RESEARCH

Knight Frank

BRISBANE CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2017

HIGHLIGHTS

Potential new developments have become the focus in the market with large tenant requirements spurring rejuvenated or new medium term projects for the Brisbane CBD.

Modest but steady improvement to the leasing market is now confirmed, with prime gross effective rents 4.7% higher than a year ago. This was due to both face rent improvement and slight incentive erosion.

Investor interest in the Brisbane CBD remains high with associated downward pressure on both prime and secondary yields. Positive signs in the leasing market are translating to more secondary building sales.

KEY FINDINGS

Total vacancy was 15.7% as at July 2017, still **down from the cyclical high** of 16.9% in mid-2016 but up from the start of 2017.

Prime and secondary effective rents grew by **4.7% p.a and 2.6% p.a** respectively in the year to July 2017; the market has begun to show improvement.

A number of **large tenant requirements** have **re-awakened the development market**, creating a pipeline of potential new buildings.

Yields remain under **downward pressure** as offshore investors increase their presence in the Brisbane CBD market. Prime and core opportunities have been limited in 2017.

JENNELLE WILSON
Senior Director — Research QLD

SUPPLY & DEVELOPMENT

New supply will remain low in the short term, with only one new project under construction and refurbished space to be the only supply for 2017. Large tenant requirements are spurring medium term proposals.

There was only a small change to the Brisbane CBD stock base during the first half of 2017, which was the withdrawal of 330m² of C Grade space at 46 George St, for change of use. This abatement in the supply and withdrawal of stock came after the calendar year of 2016 was particularly active with 190,987m² of new stock delivered to the market and 68,272m² of withdrawals. Supply in 2017 will be dominated by the return to the market of the refurbished 310 Ann St, which has been expanded to now total 18,450m². It is understood that a heads of agreement has been signed for approximately half of the building and the remaining half is also understood to be attracting strong interest.

In terms of new office supply the only project under construction with a guaranteed delivery timeframe is the Shayher Group's 300 George St. The building, which is one of three towers being constructed on the site, is well into construction with completion estimated in the first half of 2019. While no formal commitments have been announced to the office space, QSuper has entered a non-binding agreement for approximately 16,000m² of space. The full refurbishment and expansion of Health & Forestry house is expected to also be completed in H1 2019, delivering some 34,000m² back to the market.

Triggered by potential large requirements, the development pipeline for the Brisbane CBD has recently begun to build with a number of developers advancing plans. This has taken the medium term potential pipeline from being quite limited beyond the 300 George St completion to now having a number of options.

Along with the long-standing mooted developments of ISPT's 150 Elizabeth St (current approval c35,000m²) and Dexus' 20 Creek St (6,300m²) there have been a further four proposals emerge over the course of 2017, with the potential for additional schemes to emerge. In late 2016 Mirvac placed a put and call option over the 2,746m² site at 80 Ann St, currently improved with a secondary 14,429m² building. While no development application has been lodged it is understood that c55,000m² can be accommodated on the site.

