RESEARCH

SEPTEMBER 2013

BRISBANE CBD OFFICE

Market Overview

HIGHLIGHTS

- The Brisbane CBD market has been subject to muted tenant demand and contractionary influences over the past year. This has seen the vacancy rate increase to 12.8% as at July 2013, with the secondary market particularly impacted at 16.1%. The net absorption at negative 64,069m² was the greatest negative figure ever recorded over a six month period as a number of factors hit the market at the same time.
- Market rents have continued to soften as the vacant space has increased, with prime and secondary effective rents posting significant falls of 10.3% and 13.6% respectively over the year to July 2013. Further softening is expected to the end of 2013, with the vacancy rate expected to be relatively unchanged at 12.9%.
- In contrast the investment market has recorded a strong H1 2013, building on the gains made in late 2012 as AREITs and unlisted wholesale investors have continued to be active within the market. The total turnover, for assets $10 million+, over the 12 months to September 2013 has been $2.15 billion, which is on a par with the peak of the market in 2007/08. The yield firming, particularly at the prime end of the market in evidence at the start of 2013 has now moderated, with all but the most stable of income streams now judged more harshly.

Table 1
Brisbane CBD Office Market Indicators as at July 2013

Grade	Total Stock (m^2)	Vacancy Rate (%)	Annual Net Absorption (m^2)	Annual Net Additions (m^2)	Average Gross Face Rent ($/$m^2$)	Average Incentive (%)	Average Core Market Yield (%)
Prime	1,073,073	9.4	20,436	45,431	687	31.0	7.00 – 8.00
Secondary	1,119,586	16.1	-82,099	-2,569	515	32.0	8.25 – 9.75
Total	**2,192,659**	**12.8**	**-61,663**	**42,862**			

Source: Knight Frank/PCA

SUPPLY & DEVELOPMENT ACTIVITY

The first half of 2013 saw one new building added to supply, with the 18,517m² 55 Elizabeth Street reaching completion in June 2013. The building was fully leased to the ATO, with that tenant relocating from two separate CBD locations. There was also some minor return of refurbished space from buildings such as 313 Adelaide Street.

The completion of 55 Elizabeth Street represented the last delivery of significant new construction for the next two and a half years. Following relatively strong completion activity over the past two years, the hiatus in new construction completions comes at a welcome time for the market.

NO FURTHER MAJOR COMPLETIONS UNTIL LATE 2015

With growing vacancy levels, particularly amongst secondary stock, it is expected that refurbishment activity will increase in the coming year. At this stage there are staged refurbishment programmes underway within, 167 Eagle Street, 140 Creek Street, 200 Mary Street, 10 Eagle Street, 12 Creek Street and 280 Adelaide Street. Further refurbishment projects are expected to emerge as and when significant vacancies emerge within B and A grade buildings.

While the remainder of 2013 and 2014 are expected to be devoid of any new commercial building completions, 2015 and 2016 are expected to see far stronger construction completion activity. From the second half of 2015, through to the end of 2016, there is 187,889m² of space forecast to be delivered through three major projects.

The project known as 180 Brisbane, at 180 Ann Street is in the early stages of construction and is expected to be the first of the three projects completed. The project is being developed by the privately owned Daisho group and will provide 57,465m² of commercial space, with anticipated completion in late 2015.

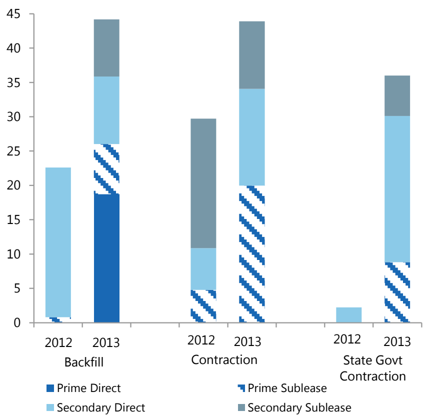
The Grocon development at 480 Queen Street, which has been onsold to DEXUS and DWPF has also commenced site works. The development is to provide 55,571m² of commercial space with an anticipated completion of H1 2016. The project is 39% pre-committed with major tenants BHP (15,000m²) and Herbert Smith Freehills (5,000m²).

