in the short term. The relocation of Westpac from 260 Queen St will trigger a full refurbishment from late 2019. The State Government has entire buildings under lease with expiries in 2020 and 2021, and any relocations from those assets may also trigger further major refurbishments.

FIGURE 4

Brisbane CBD Net Additions

'000sqm additions, withdrawals and net supply



Source: Knight Frank Research/PCA

Vacancy Rate & Outlook

Prime	11.1% -110bps y-o-y	↓
Secondary	19.3% -130bps y-o-y	↘

Source: Knight Frank Research/PCA

Vacancy fell from 16.1% to 14.6% in the past six months and will fall below 13% by the end of 2018

Sustained improvement to tenant demand within the CBD, along with stock withdrawals and no new supply, have combined to provide significant improvement to the total vacancy.

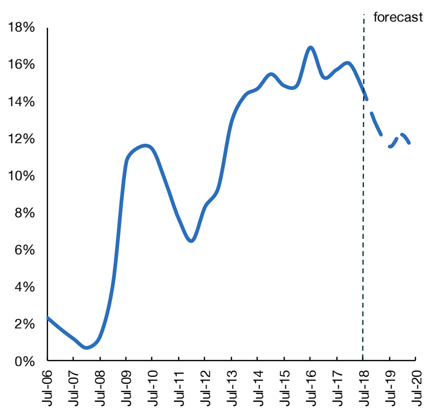
While near term net absorption is forecast to be lower in the second half of 2018, it will remain positive. Combined with the expected significant withdrawals arising from the Cross River Rail resumptions, this will take total vacancy below 13% in the short term.

Beyond that, the expected sustained tenant demand and limited new supply, until the second half of 2019, will keep total vacancy on a downward trajectory. Continued upgrading will see the bulk of this improvement remain in the prime market, however there are some positive signs emerging in the B grade market.

