RESEARCH

BRISBANE CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2019

INVESTMENT VOLUMES BUILDING

HIGHLIGHTS

Tenant demand has remained steady with net absorption positive and vacancy decreasing to 11.9%. Supply additions through late 2019 and early 2020 will place a cap on further near term vacancy falls.

Effective rental growth has continued with the majority of uplift coming from face rents as incentive erosion has slowed. Tenants are motivated to relocate and upgrade where capital costs are mitigated.

Investment volumes are high with $2.86 billion over the year to September. While 2018 was dominated by offshore buyers, 2019 to date has seen far lower activity. Yield contraction remains in force.

KEY FINDINGS

Total vacancy improved to **11.9% in July 2019 from 14.6%** a year earlier. **Upcoming supply** is expected to see vacancy tick **upwards** to the end of the year.

Prime and secondary effective rents grew by **1.2% and 5.6% y-o-y** respectively to July 2019. While **face rental growth** is strong, prime incentives have stalled.

New supply of **54,200sqm** will come online in the next six months, **derailing vacancy falls** and providing distraction for tenants and making incentives sticky. **2021 & 2022** will add a further **104,000sqm** of new space.

Total **transaction volumes remain high,** however the level of offshore purchasers has fallen in recent months.

Yields have **continued to tighten,** although the pace of contraction is reducing. The **margin to Sydney CBD is** back under **the long term average.**

JENNELLE WILSON
Partner — Research QLD

ECONOMIC OVERVIEW

While economic growth forecasts are moderating due to global factors, the underlying growth story of Brisbane and Queensland remains, with employment in the office -based sectors to show sustained growth.

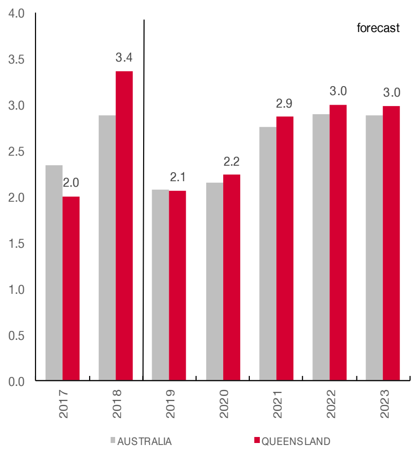
Economic growth steady but modest in 2019 & 2020

In line with global economic weakening, Australian and Queensland economic growth is expected to moderate to 2.1% for 2019. While the forecast for Australia is expected to remain static at 2.1% for 2020, Queensland is expected to see slight improvement to 2.2%. Thereafter a return to 2.9% - 3.0% for Queensland is forecast as the short term weakness unwinds. The ongoing trade tensions between the US and China and lower than expected activity in the US and Euro areas remain a downside risk.

Core office users to dominate employment growth in next five years

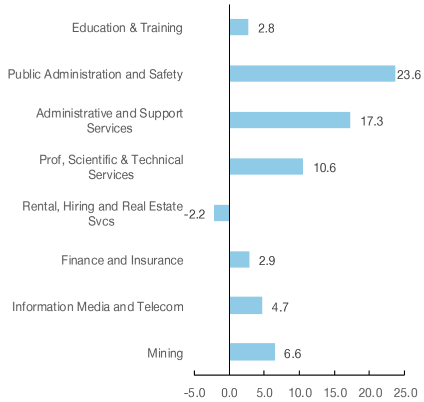
Forecast employment growth is expected to be a standout in 2019 with the Brisbane region to record 25,000+ more jobs in the core office-based industries (Oxford Economics). While 2020 is expected to be lower, the coming 5 years will average 10,500 office based jobs per annum. As shown in Figure 2 the key office occupiers of Public Administration, Administrative & Support Services and Professional & Technical Services will dominate employment growth in the medium term.

