RESEARCH

Knight Frank

BRISBANE CBD

OFFICE MARKET OVERVIEW MAY 2017

HIGHLIGHTS

With only 18,400m² of refurbished stock to come on line in 2017 and no major new supply expected prior to late 2018, the growing tenant demand and relocation activity will reduce vacancy.

Largely due to face rental growth the average prime effective rent has increased by 4.1% in the year to April 2017, the highest growth in five years. Secondary rents continue to lag with 1.7% effective rent growth.

Investor interest in the Brisbane CBD continues to build with associated downward pressure on both prime and secondary yields. Positive signs in the leasing market will translate to more secondary building sales.

KEY FINDINGS

Total vacancy was 15.3% as at January 2017, **down from the cyclical high** of 16.9% in mid-2016 with further **steady improvement** expected.

Prime and secondary effective rents grew by **4.1% p.a and 1.7% p.a** respectively as the rental cyclical low point is in the past.

Greater **leasing activity** has emerged, with upgrading and cross border activity dominant.

Yields remain under **downward pressure** as offshore investor interest continues to build. Greater activity in the secondary market is expected for 2017.

JENNELLE WILSON
Senior Director — Research QLD

SUPPLY & DEVELOPMENT

With no new stock additions expected during 2017, and for at least the majority of 2018, the market has the opportunity to re-balance. With increased tenant activity already in evidence this will further spur investment.

There was a brief, but strong, supply cycle for the Brisbane CBD in 2016, adding 190,987m² of new stock. However the coming two years will feature far lower supply. The majority of this supply was added to the premium market which grew by 64% over 2016 from 1 William St (75,853m²) and 480 Queen St (54,985m²). These were the first premium additions since the completion of 111 Eagle St in 2012 and brings the premium building stock to 335,470m², still a relatively small 15% of the market.

The other major completion, in early 2016, was the A grade 180 Ann St (57,465m²). Of the three buildings completed last year, very little space remains available. 1 William St is fully committed by the State Government, 480 Queen St has 8,800m² of sub-lease space largely within the low-rise podium, and 180 Ann St is now 83% committed. The recent commitment by Origin to eight floors (c16,250m²) on a 17 year term at 180 Ann St means only a few low rise floors remain available, with most of these under offer.

In the short term, the return of the refurbished 310 Ann St (18,450m²) will be the only significant addition to the CBD market in 2017. In terms of new construction the hiatus is expected to last unit late 2018/early 2019 when the Shayher Group's 300 George St is expected to be completed. Considered the most likely of the current proposals to proceed in the short term, the office tower of up to 47,000m² is already constructed to podium level as part of the three tower mixed use development, with the hotel and residential towers under construction.

Following Origin's 16,250m² commitment to 180 Ann St and Telstra re-committing for 10 years to 19,000m²+ at 275 George St, the number of tenants with the potential to trigger new construction remains limited. Suncorp is expected to soon come to the market with a brief for 20,000—40,000m² from late 2020. Additionally the State Government remains a target for developers with a number of tenancies remaining in older buildings. Apart from 300 George St, other proposed supply includes Dexus's Blue Tower Annex (6,300m²), ISPT's 150 Elizabeth St (c35,000m²) and Mirvac's 80 Ann St (c55,000m²) where they currently hold an option to purchase the site. For longer term supply, interest is intensifying in amalgamating a site in Queen Street.

Withdrawal of obsolete stock during 2016 somewhat offset the high supply levels, with 64,332m² permanently withdrawn for change of use, the bulk of which formed the Queens Wharf site (57,676m²). In 2017 withdrawals will still be dominated by former State Government occupied assets such as 80 Ann St (14,429m² permanent withdrawal) and the Health & Forestry Buildings (26,651m² withdrawn for refurbishment). Formerly slated for conversion into student accommodation the Health & Forestry buildings will now undergo major refurbishment and remain as office space.