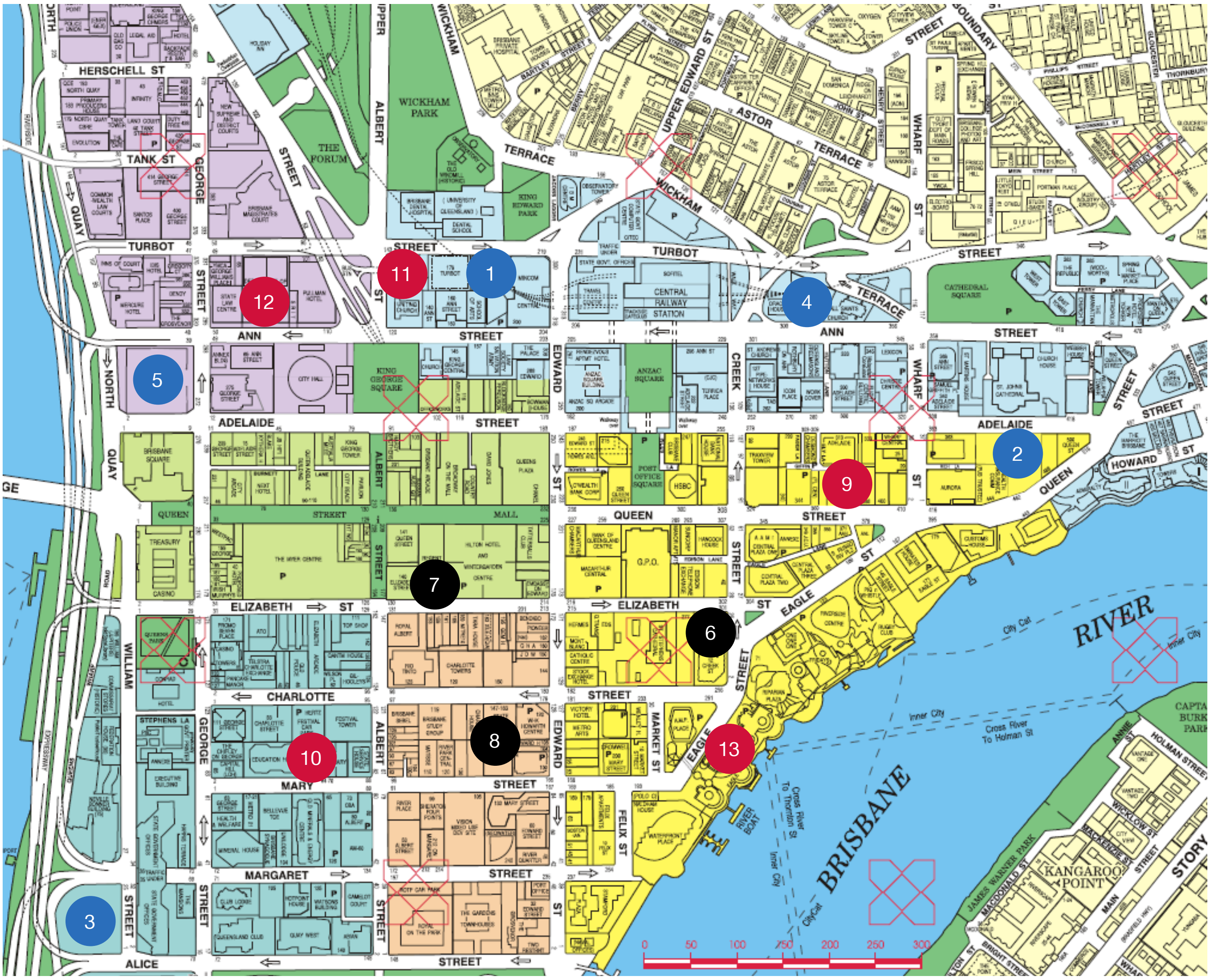
At 62 Mary St, QIC is investigating development potential with a 25,000—30,000m² building mooted, likely aimed at State Government occupancy. A joint venture between the Charter Hall Prime Office Fund and the Investa Commercial Property Fund has purchased a 2,147m² site, currently improved with three older buildings at 366—380 Queen St. While neither of the above potential projects have lodged Development Applications, they have commenced the process by seeking approval to be assessed under the previous planning scheme. One potential project which has lodged a Development Application is 143 Turbot St where APH is proposing to demolish the existing 26 level tower and build a new 30 level building with 38,290m² of office space.

TABLE 1
Brisbane CBD Office Market Indicators as at July 2017

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	1,253,800	11.7	111,788	75,853	730	36.0	5.80—6.95
Secondary	1,025,925	20.6	-70,039	-58,006	560	39.0	7.35—9.20
Total	**2,279,725**	**15.7**	**41,749**	**17,847**			

Source: Knight Frank Research/PCA *WALE 4-6 years

MAJOR OFFICE SUPPLY



1 180 Ann St—57,465m² [CBA/Tatts Gp] Daisho — Q2 2016—93% committed

2 480 Queen St—54,985m² office NLA [BHP/ PwC/Freehills] 100% committed (16% Grocon headlease) DEXUS/DWPF — Q2 2016