FIGURE 1
Economic Growth
%p.a GDP/GSP Growth Australia v Queensland



Source: Oxford Economics/Knight Frank Research

FIGURE 2
5yr Office Based Employment
'000 employment growth 2019—2023 Brisbane



Source: Oxford Economics/Knight Frank Research

TABLE 1
Brisbane CBD Office Market Indicators as at July 2019

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	9.6	20,507	-	771	35.5	5.05—6.00
Secondary	939,497	14.9	13,632	-31,723	610	38.3	5.95—7.10
Total	**2,211,600**	**11.9**	**34,139**	**-31,723**			

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

TENANT DEMAND & ABSORPTION

Space as a service continuing to expand

WeWork has continued to expand its Brisbane CBD footprint, committing to 4,600sqm in space to be refurbished at 260 Queen Street, opening 2020. While only accounting for 6% of total leasing activity in 2018 and 2019 ytd (Figure 3), the commitments by these co-working and serviced office tenants are all contributing directly to net absorption.

The largest recent office space commitment remains the decision by Rio Tinto to take approximately 20,000sqm in the Midtown Development at 155 Charlotte St. The project will be completed mid-2021. This commitment has contributed to the Resource and Energy sector accounting for 10% of leased space in the CBD. The place for Brisbane as an incubator of resource or supporting industry tenants can be seen with activity outside the Rio Tinto deal being 6 deals of 500sqm+ and 18 sub-500sqm tenants leasing space.

Due to the Suncorp pre-commitment, the Finance & Insurance sector remained the dominant tenant type with 26%, followed by the continually active Local, State & Federal Governments with 16% of activity. The legal sector has seen more activity during 2019, accounting for 6% of total activity.

While there are currently no super-tenants seeking space in the CBD there are requirements in the market. Potentially likely to favour their existing Fringe location, Sunsuper is fielding proposals for their 13,000—16,000sqm requirement. At the vanguard of a range of major legal firms with expiries in the coming five years, McCullough Robertson has a brief in the market for 5,000—6,000sqm of prime CBD space. The State Government potential 25,000sqm+ requirements are understood to be slow to progress decision-making, however are likely to re-emerge over time as upgrading and consolidation remains a central strategy. The Federal Government is considered likely to soon release a 30,000—40,000sqm brief in the market for 2024.

Net Absorption & Outlook

Prime	FY19: 20,507sqm	⇨
Secondary	FY19: 13,632 sqm	⇨

Source: Knight Frank Research/PCA

Net absorption settling into an organic growth cycle

With three consecutive six month periods of positive net absorption achieved, the Brisbane CBD market is settling back into a more standard, growth-based pattern of demand. There has been lower cross border tenant flows to either benefit or detract from the CBD net absorption figures.

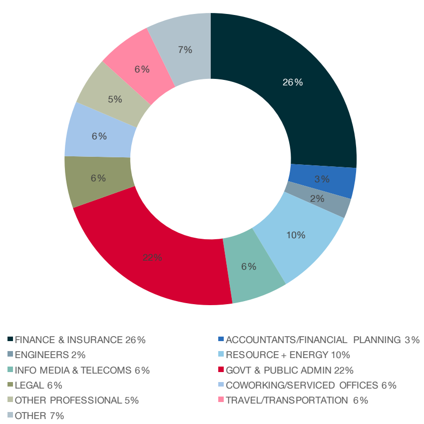
For the past 12 months both the CBD and Fringe markets have recorded positive net absorption, ending the period of one market stealing tenants from the other. While cross border moves will continue to occur as tenants' needs change, with less construction in the Fringe there will be less drift to new Fringe space from the CBD.

The prime market has continued a four-year run of positive net absorption with the most recent six month figure of 4,924sqm (annual 20,507sqm). The premium market dominated with 5,666sqm while the A grade market saw a slight decline in occupied space. The continued upgrading theme from tenants is expected to see prime net absorption maintain a positive trend, although the prime vacancy may increase in the short term due to new stock additions.

The secondary market recorded net absorption of 4,023sqm and when combined with a strong H2 2018 the annual figure of 13,632sqm is the highest annual net absorption for secondary stock since the mining project space assisted high 2012. The B grade market, supercharged by refurbishments and speculatively developed suites, recorded net absorption of 7,239sqm. The other secondary grades of C grade (-4,271sqm) and D grade (1,055sqm) were not major impacts on the secondary market.

