BRISBANE CBD OFFICE MARKET

The Brisbane CBD office market has emerged as an increasingly important office market over the last decade. However a combination of government austerity measures, relocation of CBD tenants to the fringe and suburbs, the slowing of the resources sector and a robust office supply pipeline have weakened market fundamentals.

The vacancy rate in the Brisbane CBD reached its highest recorded level in January and is forecast to continue to increase alongside weak tenant demand until peaking in late 2015/early 2016.

Consistent with the high vacancy rate, incentives have steadily increased across all grades of stock and will remain high into the foreseeable future. This has, in instances where the owner has the capacity to do so, resulted in some landlords electing to carry a vacancy until a favourable lease is secured, rather than burdening the asset’s value with a large incentive.

High office vacancy levels have also started to have a material impact on demand for car parking in the CBD. Anecdotal evidence suggests that alongside the recent increase in supply of parking spaces per employee (as a result of the decline in the CBD office workforce) long-term car parking rates have softened.

We expect this softening in car parking rates to continue into the short to medium-term as further companies relocate out of the CBD and the vacancy rate remains high.

Also, although we are not aware of any substantial effects as of yet, a sustained high vacancy rate in the CBD is likely to impact retail businesses which are reliant on the presence of office workers. This is a trend we will continue to monitor moving forward.

On the upside, despite poor leasing conditions, investment demand has been extremely strong. Strong investment demand has been primarily due to record-low interest rates and the more favourable value of the Australian Dollar for foreign investors. We do expect, however, investment demand to diminish over the coming 12 months, alongside the continual deterioration in the leasing market.

KEY INDICATORS

<table>
<thead>
<tr>
<th>Grade</th>
<th>Total Stock</th>
<th>Vacancy Rate</th>
<th>Average Gross Face Rent</th>
<th>Average Incentive</th>
<th>Average Equivalent Yield</th>
<th>2013 Sales Volume*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>204,056 m²</td>
<td>12.8%</td>
<td>$825/m²</td>
<td>26%</td>
<td>6.75%</td>
<td>Prime - $1,901,796,340</td>
</tr>
<tr>
<td>A-grade</td>
<td>869,017 m²</td>
<td>10.6%</td>
<td>$660/m²</td>
<td>27%</td>
<td>7.50%</td>
<td>Secondary - $697,090,000</td>
</tr>
<tr>
<td>B-grade</td>
<td>832,060 m²</td>
<td>18.7%</td>
<td>$530/m²</td>
<td>30%</td>
<td>8.75%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Property Council of Australia, m3property (February 2013)

* Approximate. Includes sales above $10 million in value. Site sales excluded.
KEY MARKET INFLUENCES

Economic Growth

According to the Australian Bureau of Statistics, national Gross Domestic Product increased 0.8 basis points in the December 2013 quarter, bringing annual growth to 2.8%. Domestic (national) Final Demand increased 0.1% during the quarter and 1.2% over the year.

Queensland State Final Demand decreased 0.4% over the quarter, with annual growth of 0.6%. Key contributors to the decrease in State Final Demand over the quarter were a continuing decline in public investment (having now fallen 22.8% over the past 18 months) and a decline in business investment. Housing investment increased 2.5% over the quarter, however was still 1.3% down over the year. Although not included in State Final Demand, it is worth noting that Queensland exports were up 2.8% and imports were down 15.0% over the year.

![Economic Growth Annual Change %](source: ABS, m3property)

Business Confidence

Business confidence is an important driver of tenant and investment demand for office space. According to the National Australia Bank Monthly Business Survey, confidence is currently above its long-term average. Confidence is expected, however, to remain particularly sensitive to any negative changes in both local and global economies.

![Business Confidence](source: NAB, m3property)

White Collar Employment

White collar employment is one of the key drivers of office space demand. According to BIS Shrapnel, growth in the Brisbane CBD ‘stand alone office workforce’ has averaged 2.8% per annum over the past 20 years.

![White Collar Employment](source: BIS Shrapnel)

During 2013, the CBD stand alone office workforce is forecast to have declined by 4.6%, or 5,200 full-time equivalent positions. The workforce is expected to expand marginally (0.1%/150 positions) during 2014 before returning to growth of 2.2% in 2015.

Over the five years to 2018, the stand alone office workforce is forecast to grow at an average rate of 1.5% per annum. This below-average growth will have a negative impact on office space demand, net absorption and vacancy rates.

There are several key factors currently influencing the size of the CBD workforce. These are discussed below.