At the other end of the CBD, site works are also progressing on the State Government building at 1 William Street. The building, to be developed by Cbus will contain 74,853m² of space. The State Government has committed to the whole tower, however has announced its intention to offer circa 15,000m² on the lower floors for sub-lease. This building is expected to be completed in late 2016.

Backfill & Contraction Space

As expected, backfill and contraction space has increased over the first half of 2013. Figure 1 shows space tracked by Knight Frank which is being marketed as either direct or sub-lease space which has come to the market as a result of backfill, private sector contraction or State Government contraction.

Figure 1
Brisbane CBD Backfill & Contraction
('000m²) marketed space 2012 and 2013



Source: Knight Frank

The figures from 2012 represent space which became available during 2012, but has not yet been absorbed. At this time approx. 74% (54,564m²) of the originally offered space remains available. Space has continued to come to the market during 2013 with 104,821m² available. This is either immediately vacant space, or for some sub-lease space, subject to relocation timings.

MAJOR OFFICE SUPPLY

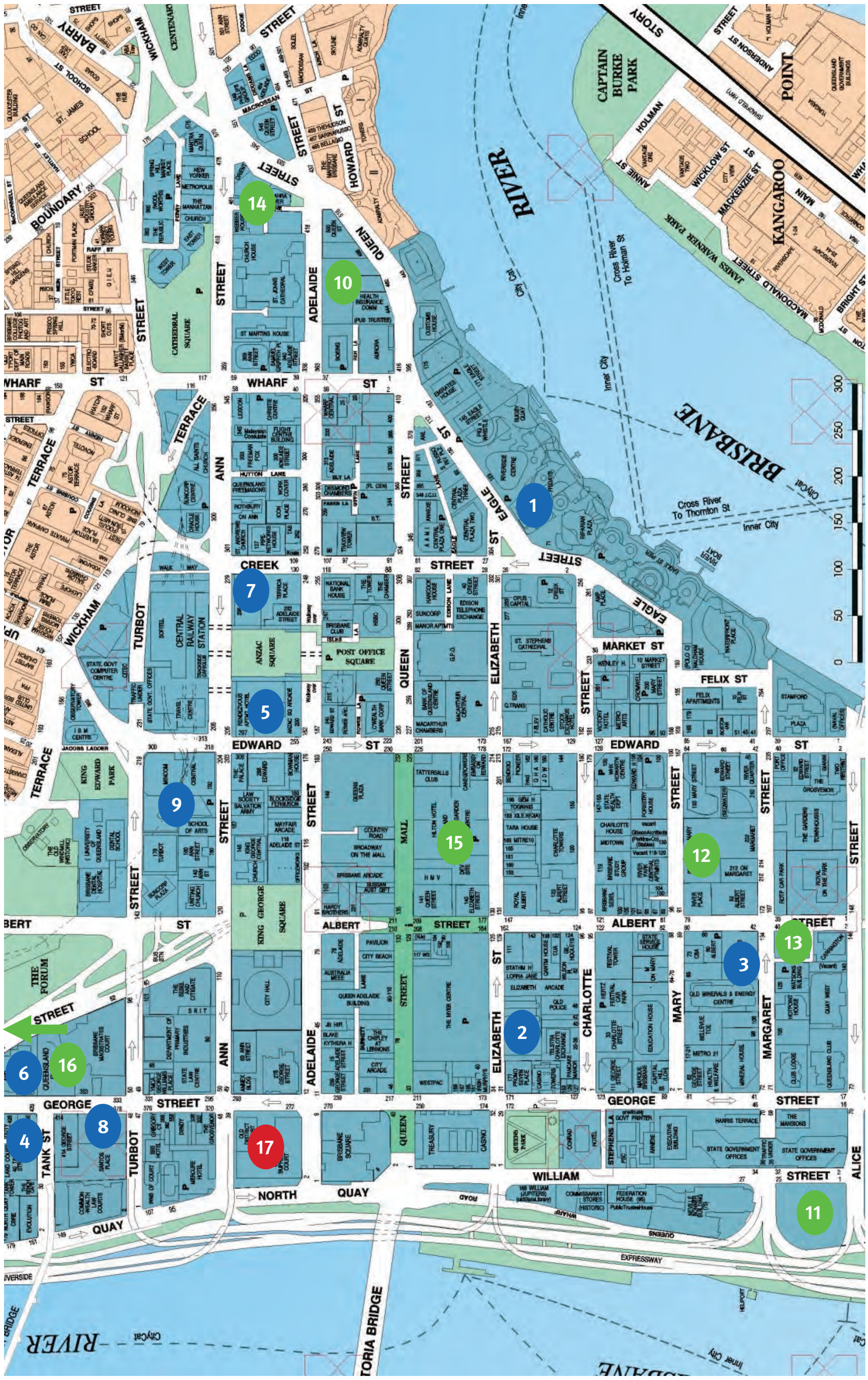
1. 111 Eagle St – 64,041m^2 [ANZ/E&Y/Arrow] GPT– June 2012 – 91% committed
2. 55 Elizabeth St -18,517m^2 [ATO] Grocon/Credit Suisse – Q2 2013 – 100% committed
3. #126 Margaret St – 5,718m^2. Investec Prop Opportunity Fund Q1 2013
4. #420 George St – 6,500m^2 Nielson Properties – Q2 2013
5. #200 Adelaide St – 6,081m^2 PFA Diversified & *State Govt* Q2 2013
6. ^Transit Centre – 8,350m^2 GPT/APPF *Urban Utilities* Q2 2013
7. ^295 Ann St – 7,370m^2. Investa Office Fund *Qld Rail* Q1 2013
8. ^400 George St – c5,000m^2 *State Govt – Q3 2013*
9. 180 Ann St – 57,465m^2 Daisho – Q4 2015
10. 480 Queen St – 55,751m^2 - [BHP/Freehills] Grocon (DEXUS/DWPF) –Q2 2016 – 39% committed.
11. 1 William St, 74,853m^2 [State Govt] Cbus Property(50% interest for sale) – Q4 2016 – 80% committed
12. 111 Mary St– 35,000m^2 Billbergia/ AMP Capital – 2015+
13. 30 Albert St – 24,838m^2 Devine Ltd (for sale) – tba
14. 550 Queen St – 18,539m^2 GFA Consolidated Properties – tba
15. The Regent Development – 50,000m^2 ISPT – 2015+
16. Transit Centre Stage II – 70,000m^2 GPT/APPF – tba
17. Law Courts Site – 45,000m^2 Shayer Group - tba