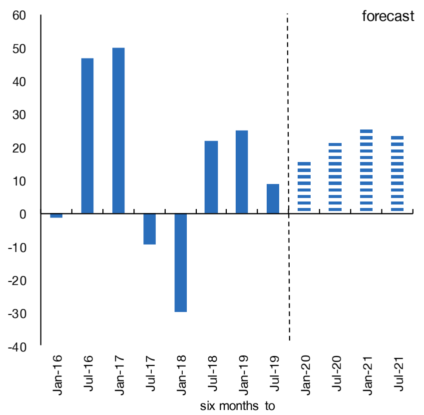
Although the total net absorption for H1 2019 was slightly disappointing at 8,947sqm the forecast through to the median term remains on a growing trend. Forecasts of white collar growth follow the expected improvement to economic activity from 2020. However, given the recent weakness in global and national economic sentiment and overall demand, there are risks to the downside of these forecasts if economic activity does slide further into 2020, rather than stabilising as currently forecast.

FIGURE 3
Tenant activity by industry
2018 & 2019 by NLA taken (inc future moves)



Source: Knight Frank Research (relocations only)

FIGURE 4
Brisbane CBD Net Absorption
('000sqm) per 6 month period



Source: Knight Frank Research/PCA

SUPPLY & DEVELOPMENT

First new building to be delivered in three years to come on line Q4 2019

The completion of 300 George Street in October/November 2019 will add some 47,700sqm of prime space to the market. This will be the first new building to be delivered in three years, since 1 William St came online in late 2016. While the refurbished 310 Ann St was delivered in late 2017 there have been no additions to supply at all during 2018 and 2019 year to date.

The withdrawal of obsolete stock has continued with the remaining tower at Roma Street Transit Centre withdrawn for demolition and the redevelopment of Roma Street station as part of the Cross River Rail major infrastructure works. The West Tower, Transit Centre, at 12,857sqm is the larger of the two withdrawals in the CBD over the past six months. The other withdrawal was 96 Albert St with the 2,560sqm C grade building withdrawn, also for demolition for the Cross River Rail project, to make way for construction of the Albert Street Station.

Net supply for the CBD has been negative for the past 2.5 years with the CBD total supply growing by less than 1% over the past five years. While there has been new or refurbished supply of 216,286sqm delivered over the five year period, this was almost matched by the total withdrawals of 203,786sqm.

TABLE 2

Brisbane CBD—Vacancy Rates

Precinct	Jan 19	Jul 19
Premium	10.4%	8.7%
A Grade	9.9%	10.0%
Prime	**10.0%**	**9.6%**
B Grade	17.1%	14.5%
C Grade	14.1%	15.1%
D Grade	20.8%	18.8%
Secondary	**16.7%**	**14.9%**
Totals	**12.9%**	**11.9%**

Source: Knight Frank Research/PCA

Medium to longer term supply prospects emerging

Aside from 300 George St there are three projects under construction. The boutique 7,200sqm, 12 Creek Street Annex, will be completed in late 2019/early 2020.

The Midtown Centre refurbishment/new development is well into construction with the façade being stripped from the old buildings. With a 44% pre-commitment to Rio Tinto, the 44,000sqm project (a mixture of 10,000sqm of new space and core & shell refurbishment) will be completed in mid-2021. The remaining development project is still at site works stage, with the Suncorp-committed 80 Ann St, set for completion during 2022.

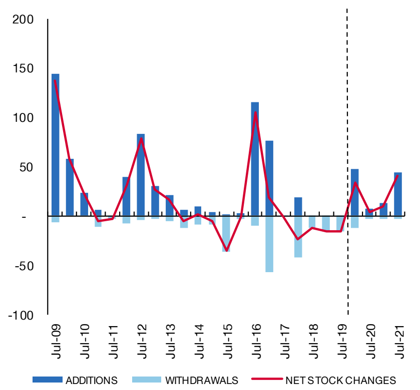
A full building refurbishment of 260 Queen Street is expected to commence later this year with completion H2 2020.