Government austerity measures

The Queensland State Government reduced its workforce by 12,720 staff members state-wide between June 2012 and June 2013. Although we are unsure of the number of staff made redundant within the Brisbane CBD, the job cuts have had a considerable impact on vacancy and the average workspace ratio.

Although it is expected that there will not be any further mass redundancies, the full impact of the State Government austerity measures on the Brisbane CBD market is yet to be felt. The Government still has a substantial amount of empty space that has not been subleased and we expect that as their leases expire over the coming three to four years, they will be putting this (primarily B-grade) space back on the market.

A number of Government owned buildings are also expected to be sold and withdrawn from the CBD market over the short to medium-term. Queensland Treasurer Tim Nicholls has quoted that the upon completion of 1 William Street in 2016, the Government will have reduced its “footprint in inner-city office space by approximately 100,000 square metres”. These austerity measures will continue to put downward pressure on net absorption and upward pressure on the vacancy rate over the coming few years.

Relocation of CBD tenants to the Fringe and suburbs

There have been a number of major firms, including Ergon Energy, Laing O’Rourke and Macquarie Bank, who have relocated out of the CBD over the past 12 months. Bank of Queensland, Ventyx and Flight Centre will also leave their current CBD locations, having taken space in Fringe locations, with planned relocations during 2014 (Bank of Queensland and Ventyx) and 2016 (Flight Centre). In total, we expect there are a further 3,000 to 3,500 workers still to move out of the CBD over the coming three years. The relocation of firms has, and will continue to, have a material impact on vacancy rates.

The increasing preference for Fringe locations is evidenced thorough tenant briefs for upcoming space requirements, which a large proportion indicating both the CBD and Fringe as potential locations.

Slowing of the resources sector

During 2013, a number of major resource companies reduced their space requirements. This trend appears to have continued into 2014 with Arrow Energy recently making a total of 14,000 square metres of space available for sublease in the CBD. The slowing of the resources sector is expected to continue to impact white collar employment, demand and vacancy in predominantly Prime grade accommodation over the short to medium-term.
BRISBANE CBD OFFICE MARKET

The Property Council of Australia Office Market Report estimates that the Brisbane Central Business District (CBD) office market comprised 2,187,123 square metres of floor space at January 2014. This represents the third largest CBD office market in Australia and 8.9% of total office space nationwide. The majority (39.7%) 869,017 square metres) of stock in Brisbane’s CBD is of A-grade quality. B-grade stock accounts for approximately 832,060 square metres, which is 38.0% of total stock. The proportion of Prime to total stock has gradually increased over the past decade, with Prime now accounting for 49.1% of the CBD market.

The following chart shows the breakdown of stock by grade.

**Demand**

Net absorption has averaged 32,868 square metres per annum over the past 10 years. The strongest net absorption over this period occurred in 2011 (91,975 square metres), as resource and resource related companies took on extra space for future expansion. During 2013 however, net absorption of -98,767 square metres was the weakest that has been recorded since the Property Council of Australia began publishing data in 1990.

<table>
<thead>
<tr>
<th>Building Grade</th>
<th>Total Vacancy</th>
<th>Sub-lease Vacancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>26,174</td>
<td>6,437</td>
</tr>
<tr>
<td>A-grade</td>
<td>91,773</td>
<td>27,159</td>
</tr>
<tr>
<td>B-grade</td>
<td>155,189</td>
<td>20,083</td>
</tr>
<tr>
<td>C-grade</td>
<td>27,933</td>
<td>1,429</td>
</tr>
<tr>
<td>D-grade</td>
<td>9,740</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>310,809</td>
<td>55,108</td>
</tr>
</tbody>
</table>

At January 2014, the CBD office market comprised a total of 869,017 square metres of Prime accommodation, 221,596 square metres of A-grade accommodation and 832,060 square metres of B-grade accommodation. This represents a total of 310,809 square metres of office space (83% of total stock) available for lease.

During 2013, net absorption of Prime accommodation was -14,485 square metres and net absorption of Secondary accommodation was -83,822 square metres. Negative net absorption in Prime grade accommodation was largely a result of the slowing in the resources sector, with several major resource companies putting sub-lease space on the market; whilst negative net absorption in Secondary accommodation was primarily a result of major government austerity measures and CBD tenant relocation to fringe locations.

m3property forecasts net absorption of approximately -32,000 square metres during 2014. We expect net absorption to return to positive levels during 2015 and average net absorption of 16,900 square metres per annum over the five years ending December 2018.