FIGURE 5

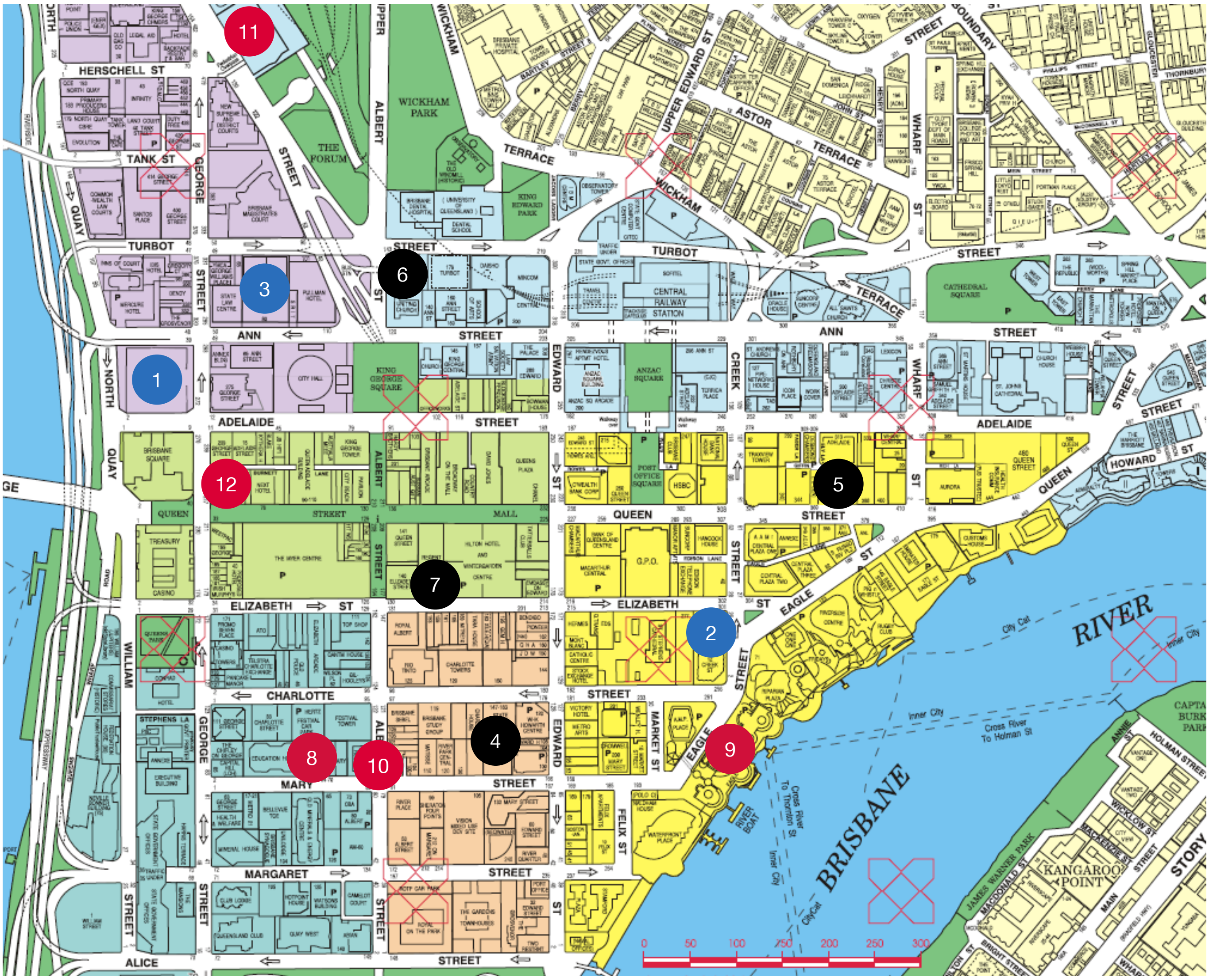
Brisbane CBD Vacancy

% total vacancy



Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY



1 300 George St—47,000sqm
Shayher Group— Q3 2019

2 20 Creek St— 7,200sqm
Dexus Property Group/DWPF—
Site Works—H2 2019

3 80 Ann St—60,243sqm [Suncorp]
Mirvac/M&C—Site Works—H1 2022
66% pre-committed

4 #Midtown Centre 155 Charlotte St & 150 Mary St^—42,000sqm
Ashe Morgan/DCM Projects
H1 2020+ STC
Development Approval

5 360-380 Queen St—55,000sqm
Charter Hall POF & ICPF—STC
Development Approval

6 143 Turbot St/343 Albert St—50,160sqm
CHC (5%)/GIC (95%)—Development Approval (unlikely to proceed short term sitting tenant re-committed)

7 150 Elizabeth St—c42,000sqm+
ISPT—STC
Likely to refresh design of existing DA

8 62 Mary St—38,000sqm
QIC—Development Application

9 Waterfront Precinct - Office component tba
Dexus Property Group—2025+
Masterplanning/ Market Led Proposal

10 Cross River Rail Albert St Station Airspace—c50,000sqm
Mooted 2025+

11 Roma Street Transit Centre Airspace
c50,0000—70,000sqm
Mooted 2025+

12 No 1 Brisbane Site,
George & Queen Sts
Charter Hall Group—Mooted

- Complete / Under Construction or Site Works / Pre-committed (blue)
- DA Approved (black)
- Development Application/ Mooted / Early Feasibility (red)

Source of Map: Knight Frank
As at August 2018, excluding strata
#major refurbishment
^formerly known as Health & Forestry House
Avail office NLA quoted.
Major Pre-commit in [brackets] next to the NLA.
STC = Timing subject to tenant commitment

RENTS & RECENT TRANSACTIONS

Rents, Incentives & Outlook

Prime Rents (g)	$750/sqm face 2.7% y-o-y $591/sqm eff 5.1% y-o-y
Secondary Rents (g)	$585/sqm face 4.5% y-o-y $357/sqm eff 4.5% y-o-y
Incentives	P:34.5% S:39.0%

Due to a combination of both face rental growth and a gradual erosion of incentives, effective rental growth has continued to gain momentum in 2018.

Prime effective rental growth is well entrenched

Recording effective annual growth of 5.1% in the year to July 2018, prime effective rents are forecast to continue to grow at between 3.5% and 5.0% y-o-y over the following three financial years. Short term growth to the end of 2018 is expected to be stronger before moderating slightly as the delivery of 300 George St impacts negotiating power.