With the recent low supply levels and sustained improvement to the vacancy rate, it is inevitable that market attention has turned to the next wave of supply. While projects such as 360-380 Queen St, 62 Mary St, 150 Elizabeth St and 143 Turbot St all have development approval, they require pre-commitment before moving to the next stage. With tenant demand for new and modern options it is expected that further projects will emerge, the most recent being Cbus at 205 North Quay.

FIGURE 5

Brisbane CBD Net Additions

'000sqm additions, withdrawals and net supply



Source: Knight Frank Research/PCA

Vacancy Rate & Outlook

Prime	9.6% -160bps y-o-y	
Secondary	14.9% -410bps y-o-y	

Source: Knight Frank Research/PCA

Vacancy has fallen to the lowest level in seven years

Sustained positive net absorption combined with stock withdrawal has assisted to bring the vacancy sharply lower. The current total CBD vacancy of 11.9% is down from the 15.6% of two years ago.

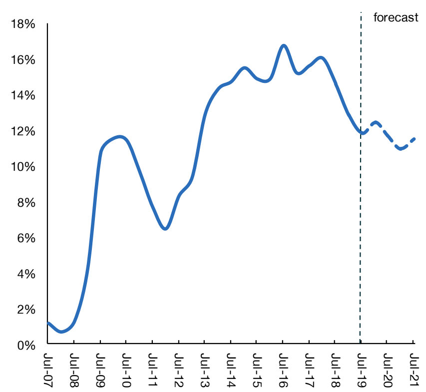
The addition of 300 George St towards the end of the year is expected to halt the trend of falling vacancy, with a lift to c12.5% expected in January 2020. The prime market, recently down to a six-year low of 9.6%, will also see vacancy increase to January. While prime net absorption is expected to stay strong, it will not outweigh the quantum of the new building.

From 2020 onwards the vacancy rate will resume a downward trend, however the quantum of the fall will be limited by the significant supply additions of 2021 & 2022. This will keep the total vacancy just above 10% until 2023/2024.