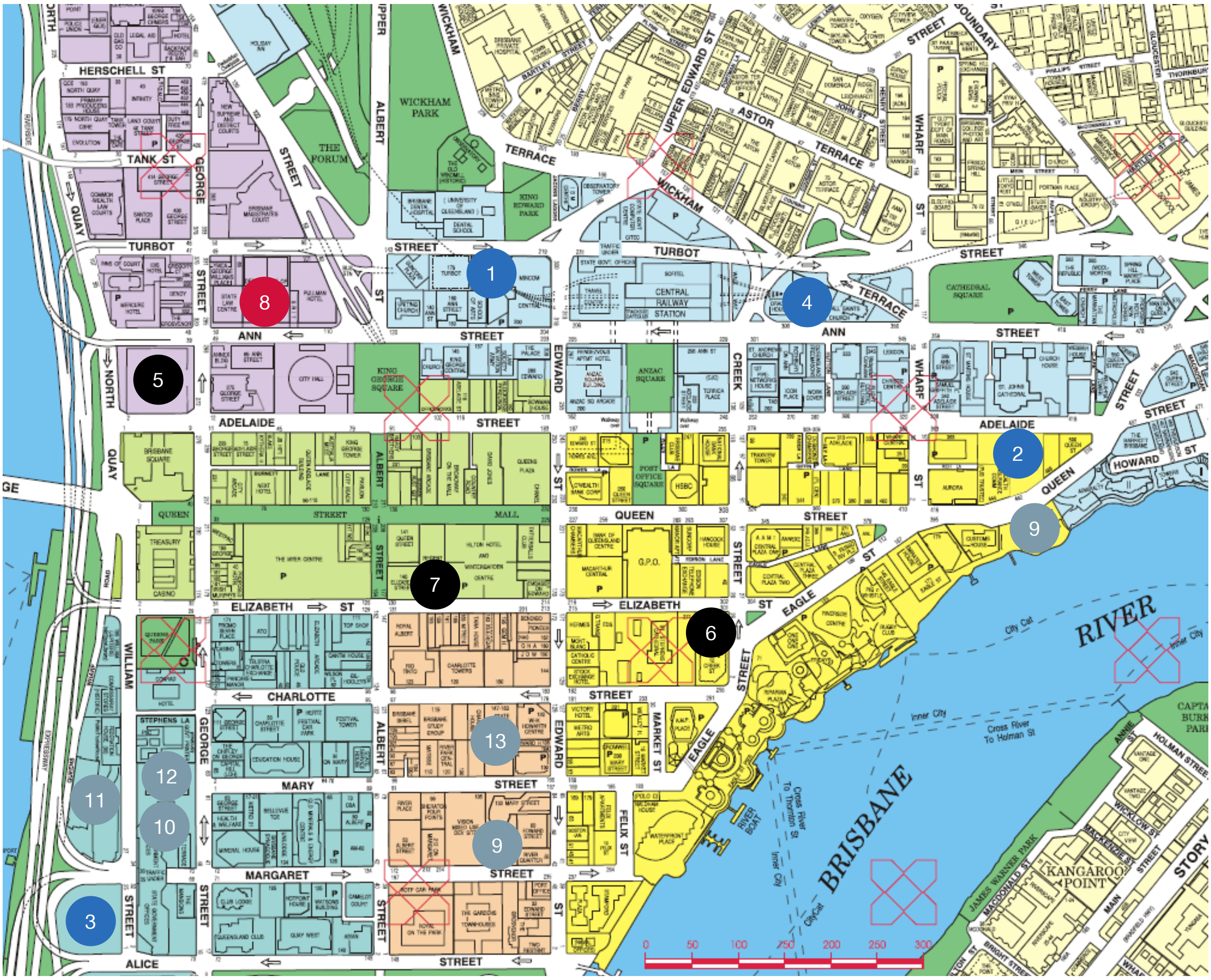
TABLE 1

Brisbane CBD Office Market Indicators as at April 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	12.0	152,505	185,427	729	36.5	5.90—7.00
Secondary	1,026,255	19.4	-57,904	-62,712	560	39.5	7.45—9.30
Total	**2,280,055**	**15.3**	**94,601**	**122,715**			