Under Construction / Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

As at September 2013, excluding strata buildings.
Major Refurbishment / entire building available
^ Sub-lease space >5,000m^2 contiguous.
Sub-Lessor indicated in *italics*
Major pre-commits in [brackets] next to NLA
Avail Office NLA Quoted
Source of Map: Knight Frank



TENANT DEMAND & RENTS

Continued soft tenant demand, in combination with tenant contraction and backfill, have combined to see the market take significant backward steps over the first half of 2013. The vacancy rate has increased to 12.8% as the market recorded the worst net absorption on record.

Table 2
Brisbane CBD – Vacancy Rates
Vacancy by building grade

Precinct	Jul 2012	Jul 2013
Premium	11.9%	12.0%
A Grade	6.3%	8.8%
Prime	**7.4%**	**9.4%**
B Grade	8.7%	17.0%
C Grade	7.9%	12.2%
D Grade	16.3%	17.6%
Secondary	**8.6%**	**16.1%**
Total	**8.2%**	**12.8%**

Source: PCA

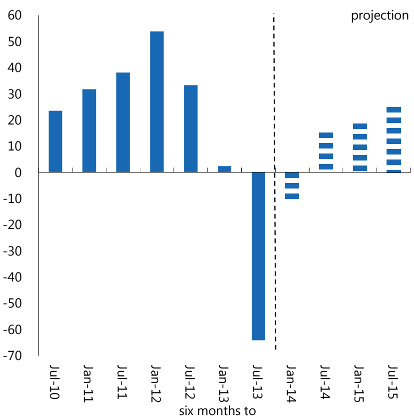
The total vacancy rate has increased from 8.2% a year ago to currently sit at 12.8%. Even though the prime market has not been immune to these influences, increasing from 7.4% to 9.4% in 12 months, the main impact has been felt within the secondary market. The secondary market vacancy rate has increased from 8.6% to 16.1% over the past year as much of the state government space relinquished has been within secondary stock.