FIGURE 6

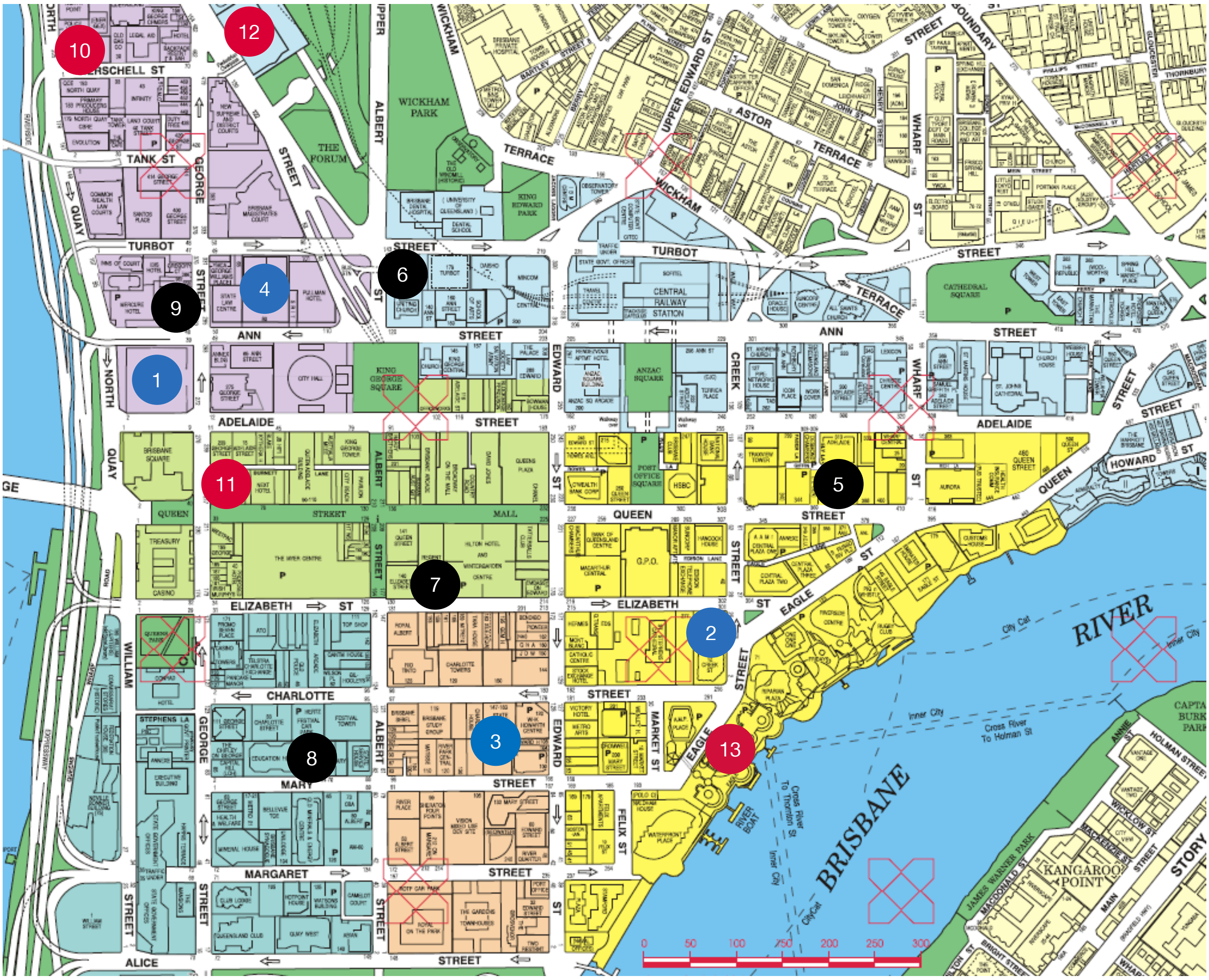
Brisbane CBD Vacancy

% total vacancy



Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY



1 — 300 George St—47,700sqm
Shayher Group—Construction
Q4 2019 - 12% committed

2 — 20 Creek St— 7,200sqm
Dexus Property Group/DWPF—
Construction—Q4 2019/Q1 2020

3 — #Midtown Centre 155 Charlotte St & 150 Mary St^—44,000sqm [Rio Tinto]
Ashe Morgan/DMC Projects—
Construction—Mid 2021— 45% pre-committed

4 — 80 Ann St—60,243sqm [Suncorp]
Mirvac/M&G—Site Works—H1 2022
66% pre-committed

5 — 360-380 Queen St—40,000sqm—55,000sqm
Charter Hall POF & ICPF—STC
Development Approval

6 — 143 Turbot St/343 Albert St—50,160sqm
CHC (5%)/GIC (95%)—STC
Development Approval

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

8 — 62 Mary St—38,000sqm
QIC—STC
Development Approval

9 — 320 George St—9,100sqm
Lionmar Holdings—tbc
Development Approval

10 — 205 North Quay—55,000—60,000sqm
Cbus/Nielson Properties
Mooted—STC

11 — No 1 Brisbane Site,
George & Queen Sts—c.35,000sqm
Charter Hall Group—Mooted

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

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

Complete / Under Construction or Site Works / Pre-committed

DA Approved

Development Application/ Mooted / Early Feasibility

Source of Map: Knight Frank
As at September 2019, 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)	$771/sqm face 2.7% y-o-y $497/sqm eff 1.2% y-o-y
Secondary Rents (g)	$610/sqm face 4.3% y-o-y $377/sqm eff 5.6% y-o-y
Incentives	P:35.5% S:38.25%

Rental growth has continued across both prime and secondary markets as vacancy has decreased and demand remains positive. While face rental growth is relatively easily achieved, incentive levels have stagnated or increased slightly.