Secondary rents have also shown effective rental growth, largely due to uplifts in face rents. This is aligned with an investment cycle across the secondary market and greater penetration of speculative fitouts in the secondary market. Both of these factors have resulted in landlords setting face rents higher. However with vacancy still high, incentives have been largely stable, with only minor attrition from 40% during 2016/17 to 39% currently.

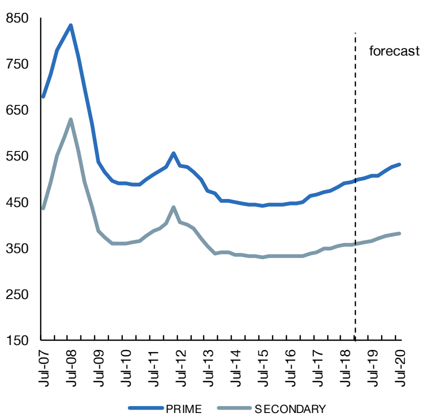
With the upgrading and investment cycle now largely throughout the secondary market it is expected that effective secondary rental growth will slow over the coming 12 months as the ability to push face rents further is limited, despite the continued withdrawal of obsolete stock. Over the next three financial years secondary effective rental growth will range between 2.5% and 4.2% y-o-y.

TABLE 3
Recent Leasing Activity Brisbane CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
266 George St	17,200	undis	15	undis	QSuper	2022
80 Ann St	39,600	c700 n	10	undis	Suncorp	H2 2021
123 Eagle St	6,800	775 g	10	35-40	Westpac	Q3 2019
69 Ann St	1,238	625 g	6.5	35-40	Brisbane Marketing	Feb 19
480 Queen St	6,414	825 g	10	35-40	DVA	Jan 19
192 Ann St	7,682	undis	15	30-35	WeWork	Nov 18
240 Queen St	1,017	710	10	35-40	Clarke Kann	Oct 18
111 Eagle St	1,160	875 g	8	undis	Marsh Insurance	Sept 18

`estimated incentive calculated on a straight line basis g gross

FIGURE 6
Brisbane CBD Rents
$/m² p.a average gross effective rent



Source: Knight Frank Research

TABLE 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
80 Ann St#	P	418.00	5.00	60,243	13,877	9.0	Mirvac Property Trust	M&G Asia Property Fund	Aug 18
217 + 231 George St & 60 Queen St	B	93.96	6.44	9,875	9,875	2.0	151 Property	Charter Hall Group 50% (new fund tbc 50%)	Aug 18
53 Albert St	A	252.00	5.73	19,059	12,513	3.4	Challenger Life	JP Morgan	Jul 18
143 Turbot St (343 Albert St)	B	108.00	6.79	19,867	5,436	4.3	Amalgamated Property Group	Charter Hall Group (5%)/ GIC (95%)	Jul 18
127 Creek St	A/B	129.13	6.21	18,303	7,055	2.5	151 Property	FIRMUS	Jun 18
414 George St	B	38.35	6.43	4,850	7,907	1.4	LaSalle Asia Opportunity Fund IV	Fife Capital	Jun 18

Source: Knight Frank Research ~# 50% sale on a fund through basis, includes 7 year rental guarantee on remaining space

INVESTMENT ACTIVITY & YIELDS

Investment activity has accelerated, dominated by secondary buildings

Over the 12 months to September 2018 there was $1.75 billion of transactions within the CBD, higher than the $1.53 billion a year earlier. Purchasing activity was dominated by offshore buyers, accounting for 78% of these transactions by value. AREITs and unlisted funds & syndicates were the remaining purchaser classes with all other buyers currently being outbid.

Taking advantage of the strong investment market conditions AREITs ($266 million), Private Investors ($340 million) and Super Funds ($252 million) were all net sellers over the past year.

The majority of sales, eight of the eleven recorded, were secondary buildings. Purchasers seeking a Brisbane presence, with core plus/value add mandates, were willing to push prices as recovery in the leasing market is well entrenched. This resulted in greater liquidity of secondary assets in the market.

Conversely there were only three prime sales, despite the strong demand, as owners held assets. The only prime transactions were 32 Turbot St ($370m), 53 Albert St ($252m) and the pre-sale of 80 Ann St ($418m 50%).