Source: Knight Frank Research/PCA ^ as at January 2017 *WALE 4-6 years

MAJOR OFFICE SUPPLY



1	180 Ann St—57,465m² [CBA/Tatts Gp] Daisho — Q2 2016—83% 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—Q1 2017
5	300 George St—47,000m² Shayher Group—H2 2018
6	12 Creek St Annex—6,300m² DEXUS Property Group/DWPF—tba
7	150 Elizabeth St—c35,000m² ISPT—subject to pre-commitment
8	80 Ann St—c55,000m² Mirvac—Mooted (site under option)
9	443 Queen St—5,560m² Cbus— withdrawn H1 2016 Residential Development
10	100 George St & annex —22,906m² Queensland Government— H2 2016 Queens Wharf Integrated Resort Dev.
11	75 William St—18,600m² Queensland Government— H2 2016 Queens Wharf Integrated Resort Dev.
12	80 George St—16,150m² Queensland Government— H2 2016 Queens Wharf Integrated Resort Dev.
13	Health & Forestry House—26,651m² Cromwell Property—H2 2017 State Govt Lease expires late 2017

- Under Construction / Complete
- DA Approved / Confirmed / Site Works
- Mooted / Early Feasibility
- Former office buildings permanently withdrawn for change of use/ redevelopment 2016 & potential 2017

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

TENANT DEMAND & RENTS

Tenant demand has continued to improve across the Brisbane CBD in the early months of 2017 with the good levels of enquiry from smaller tenants beginning to broaden into the larger size brackets. Total vacancy for the CBD has reduced from 16.9% as at July 2016 to 15.3% in January 2017 with the highpoint for this cycle now in the past. Although Knight Frank believes there are some one-off/calculation factors which have increased the magnitude of the vacancy rate decline, there is a real sense that the leasing market has turned the corner.

TABLE 2

Brisbane CBD—Vacancy Rates

Precinct	Jan 16	Jan 17
Premium	9.6%	12.2%
A Grade	11.3%	11.9%
Prime	**11.0%**	**12.0%**
B Grade	19.4%	19.7%
C Grade	16.6%	19.6%
D Grade	17.8%	14.5%
Secondary	**18.7%**	**19.4%**
Totals	**14.9%**	**15.3%**

Source: Knight Frank Research/PCA

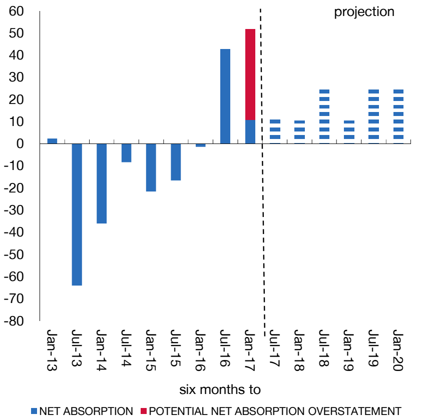
While the prime market vacancy is higher than a year ago at 12.0% (as at January 2017), it has reduced from the recent high-point of 15.7% in mid-2016. With the highpoint triggered by the new supply additions the speed at which it has reduced indicates how quickly the backfill space has largely been absorbed. With much of this backfill space offered as sub-lease, the space was largely absorbed by opportunistic tenants at discounted rents. Given the continued trend to upgrading within the market it is expected that the prime vacancy will continue to contract.

Secondary vacancy was 19.4% as at January 2017 as the total vacancy rate remains stubbornly high. While the total secondary vacant area has reduced from 203,960m² to 199,152m² over the past year the vacancy rate has remained high as a number of formerly fully occupied buildings (State Govt) have been withdrawn.