Face rents driving rental growth

Since late 2018, particularly for prime space, it has been noticeable that incentives have plateaued even while face rental growth has been solid. Since average incentives approached 35% there has been some resistance from tenants to drop incentives further. The mobility of tenants and their likelihood to upgrade accommodation at lease end has been influenced by the ability to undertake the process with little to no capital outlay. Further reductions in incentives may make this decision more difficult, particularly given the emerging economic conservatism.

Nevertheless the sustained improvement in tenant demand and prime vacancy contracting to 9.6% has provided momentum to grow face rents by 2.7% over the past year. While effective rental growth was only 1.2% in the past 12 months, there has been 11.2% total growth in effective rents over the past three years. Once the potential distraction of 300 George St is absorbed by the market we expect incentive reduction to resume with effective rental growth of 3.2% - 4.8% p.a over the next five years.

Secondary rents continued to show recovery in line with recent vacancy falls and refurbishment of assets with 5.6% effective growth in the past year. Incentives have been stable during 2019. Forecasts show annual growth of 3.0% - 5.3% over the next five years.

TABLE 3

Recent Leasing Activity Brisbane CBD

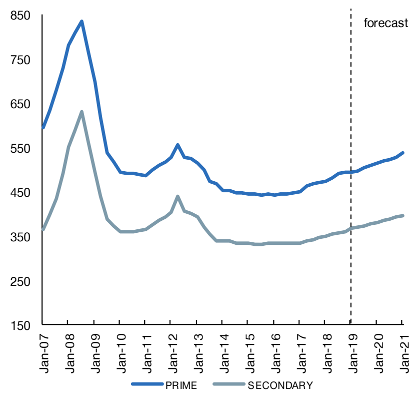
Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
260 Queen St	5,000	760 g	12	30-35	WeWork	Dec 20
180 Ann St	1,672	720 g	9	35-40	For the Record	Oct 20
66 Eagle St	1,460	760 g	10	35-40	Mills Oakley	Sep 19
275 George St	1,301	785 g	10	30-35	CDPP	Jul 19
545 Queen St	2,020	600 g	7.5	35-40	CSG International	Jul 19
12 Creek St	1,088	750 g	4	35-40	CleanCo	Mar 19
414 George St	3,368	650 g	5	30-35	DHL	Mar 19
69 Ann St	1,238	610 g	7	35-40	Brisbane Marketing	Feb 19

`estimated incentive calculated on a straight line basis g gross ^sub-lease

FIGURE 7

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
400 George St	A	485.65#	5.30	43,624	11,133	5.3	Blackstone/HSBC Trinkhaus	Cromwell Property Group	Aug 19
420 George St	B	42.10	6.25	6,019	6,995	3.4	Forza Capital	Dymocks Family	Jul 19
239 George St & 15 Adelaide St	B	214.10	6.63*	35605	6,013	2.7*	Oxford Properties	Anton Capital	Jul 19
201 Charlotte St	B	126.7	6.00	13,291	9,533	5.0	Fortius & Blackrock	Kyko Group	May 19
30 Makerston St	B	103.0	7.10	14,640	7,036	4.6	Challenger Life/ Diversified Property Fund	Sentinel Regional Office Trust	May 19

Source: Knight Frank Research #price net of incentives *weighted average.

INVESTMENT ACTIVITY & YIELDS

Turnover remains elevated; but few offshore buyers

Investment activity has remained elevated with $2.86 billion of transactions in the year to September 2019. This is roughly $1 billion higher than the corresponding period a year earlier ($1.82 billion). The elevated transaction level was assisted by the purchase of the former Investa assets by Oxford Properties in Oct 2018 for an allocated $593 million and their subsequent on-sale for c$650 million. The second tranche, The Complex, is under contract to Ashe Morgan for a gross price of $435 million, settling in October.

Despite the overall high investment activity, there has been a noticeable decline in the level of transactions being undertaken by offshore buyers during 2019. While Q1 saw $210 million of investment from Heitman and ARA Asset Management, purchasing the Quadra Pacific Assets of 288 Edward St and 133 Mary St, the two subsequent quarters have only seen $206 million in transactions to offshore buyers.