Current Yields & Outlook

Prime	5.25% - 6.25% -63bps y-o-y	↘
Secondary	6.00% - 7.50% -148bps y-o-y	↘

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

Yield gap between prime and secondary is narrowing

Yields have continued to firm substantially across both the prime and secondary markets as the general weight of funds seeking property investment and greater market interest in Brisbane have combined.

Prime yields have contracted a further 63 basis points (bps) over the past year, and a total of 225 bps since the prior peak in 2009. There remains strong demand for prime assets, however few assets have transacted, with current offers not yet tempting the majority of owners to sell. With prime assets largely in the hands of local or offshore institutional investors, there is little motivation to sell. Demand for Brisbane has already pushed the yield gap between prime Sydney CBD and Brisbane CBD yields below the long term average of 100 basis points, currently at 89 basis points.

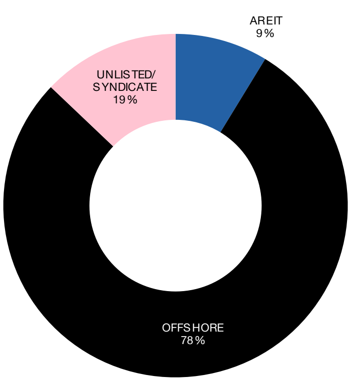
It is expected that further prime yield contraction, which is likely, is required to trigger additional prime sales in the near term.

Secondary yields, boosted by greater confidence in leasing market fundamentals, which has supported value -add strategies, have contracted by 148 basis points over the past 12 months and a total of 244 basis points over this cycle.

Leasing weakness delayed any significant improvement in secondary yields until late 2016/early 2017 and there has been an element of catch up in secondary yields since then. The current margin between prime and secondary yields is 100 bps. This gap has closed significantly in the past year from 185 basis points, and over the past six months has fallen below the long term average of 135 basis points for the first time since 2013.

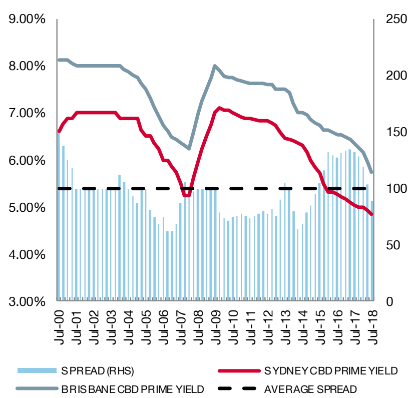
As shown in Figure 9, the secondary market has seen lower margins to prime yields, most notably during 2004—2008, falling to 50bps. This was when the secondary vacancy rate was much tighter, falling from 7% to 1% in mid-2007. With secondary effective rents still some 43% below the, somewhat artificial, prior peak in 2008 there is significant upside to that market, although dependent on capital expenditure to fully capture.

FIGURE 7
Brisbane CBD Purchaser Profile
12 months to September 2018



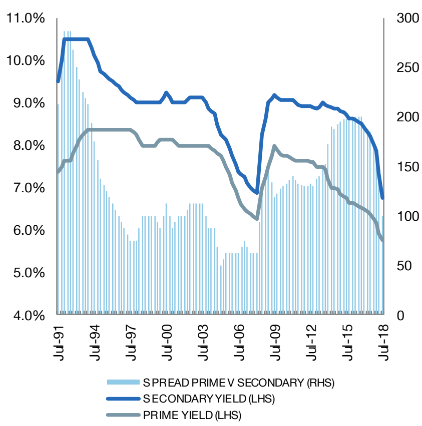
Source: Knight Frank Research

FIGURE 8
Brisbane & Sydney Prime CBD Yield
% Core Market Yield LHS & BPS Spread RHS



Source: Knight Frank Research

FIGURE 9
Brisbane CBD Core Market Yield
% Yield LHS & Basis Point Spread RHS



Source: Knight Frank Research

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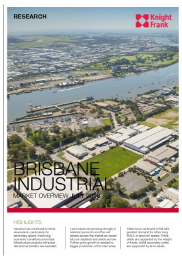

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Melbourne CBD Office Market September 2018

Multihousing Tenant & Investor Survey Australia 2018

Active Capital 2018

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