Briefing
Brisbane Fringe Office

February 2017

Highlights

- Flight Centre moves into Southpoint while construction begins on Aurecon's new head office, K5
- Savills identified 100,600 square metres of leases (above 500 square metres) for the 12 months to December 2016
- 'Mining & Utilities & Industry' was the dominant sector, leasing 32 per cent of the stock
- According to the PCA the vacancy rate in Brisbane's Fringe was 12.6 percent as at December 2016
- According to Savills December 2016 Full Floor Report there were 82 full floors available for lease in the Fringe
- Savills recorded approximately $846 million of transactions in the 12 months to December 2016
- Increased tenant activity is expected to continue with a number of major leases expiring over the new two years

Brisbane Fringe office sales market sees uplift in foreign interest…

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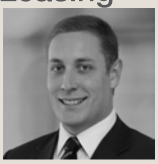

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Introduction

The Brisbane fringe office market comprises the five precincts - Urban Renewal (Fortitude Valley, Newstead, Bowen Hills and Herston), Inner South (South Brisbane, West End, Woolloongabba, Kangaroo Point, East Brisbane and Greenslopes), Milton, Spring Hill and Toowong and contains approximately 1.2 million square metres of lettable office space.

Precincts	Suburbs
Urban Renewal	Fortitude Valley, Newstead, Bowen Hills and Herston
Inner South	South Brisbane, West End, Woolloongabba, Kangaroo Point, East Brisbane and Greenslopes
Milton	Milton
Spring Hill	Spring Hill
Toowong	Toowong

Office Development

The fringe office market saw the completion of Southpoint during the last quarter of 2016, adding 23,800 square metres of stock. The year ahead will see no new stock added, however 2018 will see the addition of two new buildings.

Only two office developments remain under construction including Fortitude Valley's fully pre-committed 900 Ann St, along with Lend Lease's second office tower 'K5' within the King Street redevelopment precinct, which began construction in the last quarter of 2016. At the time of reporting, Aurecon remain the only tenants to have pre-committed to K5, having agreed to lease around 40 percent of the end office space.

Both due for completion in 2018, the two buildings combined will add approximately 35,000 square metres to the Urban Renewal precinct, which continues to attract the greatest tenant demand and subsequently the highest office occupancy levels of all the precincts within the Fringe office market.

The table below shows the projects under construction and those that may proceed in the medium term:

Current Brisbane Fringe Office Development Activity

Property	Precinct	NLA (sq m)	Type	Status	Completion	Major Tenant(s)
Southpoint, 209 Grey St, South Brisbane	Inner South	23,800	New	Complete	2016	Flight Centre (100%)
900 Ann St, Fortitude Valley	Urban Renewal	18,791	New	UC	2018	Aurizon (100%)
K5, Bowen Hills	Urban Renewal	14,500	New	UC	2018	Aurecon (40%)
11 Breakfast Creek Rd, Newstead	Urban Renewal	~30,000	New	DA	2019+	John Holland (15%)
K2, Bowen Hills (mooted)	Urban Renewal	21,000	New	DA	2019+	
CDOP7, Milton (mooted)	Milton	27,813	New	DA	2019+	
Constance St, Fortitude Valley Railway TOD (mooted)	Urban Renewal	~35,000	New	Planning	2019+	

Source: Savills Research. UC – Under Construction. DA – Development Approval/Lodged.

The planned 13-level office building K2 remains in early planning stages, with construction mooted to begin mid-2017. Along with K1 and K5, the three office towers will total over 50,000 square metres net lettable area. K2 is yet to actively commence marketing for a tenant pre-commitment and remains deferred at this stage.

The start of construction on Charter Hall's 15-level commercial building in a joint venture with John Holland is yet be announced. Construction has been mooted to begin sometime this year, dependent on more tenants pre-committing.

CDOP7 (Coronation Drive Office Park 7) while still mooted, will be the 7th commercial building within the popular Milton office park with a 12-level commercial tower, including ground level retail and an urban common area. Included in the proposal is the possibility of refurbishing a building (CDOP 09) adjacent to the site.

Fortitude Valley's train station is set to get a revamp with LaSalle Investment Management planning a new mixed use development. The project will include a new commercial office tower on Constance Street, refurbishment of the Transport House office building plus LaSalle's first apartment project in Brisbane, incorporating 207 residential units.

Leasing Activity

In the 12 months to December 2016, Savills identified 100,600 square metres of leasing activity (> 500 square metres) in Brisbane's CBD fringe office markets. This is down 7 percent on the 12 months prior, although up on the five year average (82,923 square metres). The majority of these leases, approximately 56 percent of space leased was in the Urban Renewal precinct. Similarly, the largest number of deals occurred in Urban Renewal (28).

Of the 100,600 square metres leased, 'Direct' leases accounted for 44 percent, while 'Renewals' accounted for 32 percent of total leased space.

Select Brisbane Fringe Offices Leases to December 2016

Date	Property	NLA (sq m)	Rent ($/sq m)	Tenant
Jun-16	855 Stanley St, Woolloongabba	1,000	525^	Tu Projects
Jun-16	35 Chester St, Fortitude Valley	1,004	473	Space Furniture
Jun-16	10 Browning St, South Brisbane	2,402	525	Visionstream
Jul-16	50 King St, Fortitude Valley	~6,000	NA^	Aurecon
Sep-16	12 Commercial Rd, Fortitude Valley	812	525	IPSP Billling
Oct-16	55 Little Edward St, Spring Hill	774	500	Wounds Management Innovation CRC
Oct-16	25 Montpelier Rd, Bowen Hills	902	520	St Vincent's Health Australia
Oct-16	199 Grey St, South Brisbane	2,000	585	Flight Centre
Nov-16	1 King St, Bowen Hills	1,820	NA	Snowy Mountains Engineering Corporation
Dec-16	515 St Pauls Tce, Fortitude Valley	3,790	NA"	Cardno

Source: Savills Research. ^Pre-commitment, "renewal, NA – not available, ~circa

Flight to quality remains the predominant trend with the majority of leasing activity with A Grade stock accounting for 82 per cent of leasing activity or a total of 82,089 square metres (>500 sq m) for the 12 months ending December 2016 across 47 transactions. This compares to 36 lease transactions of a total 95,258 square metres for the previous year.