3 1 William St—74,853m² [State Govt] Cbus Property/ISPT—Q4 2016 100% committed

4 #310 Ann St—18,450m² Pidgeon Family—Q3 2017

5 300 George St—47,000m² Shayher Group—H1 2019

6 12 Creek St Annex—6,300m² DEXUS Property Group/DWPF—tba

7 150 Elizabeth St—c35,000m² ISPT—subject to pre-commitment

8 #Health & Forestry House—34,000m² Ashe Morgan—H1 2019

9 366-380 Queen St—c45,000m² Charter Hall POF & ICPF—mooted

10 62 Mary St—c25,000m² - 35,000m² QIC—mooted

11 143 Turbot St—38,290m² Amalgamated Property Group—Development Application

12 80 Ann St—c55,000m² Mirvac—Mooted (site under option)

13 Eagle Street Pier - Office component tba Dexus Property Group

Under Construction / Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

Source of Map: Knight Frank
As at September 2017, excluding strata
#major refurbishment
Avail office NLA quoted.
Major Pre-commit in [brackets] next to the NLA.

TENANT DEMAND & RENTS

The Brisbane CBD leasing market has continued to demonstrate that it has turned the corner, although much of this improvement is limited to the prime market. From a cyclical high of 15.5% in mid-2016, following the additions of 180 Ann St and 480 Queen St, the prime vacancy has fallen steadily to now sit at 11.7%. While the premium market was impacted most by this new supply, it has recovered quite quickly. The A Grade market is also improving with upgrading of accommodation a common theme in the market.

TABLE 2
Brisbane CBD—Vacancy Rates

Precinct	Jul 16	Jul 17
Premium	21.1%	11.8%
A Grade	13.9%	11.6%
Prime	**15.5%**	**11.7%**
B Grade	18.7%	20.0%
C Grade	17.5%	23.8%
D Grade	16.8%	16.1%
Secondary	**18.4%**	**20.6%**
Totals	**16.9%**	**15.7%**

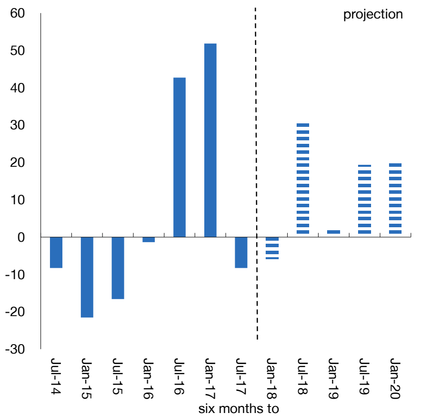
Source: Knight Frank Research/PCA

With the only new prime supply for 2017 understood to be largely, if not fully committed, this reduction in prime vacancy is expected to continue.

Secondary vacancy was 20.6% as at July 2017—an increase from the 18.4% recorded a year earlier. Tenants in B Grade buildings are taking advantage of the market to move to better quality space, leaving gaps behind in secondary buildings. Additionally while the secondary vacancy itself is only some 12,000m² higher than a year ago, the removal of a number of formerly fully occupied secondary buildings in the State Government relocations and subsequent withdrawals have impacted positively on the vacancy rate.

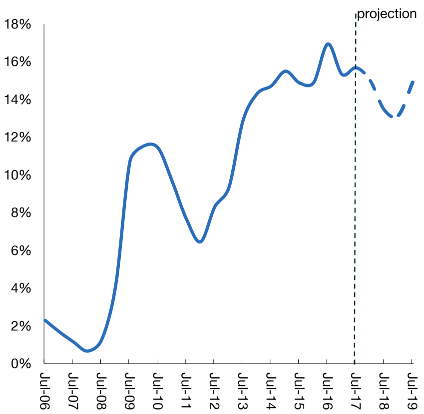
The sub-lease vacancy rate has more than halved over the past year—from 3.1% in July 2017, down to the current level of 1.5%, with sub-lease no longer considered to be a drag on the market.

FIGURE 1
Brisbane CBD Net Absorption
('000m²) per 6 month period



Source: Knight Frank Research/PCA

FIGURE 2
Brisbane CBD Vacancy
% total vacancy



Source: Knight Frank Research/PCA

Net Absorption

As expected the net absorption recorded in 2016, particularly the second half of 2016, was overstated due to the double counting of some occupancy, and the unwinding of this impact will dampen net absorption for the whole of 2017.