Net Absorption

The Brisbane CBD market recorded negative net absorption of -64,069m² during the first half of 2013. This represented the highest negative figure recorded by the PCA since the series began in 1990. Unlike many other major centres, the Brisbane CBD didn't record major negative net absorption in the immediate aftermath of the GFC. Instead it has taken a combination of factors to create this, one off, major negative result. The major contributors to this strongly negative result are backfill spaces from tenants relocating to new accommodation either in the CBD or Fringe markets, the State Government contraction of occupied office space and the cost cutting and contraction coming from the private sector. Initially this contraction was concentrated in the resource, energy and engineering sectors, however the finance industry has also recently added a number of sub-lease spaces to the market.

Despite the worst impact of these factors being in the past, the net absorption is not expected to recover in the short term, with a negative result expected for the second half of 2013. However this is not expected to be anywhere near as severe as in the first half of the year, with -11,170m² forecast. The exact figure will be determined by the proportion of space, currently being marketed for sub-lease but still occupied, which may become physically vacated prior to year's end. This space has the potential to alter the official vacancy rate by almost 1 percentage point if all of it was to be included in the figures.

Figure 2
Brisbane CBD Net Absorption
('000m²) per 6 month period

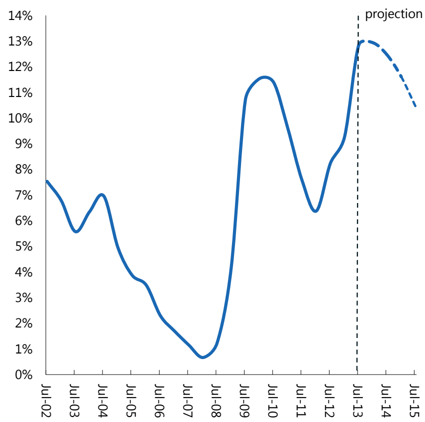


Source: PCA/Knight Frank

Net absorption is expected to return to positive levels in the first half of 2014, with the steady improvement in international economic factors expected to have a flow through in confidence to the Australian market which has been crippled by indecision, exacerbated by the lengthy Federal election campaign. Stronger underlying demand during 2014 and 2015 will be mitigated by tenant relocations from the CBD to new Fringe accommodation such as Ventyx (6,000m² 2014), Bank of Queensland (8,000m² in 2015) and Flight Centre (12,000m² in 2016).

Anticipated Vacancy Levels

Figure 3
Brisbane CBD Vacancy
% total vacancy



Source: PCA/Knight Frank

The vacancy rate is expected to remain relatively unchanged to the end of the year, increasing to 12.9%, with positive impacts such as the withdrawal of stock largely balanced by space currently available on a sub-lease basis converting to vacant space.

Thereafter, even though the net absorption is expected to take 12-18 months to recover to trend levels, the absence of any new supply to the market will assist to bring the vacancy rate down during 2014 and 2015. At this stage, however, the vacancy rate is not forecast to fall below 10% before the next wave of supply additions in late 2015/2016. The reduction in the vacancy rate may be accelerated by additional withdrawals of stock for a change of use. The first of these is 80 Albert Street, with the 9,469m² building to be withdrawn in Q3 2013 before undergoing works for a hotel conversion. The State Government has announced the intention to demolish the Executive Centre and State Works Centre in George Street to facilitate mixed use redevelopment of this precinct. At this stage Knight Frank have assumed this is undertaken in late 2016.

Tenant Demand

Tenant demand has been soft over the past 12 months, with contraction a greater immediate influence on the market than tenant demand. The major corporate influences at this time are conservatism and cost control, with relocation to new premises falling beyond the appetite for risk for many entities at this time. It is hoped that with the Federal election in the past, and continued positive global economic news, that this sentiment may begin to unwind over the coming months, with the impact to be felt within the market from early 2014. Anecdotal evidence indicates that there is already some improved enquiry emerging from smaller (sub-500m²) tenants.