FIGURE 1

Brisbane CBD Net Absorption

('000m²) per 6 month period



Source: Knight Frank Research/PCA

Net Absorption

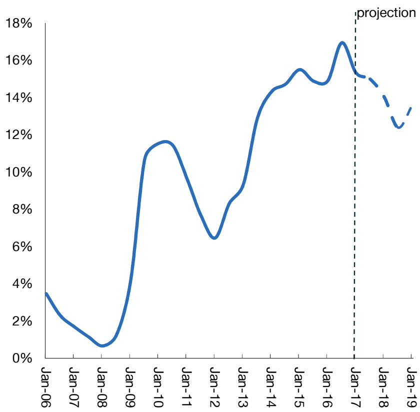
Following three years of negative net absorption, the Brisbane CBD has recovered over the past 12 months with a total of 94,601m² absorbed according to the PCA survey. This was dominated by the prime market with a total of 152,505m² absorbed, largely due to take-up in the newly completed buildings and solid take-up of associated prime backfill space. In contrast the secondary market saw negative net absorption of 57,904m² as obsolete space was vacated and in many cases also withdrawn from stock.

In the prime market good net absorption was recorded in both the premium (89,590m²) and A Grade (18,127m²) sectors. The particularly high premium net absorption was largely due to the completion of 1 William St (75,853m²) which was fully leased to the State Government (relocating from lower grade buildings) making the whole of the building NLA a net gain for premium grade. Additionally there was continued high absorption of backfill sub-lease space in premium buildings such as 123 Eagle St and 71 Eagle St. This resulted in the total premium vacancy reducing from 21.1% in mid-2016, to 12.2% as at January, with the premium sub-lease vacancy also falling from 14.1% to 4.4%.

FIGURE 2

Brisbane CBD Vacancy

% total vacancy



Source: Knight Frank Research/PCA

While there is definite positivity in the Brisbane CBD leasing market, Knight Frank believes the above figures represent an element of overstatement for the second half of 2017. In part this is due to the complexity of the State Government's upgrading of their office accommodation, spear-headed by the move to occupy the whole of the newly completed 1 William St. Beyond the buildings to be demolished for the Queens Wharf site, there are a further two buildings which are in the process of being vacated by the State Government. These are 80 Ann St (14,429m²) where the lease to the State expired in February 2017 and Health & Forestry House (26,651m²) 147-163 Charlotte St & 142-160 Mary St which has a lease in place to the State until December 2017. Counting these buildings as fully occupied, as well as 1 William St, overstates the net absorption by circa 40,000m².

Nevertheless the recent net absorption result for the CBD represents continued good rebounding for office demand, particularly given Flight Centre's relocation out of the CBD to the Fringe market. The underlying net absorption is expected to continue to grow through 2017 with inflows from the Fringe market building. However as the remaining state government buildings are vacated the numbers for 2017 are expected to understate underlying market activity.

Vacancy

The Brisbane CBD total vacancy rate decreased to 15.3% as at January 2017, from what will form the cyclical high of 16.9% in July 2016. This improvement has occurred due to an increase in base office demand and little backfill vacancy created from the new supply. As discussed above, the State Government relocated into the newly completed, fully leased building at 1 William St and at the time created no backfill vacancy, however some may emerge during 2017 if the buildings are not withdrawn from stock.

Limited supply in 2017, comprising the refurbished 310 Ann St, will assist to bring the vacancy rate down over the course of 2017 and 2018, reaching 12.4%, until significant anticipated supply slows improvement in late 2018.

Tenant Demand

The trend towards greater tenant activity has continued to build into early 2017. Additionally there is now noticeably greater tenant activity and mobility in 1,000m²+ tenants, a sector of the market which had been lacking in activity until recently. Upgrading remains a dominant theme in the market whether in terms of building grade (i.e. Qld Treasury—2,830m² relocating from A to premium) or from the Fringe markets into the CBD (Sonic Health Plus—1,247m² moving and consolidating from Spring Hill to 410 Ann St and Origin Energy-16,250m² consolidating from Milton to 180 Ann St). Further relocation of Fringe tenants into the CBD is expected over the course of 2017 with Allianz (c8,000m²) considering a CBD location.