The overstatement, estimated by Knight Frank at approximately 40,000m². This was aligned with the difficulty of tracking the State Government relocations as they undergo a period of upgrading their accommodation, in tandem with moving into 1 William Street and moving from older secondary space. In H2 2016 the State was counted as occupying all of 1 William St (75,853m²) as well as in three buildings which were to be vacated as part of the relocation programme.

Part of this double counting has now been unwound with 80 Ann St (14,429m²) counted as vacant in the July 2017 survey, contributing to the negative result. The twin buildings of Health & Forestry House (26,651m²) will be fully vacated by the time of the next survey and will most likely have been withdrawn for a full refurbishment, completing the unwinding of the abnormality in the numbers.

While the result for the first half of 2017 was –8,299m², as outlined above, Knight Frank believes this understated the actual market activity, with the underlying net absorption judged to be 6,130m², of which 66% (4,071m²) is within prime space. While this was relatively modest net absorption it does continue the trend of positive underlying take-up since early 2016.

The second half of 2017 is also expected to record negative net absorption in the official figures, with the c15,000m² of underlying net absorption outweighed by the expected impact of the withdrawal of the Health & Forestry building from the figures. In contrast, the market is expected to start 2018 strongly with incoming tenant Origin adding 16,250m² of pure demand to an improving market. In addition, the potential relocation out of the CBD by Aurizon (leaving c16,520m²) and Aurecon (c6,600m² currently occupied) will negate organic demand growth in the second half of 2018.

Longer term the improving economy (QLD GSP of 2.4% p.a as at July 2017) and the most recent Brisbane population growth of 1.8% p.a in the 2016 Census, displays positive indicators that the underlying demand in Brisbane is improving. For 2019 the forecast net absorption equates to 19,600m² per six month period and while this is above the long term average (12,875m²) it remains well below peak levels.

Vacancy

The Brisbane CBD total vacancy rate increased to 15.7% as at July 2017, but remains below the cyclical high recorded in mid-2016 of 16.9%. Despite expected negative net absorption in the second half of the year, the vacancy is still expected to decrease to January 2018 to 15%. This will be assisted by the expected addition of 310 Ann St being outweighed by withdrawals of stock (80 Ann St—permanent, Health & Forestry House—for refurbishment). With no major additional supply expected during 2018, the vacancy will have the chance to decrease, forecast to reach 13.2% in January 2019, before additions of 73,651m² boost available space again, taking the vacancy back towards 15% for a short time. The expected tenant driven new construction in 2020-2022 will likely see the overall vacancy remain elevated as market as a whole, with un-refurbished buildings to face an uphill battle.

Tenant Demand

The long-awaited announcement of Suncorp's brief is the most significant formal requirement in the market at this time. Suncorp has requested between 30,000m²—40,000m² of core office space with access to a further 10,000m² of flexi space with occupation in 2021. The anticipation of this brief has been behind many development proposals being revived or progressed. Additionally the State Government may trigger new building construction as it deals with a number of major expiries for 2021 and 2022 across whole buildings or significant tranches, much of which is in secondary space.

Confidence in the CBD has benefitted from recent larger tenant activity — starting with Tatt's Group (18,000m²) and Origin (16,250m²) committing to 180 Ann Street for relocations from the Fringe into the CBD. Additionally Allianz plan to relocate from Toowong into c8,000m² of space in the CBD. QSuper (16,000m²) is also likely to announce a major commitment in the near future, consolidating from a number of separate locations. While the ATO brief for up to 24,000m² in 2019/2020 appears to be aimed more at Fringe or suburban locations. The CBD remains in the mix, however timing is a potential barrier for CBD developments, particularly new builds.

While larger tenants are making headlines for the CBD, the overall tenant demand has remained patchy. The smaller end of the market, sub-500m², has continued to be active and favouring spec fitouts, although there is now broad choice for this product. Mid-sized tenants of 1,000m²—5,000m² have remained relatively quiet in the market during 2017 to date. However co-working groups such as The Hub and Christie Corporate are actively seeking space in the CBD, which will lift activity in that size range.