**Supply**

The only new stock added to the CBD market during 2013 was 55 Elizabeth Street, which added 18,000 square metres of new A-grade accommodation to the market.

Currently under construction in the CBD are 480 Queen Street (54,000 square metres), 80 Ann Street (57,465 square metres) and 1 William Street (75,000 square metres). Combined, these three developments will add approximately 186,500 square metres of Prime accommodation to the market from late 2015 onwards.

Approximately 37% of 480 Queen Street (20,600 square metres) has been pre-committed by BHP, Herbert Smith Freehills and the Executive Centre. 180 Ann Street was undertaken as a speculative development and is yet to secure any tenant pre-commitment. The State Government is taking 60,000 square metres (80%) of space at 1 William Street and is attempting to sub-lease the remaining 15,000 square metres. Therefore, the total amount of uncommitted space in these three buildings is approximately 106,000 square metres.

In addition to the three new buildings under construction is the major refurbishment of 235 Edward Street (2,000 square metres), due for completion during the second half of this year.

**Vacancy**

The total vacancy rate in the Brisbane CBD was 14.2% at January 2014, representing 310,809 square metres of vacant floor space.

Total vacancy increased 1.4 percentage points over the six months to January, and 4.9 percentage points over the 12 months. Notably, the sub-lease vacancy rate was 2.5% at January, the highest recorded by the Property Council of Australia for the Brisbane CBD since the series started.
Premium gross face rents are forecast to decline by an average of 1.4% per annum over the next three years. Alongside an increase in incentives to 30% by September 2016, effective rents are forecast to decline at an average rate of 3.2% per annum through to December 2016.

A-grade

A-grade gross face rents averaged $660 per square metre during the December quarter (typically ranging between $600 per square metre and $740 per square metre) having declined 1.9% over the year. A-grade incentives averaged 27% during the quarter, resulting in average effective rents of $485 per square metre.

B-grade

B-grade gross face rents ranged between $490 per square metre and $615 per square metre during the December 2013 quarter, with an average of $530 per square metre. Gross face rents declined 4.2% over the year. With incentives averaging 30% during the December quarter, the average gross effective rent was $370 per square metre, having declined 6.8% over the year.

We expect the vacancy rate to continue to increase during 2014 and 2015, peaking between 17.0% and 17.5% late 2015/early 2016 as the current round of construction is completed. Between 2015 and 2017 there are a number of government buildings mooted for withdrawal from the market and this will contribute to a decline in vacancy from 2016 onwards.

Rental Market

The GFC saw face and effective rentals decline in absolute terms as demand was significantly affected by the economic downturn. Some rental growth was evident after the initial decline in 2008, however this has since been reversed.

Most recently, the combination of government austerity measures, relocation of CBD tenants to the Fringe and suburbs and a slowing of the resources sector has seen rental growth decline somewhat. This decline is expected to continue in the short-medium term.

One of the most salient features of the current rental market is the increasingly large incentives being offered to tenants. Average Premium, A-grade and B-grade incentives are listed however it is important to note that we have seen some examples of significantly higher incentives than the averages listed.

Premium

Premium gross face rents ranged between $670 per square metre and $880 per square metre during the December quarter. The average rent, $825 per square metre, declined 1.2% over the year. Incentives averaged 26% during the quarter, having increased from 21% during the December quarter of 2012. Premium gross effective rents averaged $610 per square metre during the December quarter.
Investment market

Despite poor leasing conditions, Brisbane’s investment market performed strongly during 2013 with robust activity being the result of the weight of money, low interest rates and the more favourable dollar for foreign investors.

m3property recorded 22 sales over $10 million during 2013. The total value of sales during the year was $2.62 billion, increasing 155% from $1.03 billion in 2012. Excluding the site sale of 30 Albert Street, by value, approximately 73% ($1.90 billion) of sales recorded were of Prime stock. The number of Secondary-grade transactions increased from seven 2012 to 12, with a total value of $697.09 million, during 2013.

SALE ANALYSIS – AM60, 42-60 Albert Street, Brisbane

A modern office building situated within the traditional government and residential precinct of the Brisbane CBD. It was completed in 2009 and provides three levels of basement parking for 120 vehicles (at a ratio of 1:177), three ground level retail tenancies, and 20 upper levels (including a mezzanine) of A-grade office accommodation with an average floor plate of approximately 1,043 square metres. The building has achieved five-star Green Star and NABERS Energy ratings.