The demand from smaller tenants sub-250m² has continued to form a large part of the number of deals underway in the CBD market, particularly within speculatively fitted out suites. The ease of choice for speculative suites as well as the generally shorter lead time has continued to encourage and foster mobility for these smaller tenants. Over the past six months the tenant demand has not been aligned with any particular industry with steady activity across the board with IT (Digital Sense), Personnel (Just Digital People, Attract People, Hays Recruitment) and Building/consultancy (Honeycombes, Conrad Gargett) and Travel (China Eastern Airlines, Air NZ) all active sectors.

Rental Levels

Brisbane prime gross effective rents have begun to show some improvement after reaching a low-point in January 2016 and remaining stable for much of 2016. Prime gross face rents currently average $729/m², up by 3.3% over the past year. In the same period incentives have fallen slightly from an average of 37% to 36.5%, resulting in gross effective rental growth of 4.1% over the 12 month period. This is the highest level of effective rental growth recorded since April 2012 when the resources boom was in force.

Largely boosted by a better than expected increase in gross face rents, this rate of rental growth is higher than was expected, given the considerable vacancy which remains. However sentiment has clearly turned with the lack of new supply, improving leasing activity and steady influx of tenants from the Fringe having an impact on confidence. Going forward gross effective rental growth is forecast at 3.7% for the coming 12 months. As incentives remain stubbornly high with only marginal falls, the continued improvement to face rents will be the greatest driver of rental growth. In the longer term effective rental growth expectations for the calendar years of 2018—2020 will range between 5.0% and 6.0% per annum. Nevertheless it will be mid-2019 before the effective rent returns to levels seen in late 2009 ($500+/m²), beyond the pre-GFC peak.

Secondary market rents have remained quite flat with average incentives down marginally to 39.5% from the peak of 40%. The gross face rent increased by 0.9% in the year to April 2017 to sit at $560/m², with effective rents growing by 1.7% to $339/m². In the next year face rental increases along with further minor incentive firming will see gross effective rental growth of 2.6% with the secondary market expected to lag prime market improvement in the near term.

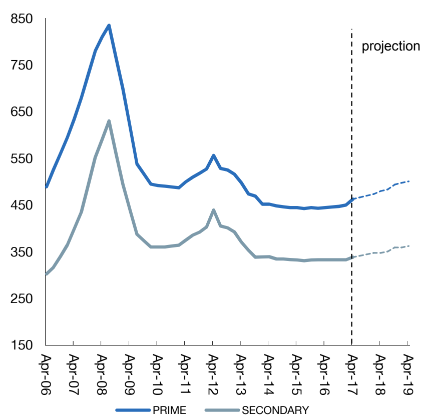
TABLE 3
Recent Leasing Activity Brisbane CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
180 Ann St	16,250	undis	17	undis	Origin	Mar 18
295 Queen St	8,064	undis	10	undis	NAB	Oct 17
260 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
340 Adelaide St	902	545 g	5	35-40	Covermore	Feb 17
120 Edward St	1,625	570 g	5	35-40	Arcadis	Feb 17
32 Edward St	1,574	570 g	5	<20%	Lifeflight Australia	Feb 17
410 Ann St	1,247	520 g	5	35-40	Sonic HealthPlus	Sep 16

`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



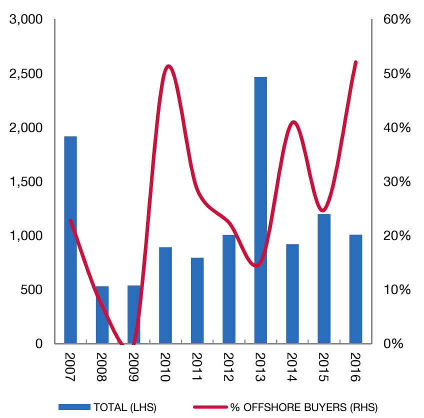
Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Investor interest has continued to build in the Brisbane CBD market as the Sydney and Melbourne CBDs are 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 there now seen to be a time limit to purchase Brisbane assets to fully benefit from the expected recovery in tenant demand.