Rental Levels

The improving confidence in prime market demand has triggered growth in prime gross effective rents. Prime gross face rents currently average $730/m², up by 3.1% over the year to July 2017. In the same period incentives have fallen from an average of 37% to 36.0%, resulting in gross effective rental growth of 4.7% over the year. This is a welcome return to effective rental growth after rents fell between 2013 and early 2016, before drifting for much of 2016.

Going forward prime rents are expected to maintain a steady appreciation over the next three years, despite the overall vacancy remaining high. Demand for prime space will continue to grow with upgrading and consolidation remaining drivers for tenants to relocate. While gross face rents are only expected to appreciate by an average of 2.2% p.a in the three years to July 2020, a slow but steady erosion of incentives will see gross effective rents average 4.3% p.a.

Secondary market rents have been slower to respond with growth drawn from the market by improved product through refurbishment rather than increased market demand. Secondary gross face rents increased by 0.9% in the year to July 2017 to sit at $560/m² with average incentives down to 39.0% from the peak of 40%. This equated to effective annual rental growth of 1.7%.

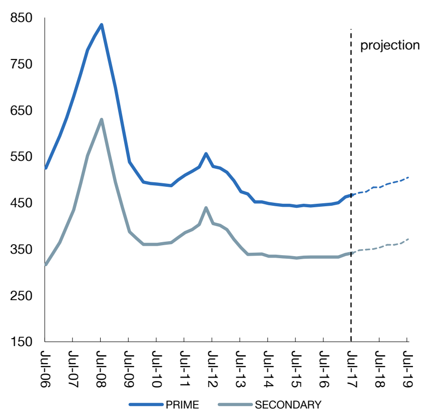
TABLE 3
Recent Leasing Activity Brisbane CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
180 Ann St	2,991	665 g	10	35-40	Stanwell	Jun 18
369 Ann St	2,227	510 g	7	25-30	Kaplan	Apr 18
180 Ann St	16,250	undis	17	undis	Origin	Mar 18
345 Queen St	1,600	710 g	10	35-40	Avant	Nov 17
259 Queen St	8,064	undis	10	undis	NAB	Oct 17
175 Eagle St	1,000	730 g	10	30-35	Victory Serviced Offices	Jul 17
240 Queen St	1,000	685 g	10	35-40	Conrad & Gargett	Jul 17
111 Eagle St	2,830	875 g	8	35-40	QLD Treasury Corp	Jun 17

`estimated incentive calculated on a straight line basis g gross

Source: Knight Frank Research

FIGURE 3
Brisbane CBD Rents
$/m² p.a average gross effective rent

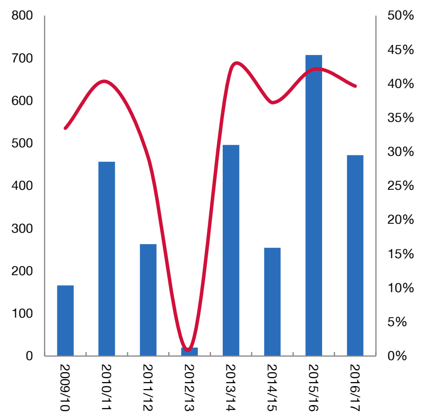


Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Investor interest has continued to build in the Brisbane CBD market due to the Sydney and Melbourne CBDs recording ever-lower yields and a climate of fewer opportunities. Additionally the certainty that the leasing market has bottomed in the Brisbane CBD is providing impetus to the investment market with the view now that there is a time limit to purchase Brisbane assets to fully benefit from the expected recovery in tenant demand. Additionally the demand from large tenants for new space is providing the opportunity to secure core investments with limited national supply of these assets.