<table>
<thead>
<tr>
<th>Sale Price</th>
<th>Sale Date</th>
<th>Vendor</th>
<th>Purchaser</th>
<th>NLA</th>
<th>PY</th>
<th>EY</th>
<th>MY</th>
<th>IRR</th>
<th>WALE</th>
</tr>
</thead>
<tbody>
<tr>
<td>$161,300,000</td>
<td>Q4 2013</td>
<td>LaSalle Investment Management</td>
<td>Dexus Wholesale Property Fund</td>
<td>21,263 m²</td>
<td>9.31%</td>
<td>7.92%</td>
<td>7.67%</td>
<td>8.37% (based on 3.00% growth per annum)</td>
<td>4.55 years by area / 4.31 years by income</td>
</tr>
</tbody>
</table>

Brisbane CBD Transactions 2013 ($>$10m)

<table>
<thead>
<tr>
<th>Address</th>
<th>Date</th>
<th>Grade</th>
<th>Sale Price</th>
<th>EY</th>
<th>PY</th>
<th>$/m² NLA</th>
</tr>
</thead>
<tbody>
<tr>
<td>42-60 Albert Street, Brisbane.</td>
<td>Dec-13</td>
<td>Prime</td>
<td>$161,300,000</td>
<td>7.92%</td>
<td>9.31%</td>
<td>$7,586</td>
</tr>
<tr>
<td>307 Queen Street, Brisbane.</td>
<td>Nov-13</td>
<td>Secondary</td>
<td>$120,800,000</td>
<td>7.96%</td>
<td>7.16%</td>
<td>$6,184</td>
</tr>
<tr>
<td>30 Albert Street, Brisbane.</td>
<td>Nov-13</td>
<td>n/a</td>
<td>Undisclosed</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>1 William Street, Brisbane. (50% interest)</td>
<td>Nov-13</td>
<td>Prime</td>
<td>$400,000,000</td>
<td>n/a</td>
<td>6.50%</td>
<td>$10,667</td>
</tr>
<tr>
<td>82 Eagle Street, Brisbane.</td>
<td>Oct-13</td>
<td>Secondary</td>
<td>$24,500,000</td>
<td>7.75%</td>
<td>8.77%</td>
<td>$5,368</td>
</tr>
<tr>
<td>179 Turbot Street, Brisbane</td>
<td>Oct-13</td>
<td>Prime</td>
<td>$172,296,340</td>
<td>n/a</td>
<td>n/a</td>
<td>$8,979</td>
</tr>
<tr>
<td>157 Ann Street, Brisbane.</td>
<td>Sep-13</td>
<td>Secondary</td>
<td>$39,000,000</td>
<td>n/a</td>
<td>n/a</td>
<td>$5,839</td>
</tr>
<tr>
<td>127 Creek Street, Brisbane.</td>
<td>Jul-13</td>
<td>Secondary</td>
<td>$71,000,000</td>
<td>n/a</td>
<td>n/a</td>
<td>$3,854</td>
</tr>
<tr>
<td>63 George Street, Brisbane.</td>
<td>Jun-13</td>
<td>Secondary</td>
<td>$37,000,000</td>
<td>n/a</td>
<td>10.67%</td>
<td>$3,496</td>
</tr>
<tr>
<td>147-163 Charlotte Street, Brisbane.</td>
<td>Jun-13</td>
<td>Secondary</td>
<td>$65,000,000</td>
<td>22.25%</td>
<td>20.82%</td>
<td>$2,439</td>
</tr>
<tr>
<td>54 Mary Street, Brisbane.</td>
<td>Jun-13</td>
<td>Secondary</td>
<td>$66,000,000</td>
<td>n/a</td>
<td>12.79%</td>
<td>$2,946</td>
</tr>
<tr>
<td>33 Charlotte Street, Brisbane.</td>
<td>Jun-13</td>
<td>Prime</td>
<td>$78,500,000</td>
<td>n/a</td>
<td>9.28%</td>
<td>$5,119</td>
</tr>
<tr>
<td>61 Mary Street, Brisbane.</td>
<td>Jun-13</td>
<td>Secondary</td>
<td>$90,000,000</td>
<td>n/a</td>
<td>11.51%</td>
<td>$3,131</td>
</tr>
<tr>
<td>111 George Street, Brisbane.</td>
<td>Jun-13</td>
<td>Prime</td>
<td>$143,000,000</td>
<td>n/a</td>
<td>8.81%</td>
<td>$4,977</td>
</tr>
<tr>
<td>80 Albert Street, Brisbane.</td>
<td>May-13</td>
<td>Secondary</td>
<td>$37,200,000</td>
<td>n/a</td>
<td>11.48%</td>
<td>$3,929</td>
</tr>
<tr>
<td>259 Queen Street, Brisbane.</td>
<td>May-13</td>
<td>Prime</td>
<td>$173,000,000</td>
<td>7.72%</td>
<td>8.64%</td>
<td>$6,979</td>
</tr>
<tr>
<td>116 Adelaide Street, Brisbane.</td>
<td>Apr-13</td>
<td>Secondary</td>
<td>$34,500,000</td>
<td>n/a</td>
<td>n/a</td>
<td>$4,986</td>
</tr>
<tr>
<td>33 Queen Street, Brisbane.</td>
<td>Apr-13</td>
<td>Prime</td>
<td>$34,000,000</td>
<td>8.42%</td>
<td>9.76%</td>
<td>$5,617</td>
</tr>
<tr>
<td>62 Ann Street, Brisbane.</td>
<td>Apr-13</td>
<td>Secondary</td>
<td>$37,000,000</td>
<td>n/a</td>
<td>13.50%</td>
<td>$2,510</td>
</tr>
<tr>
<td>41 George Street, Brisbane.</td>
<td>Apr-13</td>
<td>Secondary</td>
<td>$75,000,000</td>
<td>n/a</td>
<td>14.01%</td>
<td>$2,527</td>
</tr>
<tr>
<td>480 Queen Street, Brisbane.*</td>
<td>Apr-13</td>
<td>Prime</td>
<td>$543,900,000</td>
<td>7.25%</td>
<td>n/a</td>
<td>$9,789</td>
</tr>
<tr>
<td>400 George Street, Brisbane. (50% interest)</td>
<td>Mar-13</td>
<td>Prime</td>
<td>$195,800,000</td>
<td>6.98%</td>
<td>7.08%</td>
<td>$9,004</td>
</tr>
</tbody>
</table>