As shown in Figure 8 the balance between domestic and offshore buyers has completely flipped in the 2019 year to date figures with offshore purchasing representing only 17% of transactions, compared with 73% in 2018.

Current Yields & Outlook

Prime	5.05% - 6.00%	-23bps y-o-y
Secondary	5.95% - 7.10%	-23bps y-o-y

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

Uncertainty surrounding the land tax foreign surcharge delaying decisions

The Queensland Government, somewhat unexpectedly, announced in the June budget that the 2% land tax foreign owner surcharge would now apply to corporates and trustees.

This has taken investors by surprise and while the majority of commercial leases allow for partial recovery of land tax as an outgoing from tenants, this has recently impacted on offshore investor participation in sales campaigns.

While the legislation to implement this change has passed, making the surcharge payable on 30 June 2019 notices, the Office of State Revenue has not yet issued notices to entities likely to be affected while ex-gratia relief provisions are drafted. Industry bodies are negotiating with the QLD Government to reduce the scope of this impost, however to date, ex-gratia relief provisions have not been released, although are expected during September.

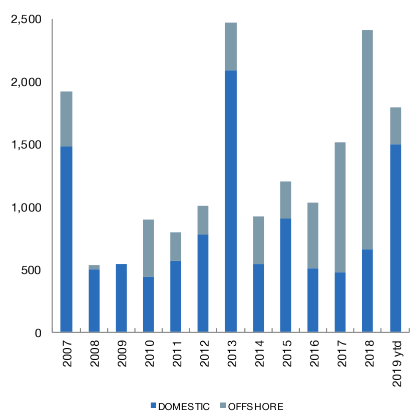
Weight and cost of funds draw yields lower

While the rate of yield compression has slowed, both prime and secondary yields have firmed further over the past six months. Compressing by 23 basis points over the past year Brisbane CBD yields are starting to move more in line with the Sydney and Melbourne CBDs. This comes after a period of accelerated yield compression as Brisbane was re-rated by investors.

The Brisbane CBD underwent a period of faster yield contraction from mid-2017 into 2018 as rental growth prospects firmed due to sustained tenant demand improvement. This has seen the yield gap between Sydney and Brisbane close from a recent high of 147 bps in July 2017 to the current 95 basis points. This is below the 10-year average of 99 basis points.

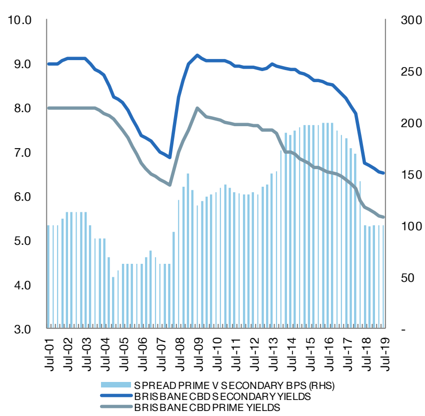
With yields recently stabilising in the larger core markets the expectation is for Brisbane yields to mirror that stabilisation in the short term. However yields remain exposed to the bond market and long term interest rates with the recent falls and expectations of sustained low bond yields to support further firming in 2020.

FIGURE 8
Brisbane CBD Transaction Activity
$ millions transactions $10m+ & source of funds



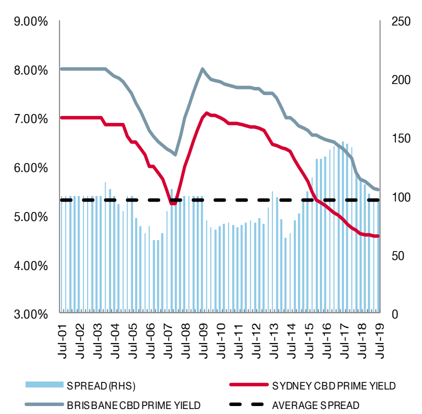
Source: Knight Frank Research

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



Source: Knight Frank Research

FIGURE 10
Brisbane & Sydney Prime CBD Yield
% Core Market Yield LHS & BPS Spread RHS



Source: Knight Frank Research

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