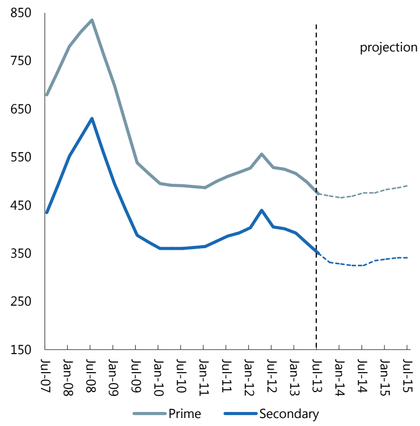
Despite the generally lacklustre leasing environment, larger tenants have continued to make decisions for their longer term accommodation needs following on from BHP's commitment to c15,000m² in 480 Queen Street earlier in the year. After a lengthy search, Boeing has elected to remain within the CBD, leasing 7,549m² within 150 Charlotte Street. Peabody Coal and Flight Centre have also selected their future accommodation, although neither chose to remain in the CBD. Demonstrating the mercurial nature of the leasing market is Newcrest Mining which earlier in the year had an active brief for 5,000 – 7,000m² for 2015, but has recently closed its Brisbane operations after posting a significant loss in FY2012/13. There are also a number of professional firms with lease expiries in 2015 which have now come to the market. This is considered a good leading indicator that the rental market is close to the bottom.

Rental Levels

Rental rates have fallen over the past year as the increased level of vacancy and marketed space has made its impact. Marketed space refers to sub-lease space which is being actively marketed but can still be occupied by the entity seeking to downsize. Frequently these sub-lease rents are at significant discounts and can undermine the market rental landscape as a whole.

Prime accommodation has seen gross face rents remain relatively stable, falling by 1.2% over the past year to be $687/m² as at July 2013. In contrast, the effective rents have declined significantly, down by 10.3% over the same period as incentives have increased across the board. Average prime incentives have increased from 24.5% as at July 2012 to be 31%, with the market consistently recently recording deals at or above 30%. With the market expected to remain tough for the rest of 2013 and into early 2014 the prime market effective rents are expected to soften a further 1-2% before improvement begins to be seen from mid-late 2014.

Figure 4
Brisbane CBD Rents
$/m² p.a average gross effective rent



Source: Knight Frank

Average gross secondary face rents are currently $515/m², as unlike the prime market, face rental discounting has been in evidence. Face secondary rents have fallen by 7.2% over the past 12 months, and when combined with average incentives increasing from 27% to 32%, has resulted in effective rents falling by 13.6%.

Further softening of both prime and effective secondary rents are expected, as secondary accommodation will continue to face high competition for tenants. In particular it is anticipated that there will be increasing refurbishment activity, however this is likely to improve a buildings' ability to attract tenants, but may not result in an increased rental result. Overall secondary effective rents are forecast to fall by a further 7.2% to mid-2014, before stabilising, with little significant improvement until later in that year.

Table 3
Recent Leasing Activity Brisbane CBD

Address	Grade	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Incentive (%)`	Lease Type	Tenant	Start Date
150 Charlotte St	A	7,459	595 g	10	25-30	Existing	Boeing	Jul 14
145 Ann St	A	1,102	695 g	10	25-30	New	Aust Govt Solicitor	Feb 14
192 Ann St	A	2,834	510 g eff	3	Nil	Existing	Aurizon	Aug 13
260 Queen St	B	7,125	undis	3	Nil	Sitting Tenant	Westpac	Jul 13
60 Albert St	A	3,500	undis	1.5	undis	Sub-lease	Prime Minister's Office	Jul 13
307 Queen St	B	796	585 g	5	25-30	Existing	QSNTS	Jul 13
288 Edward St	B	688	470 g	5	30+	Existing	Oaks	Oct 13

Source: Knight Frank g gross `estimated incentive calculated on a straight line basis

INVESTMENT ACTIVITY & YIELDS

A number of headline transactions and larger portfolio sales have resulted in a high level of transactional activity within the Brisbane CBD market, particularly in the first half of 2013. Over the twelve months to September 2013 there have been 22 sales in excess of $10 million with a total transaction volume of $2.15 billion. This level of transaction activity is on a par with the peak of the market in 2007, where the financial year 2007/08 recorded $2.27 billion in transaction activity.