FIGURE 4
CBD Office Investment ($10m+)
$ million Brisbane & % turnover offshore buyers



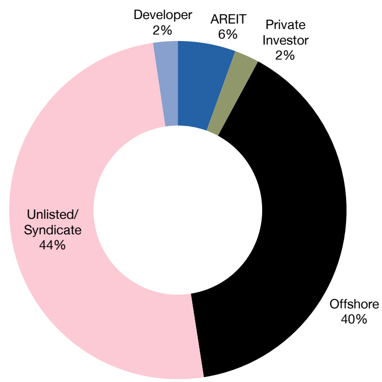
Source: Knight Frank Research

Despite this steady and growing interest, particularly from offshore buyers, the level of transactions was steady in the Brisbane CBD during 2016-17 with 12 sales, or part sales, totalling $1.191 billion recorded during 2016-17. There was appreciably more market activity during H1 2017 than was seen in H2 2016. Nevertheless the financial year total was lower than the $1.68 billion recorded in the year before and a reflection of the relatively limited opportunities which have been made available to the market.

Despite the limited opportunities, offshore investors increased their exposure to the Brisbane market acquiring $472.1 million during 2016-17, accounting for 39.6% of purchasing activity by value. As shown in Figure 4, the penetration of offshore investors into Brisbane CBD transactions has been quite steady between 37% and 42% over the past four years as investors became more comfortable with Brisbane market dynamics.

The largest recent transaction was the transfer of a 50% interest in 400 George Street for an estimated $210 million as part of 151 Property's acquisition of the MAC portfolio. Due to the geographically diversified and mixed property types within the portfolio, the allocated price potentially represents the portfolio nature of this transaction.

FIGURE 5
Brisbane CBD Purchaser Profile
2016/17



Source: Knight Frank Research

Other significant transactions of recent months have included Propertylink/ Goldman Sachs purchasing 50 Ann St for $144.6 million and Deutche Asset Management acquiring 120 Edward St for $141.28 million off-market.

Unlisted Funds and Syndicates have remained strong buyers in the Brisbane market, accounting for 44% over the past financial year. This was anchored by GWOF's increased ownership in 111 Eagle St ($282.4 million), there was also a number of private syndicates or investment groups such as Capital Property Funds, Axis Capital, and Ashe Morgan active in the market.

TABLE 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
366-380 Queen St	Site	53.75	n/a	2,147~	25,035~	n/a	Three adjoining owners	Charter Hall POF & Investa ICPF	Jun 17
400 George St (50%)	A	210.00*	c6.50	43,493	9,657	3.5	Motor Accident Commission SA	151 Property Group (Blackstone)	Jun 17
120 Edward St	B	141.28	5.46	15,271	9,251	3.5	Private Investors	Deutsche Asset Mgt	May 17
545 Queen St	B	70.50	6.70*	13,581	5,191	n/a	GPT Wholesale Fund	Axis Capital Pty Ltd	May 17
147 Charlotte St & 146 Mary St	B	65.00	n/a#	26,651	2,439	0.6	Cromwell Property Group	Ashe Morgan Group	May 17
50 Ann St	B	144.60	8.20	25,519	5,667	3.6	CIMB	Propertylink/Goldman Sachs	May 17

Source: Knight Frank Research ~site and $/m² of site the three buildings on the site have an NLA of approx 9,400m² *allocated price as part of a major portfolio sale # Fully leased to State Govt with expiry December 2017 ^Building has a high carparking component of 321 bays which impacts the $/m² NLA and WALE quoted is by income

Prime and secondary yields have both continued to firm and indications remain for a firming bias through to the end of 2017. The Brisbane CBD prime yields have fallen to a median range of 5.80% - 6.95% as demand continues to grow and the breadth and depth of potential purchasers expands. The average prime yield of 6.38% represents a fall of 17 basis points over the past year and 162 basis points through this firming cycle. Despite the increased investment interest, particularly for prime core assets, few transactions have occurred at this end of the market, with 400 George Street the only prime asset to transact in recent months and with the portfolio sale potentially skewing the core market yield, which was estimated at 6.50%.

Secondary yields currently range between 7.35% - 9.20%, reflecting an average of 8.28%, a 27 basis point decrease over the past year and 91 bps since the prior peak. After widening over the past two years, the secondary yield range has begun to narrow as greater investor interest and appetite for risk/ refurbishment opportunities has begun to impact on the upper yield range, drawing it down in line with the lower yield range.