Despite this steady and growing interest, particularly from offshore buyers, the level of transactions remained relatively low in the Brisbane CBD during 2016 with ten sales, or part sales, totalling $1.008 billion recorded during 2016. This was lower than the $1.20 billion recorded in the year before and a reflection of the relatively few opportunities which were available to the market during 2016.

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

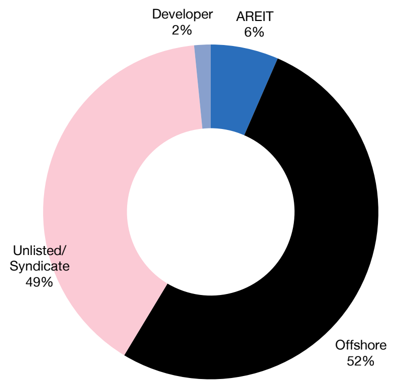


Source: Knight Frank Research

Despite the limited opportunities offshore investors increased their exposure to the Brisbane market acquiring $525.3 million during 2016, up from $297.1 million in 2015. As shown in Figure 4, the penetration of offshore investors into Brisbane CBD transactions was a record high level at 52%, just ahead of the 51% market share in 2010 when Keppel REIT Asia and PNB made key investments into the city.

The largest transaction in the Brisbane CBD during 2016 was an off-market transfer of a 33% share in 111 Eagle Street with the triggering of an option between co-owners for GWOF to take up the ADIA interest in the building for $282.4 million. The next largest was the $188.0 million sale of 300 Queen Street, purchased by offshore entity ARA Asset Management. Other significant offshore acquisitions during 2016 included AEP Investment Management's $159.8 million purchase of 41 George St, Investec Australia Property Fund's 50% acquisition of 324 Queen St for $66 million, and Wee Hur's acquisition of 80 Ann St for $62.5 million.

FIGURE 5
Brisbane CBD Purchaser Profile
2016



Source: Knight Frank Research

The first major sale of 2017, the $142.5 million transfer of 307 Queen St, was also to an offshore buyer with LaSalle Investment Management acquiring on behalf of a third party.

Unlisted Funds and Syndicates have also been strong buyers in the Brisbane market and apart from GWOF's increased ownership in 111 Eagle St, there was also APPF's acquisition of the remaining 50% of Transit Centre for $62.6 million and Primewest's purchase of 308 Queen St for $37.3 million. Already in 2017 the sector has been active with syndicator Capital Property Funds purchasing 126 Margaret St for $34 million and private

TABLE 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
545 Queen St	B	70.50	n/a*	13,422	5,253	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
40 Tank St	B	56.10	undis	6,218	9,022^	6.3^	151 Property Group	Ariadne/Kevin Seymour	Apr 17
126 Margaret St	B	34.00	7.16	5,583	6,090	3.8	Investec Property Opportunity Fund 2	Capital Property Funds	Feb 17
307 Queen St	A	142.15	6.81	19,446	7,310	3.2	GDI Property Group	LaSalle Investment Management	Jan 17
324 Queen St	A	132.00	7.16	19,874	6,642	3.2	Brookfield Property Partners & DWPF	Abacus Property Group & Investec Australia	Dec 16

Source: Knight Frank Research *sold 63% vacant without income support. # 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

syndicator Axis Capital placing 545 Queen St under an unconditional contract for $70.50 million.