Yields

Brisbane CBD office yields have followed the general trend observed in recent years. Yields tightened up to the GFC driven by the weight of investment demand. The GFC saw yields soften sharply before peaking and subsequently undergoing moderate compression.

Prime yields ranged between 6.50% and 8.25% during the December quarter. Premium yields averaged 6.75%, having tightened 50 basis points over the 12 months to December, whilst A-grade yields averaged 7.50%, having remained stable over the year. Surprisingly, B-grade yields tightened 25 basis points over the 12 months to average 8.75% during the quarter.

Prime yields are expected to soften over the coming few years as a result of increasing leasing risk. We expect that Premium yields will soften to average 7.25% and A-grade will average 8.00% by mid-2016. The arbitrage between interest rates and property yields is expected to maintain investor interest. We forecast B-grade yields to also soften over the next two years, averaging (and then remaining stable at) 9.50% from mid-2016. This will be a result of the weak leasing market and forecast declines in rental values.
OUTLOOK

The outlook for the Brisbane CBD office market is negative.

“face and effective rents will continue to decline over the short to medium-term”

There is a large amount of supply under construction in the CBD, a considerable proportion of which is without tenant pre-commitment.

We forecast vacancy to peak at between 17.0% and 17.5% towards the end of 2015 as a result of the weak leasing market and the large amount of supply mooted for completion in the CBD from late 2015 onwards.

Leasing demand is expected to remain weak during 2014. We forecast this to translate into net absorption of -32,000 square metres for the year, before returning to positive levels during the 2015 calendar year.

As a result of increasing vacancy and poor market fundamentals, face and effective rents will continue to decline over the short to medium-term.

Yields are forecast to soften across all grades of stock over the coming few years. We forecast Prime yields to soften by 50 basis points and B-grade yields to soften by around 75 basis points over the next two years. Yield softening will be a result of increased leasing risk and forecast decreases in rental rates.

Over the long-term, the Brisbane CBD is expected to become an increasingly important professional, business and finance services hub, in part, by an increasingly diverse Brisbane and Queensland economy. This will also mean that older Secondary stock will be increasingly redeveloped, modernised or converted to another use with office stock also increasingly being green star rated.

Definitions

Grade: is determined using the PCA report “A Guide to Office Building Quality”.
Prime: Combination of Premium and A-grade.
Secondary: Combination of B, C and D-grades.
Net lettable area (NLA): defined in accordance with the PCA “Method of Measurement”
Completion date: determined by issue of a “Certificate of Occupancy”
Pre-commitment: contract signed to occupy space in new or refurbished space prior to construction commencing.

m3property Research

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