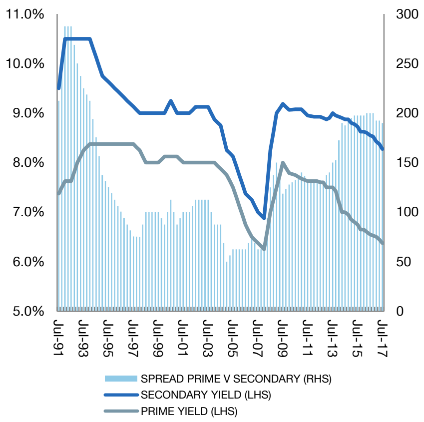
Along with green shoots appearing in the Brisbane leasing market, investment demand is being reinforced by the continued high spread between the Brisbane yields and Sydney/Melbourne. While both Sydney and Melbourne CBDs are far further through the leasing demand cycle, with signs of improvement in the Brisbane market, investment interest has further increased. As shown in Figure 7, the current spread between prime yields in the Brisbane and Sydney CBDs is 132 basis points, in line with the cyclical high of 132 basis points at the start of 2016 and above the long term average of 101 bps.

With eight major sales in the first half of 2017 transaction activity quickly picked up when assets became available to the market. Activity in the second half of the year may be constrained by the lack of stock with only the recently marketed assets at 160 Ann Street (unconditional) and 150 Charlotte Street (conditional) understood to be subject to contract at this time.

FIGURE 6

Brisbane CBD Core Market Yields

% Yield LHS & Basis Point Spread RHS

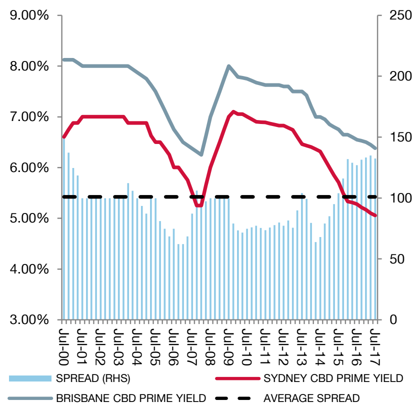


Source: Knight Frank Research

FIGURE 7

Brisbane CBD & Sydney CBD Yields

% Yield LHS & Basis Point Spread RHS



Source: Knight Frank Research

Outlook

- Tenant activity is expected to remain at improved levels during the remainder of 2017 with the quantum of deals mostly coming from tenants sub-500m². At the same time the formalisation of a number of major tenant requirements such as Suncorp and ATO, along with the expectation that the State Government will continue to upgrade, is bringing more confidence into the market.
- The use of speculative fitouts, particularly at the smaller end of the market is likely to continue, although tenants are starting to have more choice in this sector. Nevertheless secondary landlords must keep upgrading their buildings to attract tenant interest.
- Effective rents, through a mixture of face rental growth and slight incentive falls are now confirmed to have turned the corner with 4.7% growth for prime and 2.6% for secondary over the past year. This trend will continue with prime effective growth of 5.0% - 6.0% p.a forecast over the next three years.
- The vacancy rate and net absorption will continue to understate market activity to the end of 2017 as the major State Government relocations take time to filter into the figures. Vacancy will retract to the low-mid 13% range during 2018 before increasing due to additional supply in 2019. Despite the vacancy remaining in double figures a mini-supply cycle is expected to be triggered to satisfy major tenant requirements.
- Yields remain under downward pressure with interest in the Brisbane market continuing to build with both the yield gap to Sydney and Melbourne and positive signs in the leasing market underpinning this investment interest.
- The potential for a new long-WALE prime building to be delivered in the medium term is creating high interest, with potential investors seeking to gain control of the investment opportunity from the development phase.

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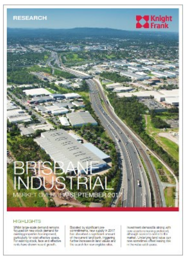

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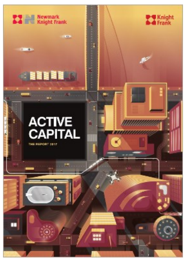

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