During 2016 both prime and secondary yields continued to firm and indications remain of a firming bias into 2017. The Brisbane CBD prime yields have fallen to a median range of 5.90% - 7.00% as demand continues to grow and the breadth and depth of potential purchasers expands. The average prime yield of 6.45% represents a fall of 15 basis points over the past year and 155 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. The three prime assets which were transacted on-market during 2016 were older assets with relatively shorter WALEs.

Secondary yields currently range between 7.45% - 9.30%, reflecting an average of 8.38%, a 22 basis point decrease over the past year and 81 bps since the prior peak. After steadily 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.

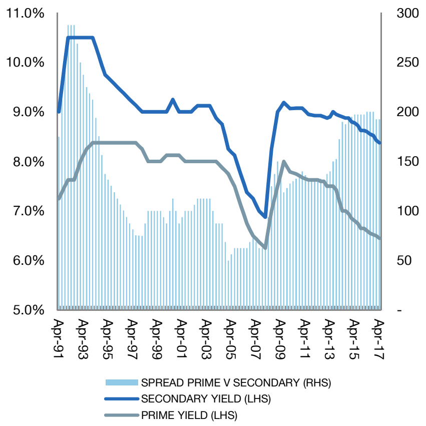
Along with green shoots appearing in the Brisbane leasing market, investment demand is being reinforced by the continued high spread between the Brisbane yields and Sydney/Melbourne. While both Sydney and Melbourne CBDs are far further through the leasing demand cycle, with signs of improvement in the 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 133 basis points, back in line with the cyclical high of 132 basis points at the start of 2016 and above the long term average of 100bps.

With six sales in the first months of 2017 and other assets such as the 50% interest in 400 George St and 120 Edward St in due diligence, the sales activity levels for the Brisbane CBD are looking promising.

FIGURE 6

Brisbane CBD Core Market Yields

% Yield LHS & Basis Point Spread RHS

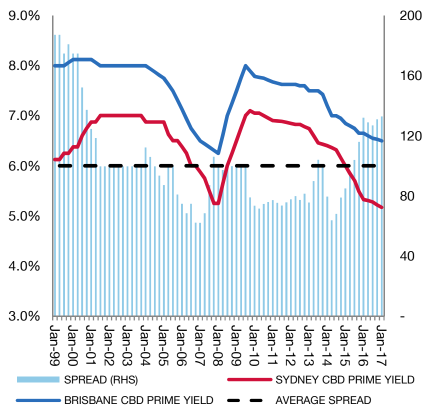


Source: Knight Frank Research

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 2017 with the number of deals underpinned by smaller tenants. At the same time there is greater intent from larger tenants to both test the market and relocate with inflows from Fringe and suburban locations to continue.
- The use of speculative fitouts, particularly at the smaller end of the market is likely to continue, although tenants are starting to face high choice in this sector. Nevertheless secondary landlords must keep working on their buildings to attract tenant interest. The use of spec fitouts has also allowed the face rents to be pushed for these smaller secondary suites, however the market average rents (based on a full floor basket) have shown less improvement.
- Effective rents, largely through face rental growth have consolidated the green shoots in evidence in late 2016 with 4.1% growth for prime and 1.7% for secondary over the past year. This trend will continue with prime effective growth of 5.0% - 6.0% in 2018-2020.
- The vacancy rate is expected to continue to decline, reaching 12.4% before responding to expected new supply in 2018, which will interrupt the steady improvement. Due to timing impacts of former State Government occupied buildings the official stats are expected to under-state the level of market activity during 2017.
- 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 changing fortunes in the leasing market is introducing a level of urgency for market players without exposure to Brisbane, with the expectation that transactions need to be entered into soon to fully gain exposure to improvements in the leasing market. While most purchasers, particularly offshore buyers, remain attracted to core assets the limited opportunities in the market is expected to divert a portion of this demand into value-add purchases.

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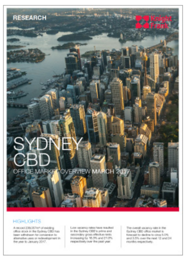

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