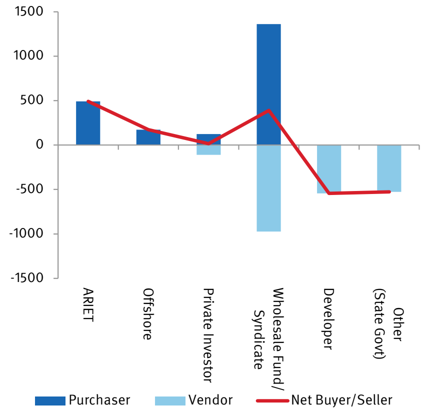
The largest single transaction over the past six months has been the pre-purchase of 480 Queen Street. In this transaction DEXUS and DWPF have agreed to purchase the development from Grocon at an estimated price, subject to final parameters on construction completion, of $543.9 million. This reflects a core market yield of 7.25% on the tower which has 39% pre-commitment and a 2 year rental guarantee from Grocon over any vacant space on completion.

The State Government divestment of seven largely owner occupied commercial assets was undertaken in two tranches. The first, purchased equally by QIC Infrastructure Management No.2 and QIC Private Capital, covered 111 George Street, 33 Charlotte Street, 81 George Street, 54 Mary Street and 61 Mary Street for a total of $414.5 million. The remaining two properties, 80 Ann Street ($37 million) and 41 George Street ($75.5 million) were purchased 50% by QIC Infrastructure Management No.2 and 50% by QIC Investments No. 3.

The other recent significant sales have included the finalisation of the sale of Grosvenor's 50% interest in 400 George St. This asset was purchased by the South Australian Motor Accident Commission for $195.8 million which reflected a core market yield of 6.99% with a WALE of 7 years. Grosvenor continued its divestment programme with another major sale of 2013, with Investa Commercial Property Fund buying 259 Queen Street from the group for $173 million. The 24,789m² A grade building is well located in the heart of the CBD, but faces some challenges with two large tenants Peabody Coal and Bank of Queensland both intending to relocate in 2014 and 2015 covering some 50% of the building.

Reflecting the benefits of repaired balanced sheets, AREITS were the greatest net purchaser class across the Brisbane CBD over the past 12 months. This was dominated by DEXUS Property Group's purchase of 50% interests in 12 Creek St and 480 Queen Street. Other active participants were Abacus Property Group and Cromwell.

Figure 5
Brisbane CBD Purchaser/Vendor
$ million sales over $10million yr to Sept 2013



Source: Knight Frank

Table 4
Recent Sales Activity Brisbane CBD

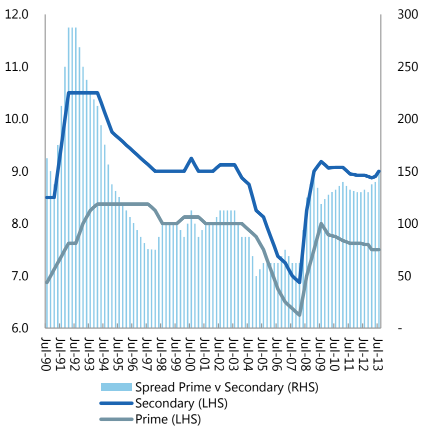
Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
127 Creek St & 40 Tank St*	B/C	101.5	n/a	24,788	4,095	n/a	GE Real Estate	Blackstone	Aug 13
80 Albert St	B	37.2	11.48^	9,469	3,928	n/a	Private Property Syndicate (Colonial)	Frasers Hospitality	Jul 13
259 Queen St	A	173.0	7.54	24,789	6,979	3.4	Grosvenor Aust	Investa Commercial Property Fund	Jun 13
147 Charlotte St & 160 Mary St	B	65.0	20.77^	26,651	2,439	3.2	Suncorp Securitisation	Cromwell Diversified Property Trust	May 13
116 Adelaide St	B	34.6	8.55	6,944	4,983	5.5	Private Investor	HCK Assets	Apr 13
State Govt Portfolio	Var.	527.0	n/a	148,601	3,781	Var.	State Govt	Various QIC Funds	Apr 13
33 Queen St	B	34.0	9.40^	6,082	5,590	1.6	Private Investor	Abacus Prop. Group	Mar 13
480 Queen St	P	543.9#	7.25	55,561	9,789		Grocon	DEXUS Property Group / DWPF	Mar 13
400 George St	A	195.8 (50%)	6.99	43,493	9,004	7.0	Grosvenor Aust	SA Motor Accident Commission	Mar 13

Source: Knight Frank ^ passing yield *Sale price reported allocation – 127 Creek St - $71million; 40 Tank St - $30.5 million
Pre-sale and fund through so final price to be determined at the end of the construction phase.

In the same vein as AREITs, the wholesale funds and syndicators have also been active in the market, with both strong purchasing and divestment activity. Overall the sector was a net buyer to the tune of $390 million, second only to the AREITs at $492 million. Developers (largely through Grocon's pre-sale of 480 Queen St) and Other (though the State Government divestment of assets) were both strong net sellers in the market.

The increasing focus on larger, prime assets by institutional buyers and emerging evidence of some competition between buyers for these assets, has meant that the private investors have been far less visible in the market over the past year. Nevertheless they have remained net buyers, accounting for $124.5 million in purchases. Similarly offshore buyers have remained a factor in the market, however with no major prime acquisition, they have not been the dominant force in the market, accounting for a number of smaller sales, including Frasers Hospitality's purchase of 80 Albert Street for conversion into a hotel.

Figure 6
Brisbane CBD Yields & Risk Spread
%yield (LHS) & spread prime v secondary bps (RHS)



Source: Knight Frank

Yields have stabilised, despite the increased competition and demand, particularly at the prime end of the market, as the deteriorating leasing market conditions has resulted in more conservative assumptions. This will impact secondary assets to a greater extent than prime, widening the yield spread (see Figure 6).

OUTLOOK

Tenant demand and rental conditions have softened considerably over the past year, as a number of separate influences have been active within the market. On the flip side the investment demand has increased steadily over the course of 2013, with local institutional investors seeking to expand their presence within the Brisbane market.

Following the strongly negative net absorption of -64.069m² in the first half of 2013, the outlook for the remainder of the year is for a further modest fall in net absorption. However it is expected that the worst of the contractionary influences are now in the past. Nevertheless with the vacancy rate now at 12.8%, and expected to remain relatively stable for the remainder of the year, the impacts on the rental landscape will be felt for the coming 18 months.

THE WORST OF THE NEGATIVE INFLUENCES ARE IN THE PAST; BUT IMPACTS WILL CONTINUE TO BE FELT

Given the generally slow but stable improvements being seen within the US and China economies, the underlying global conditions are expected to return to a more supportive environment in the near term. With a degree of correlation observed between the Brisbane office market demand and resource sector profitability, improvements in this sector will be closely watched. Sustained price improvements to coal, in particular, is expected to translate relatively quickly to improved profitability with most major resource corporates well advanced with cost cutting programmes.

With no new supply additions until 2015, the Brisbane CBD market has been afforded a welcome respite which will assist recovery of the vacancy rate during 2014 and into 2015. In addition, following the lead of 80 Albert Street there may be further withdrawals of office accommodation for redevelopment or a change of use. The State Government has already flagged the removal of some 35,108m² of stock via the proposed demolition of the Executive Building and State Works centre although the timing is not confirmed. Cromwell may also consider alternative uses to Health House and Forestry House when they fall vacant at the end of State Government leases in 2015 and 2017 respectively.

In contrast to the conditions within the leasing market, sales activity within the CBD has been at strong levels. The demand from institutional investors for prime stock, in tandem with a major state government portfolio divestment, has seen total turnover over the past year in line with levels seen at the height of the market in 2007/08. Despite continued interest from off-shore investors, it has largely been the local AREITS and Wholesale Funds which have been the dominant purchasers during 2013.

Increasingly, investors are responding to the leasing market conditions and are placing ever-greater weight on properties with longer WALEs to de-risk the income stream. However A grade stock with these characteristics is relatively rare and the appetite to place funds may overcome such negatives. Marketed assets such as 60 Albert Street, 179 Turbot Street and a 50% interest in 1 William Street are understood to be well advanced in the sale process.

The yield tightening which was seen at the top end of the market in the first half of 2013 has now largely been tempered by caution, with prime yields stabilising at a median of 7.5%. The secondary market is expected to trade across a wide yield band averaging 8.9%, with yields responding to individual asset uncertainties.

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