Secondary grade stock also saw a lift in activity with 15 tenancies secured during 2016, compared to 9 the previous year.

With limited availability of quality office accommodation, and improving occupancy levels, developers are likely to once again be considering commercial development. With the surge in residential apartment projects reaching its peak, commercial projects may again become a viable option, albeit requiring pre-commitments prior to construction commencing.

Ongoing competitive rents and incentives, continues to attract tenants from the suburbs into the Fringe and CBD office markets. Value for money and quality of stock is also a draw card for a number of tenants looking to the Fringe. Lend Lease's K1 building in Bowen Hills is now fully leased, having secured SMEC and Medtronic during the last quarter of 2016.

Based upon the latest figures from the Property Council, the Fringe office market recorded 15,462 square metres positive net absorption for the 12 months to December 2016.

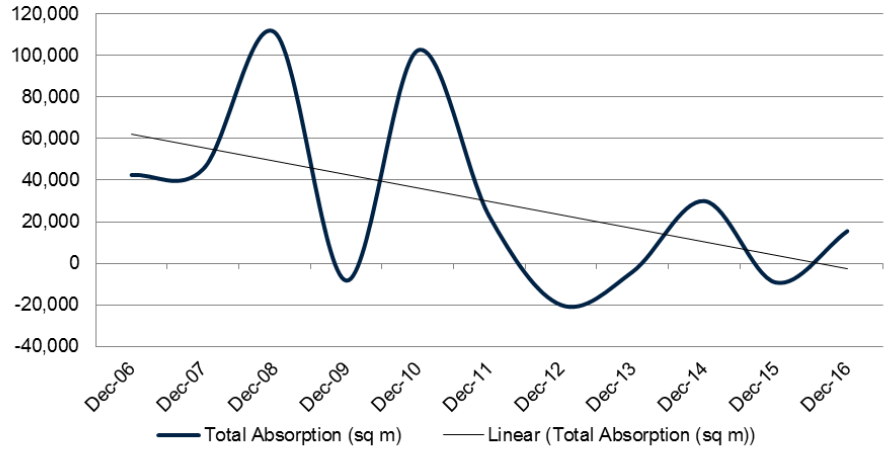
In line with that seen across the CBD office market, this positive result is a reflection of improved tenant demand across the Fringe office markets.

Both A and B Grade stock recorded positive net absorption of 14,121 and 4,905 square metres respectively, with the Inner South, Milton and Urban Renewal precincts recording the strong tenant demand for the period.

Of the 100,600 square metres leased in Brisbane's CBD fringe office markets (>500 sq m) in the last twelve months, 'Mining & Utilities & Industry' was the dominant sector, leasing 32 per cent of the stock, or 32,330 square metres. Of this, engineering firms such as SMEC, Sandvik and Aurecon contributed to the sector's improved leasing activity, up from 26,719 square metres in the previous year.

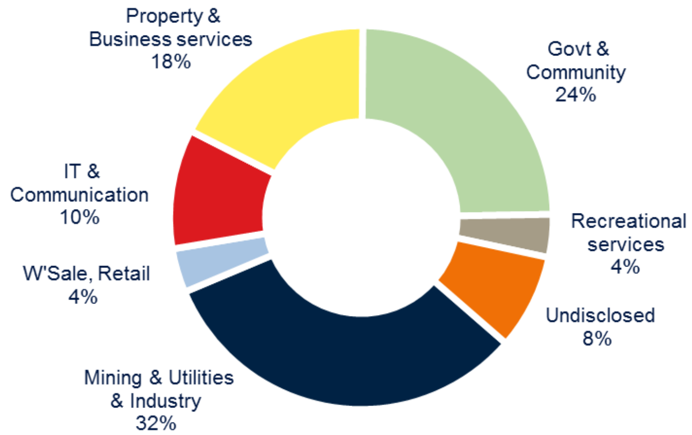
The 'Property & Business services' sector however continues to record the highest number of transactions, with 16 leases signed during 2016, compared to 10 the previous year.

Brisbane Office
Fringe Net Absorption (sq m)
Dec-06 to Dec-16



Source: PCA / Savills Research

Brisbane Office
Total Reported Leased in CBD Fringe (%)
12 months to Dec-16



Source: Savills Research

Similar to the trend being seen in the Brisbane CBD, Savills are witnessing strong demand from the 'Government and Community' sector with health and education contributing strongly to leasing activity for the year ending December 2016. Businesses such as Wounds Management Innovation securing 774 square metres and Terrace Eye Centre securing 725 square metres in Spring Hill, as well as St Vincent's Health Australia leasing 902 square metres in Bowen Hills.

The growing State Government's impact on the office leasing market has not been limited to the CBD, with Department's such as the Department of Crime and Corruption renewing their lease with Green Square North Tower, contributing around 7,500 square metres to total leasing activity for the year.

Office Vacancy

Brisbane Fringe Vacancy Rates – December 2016

Precinct	Stock (sq m)	Vacancy (sq m)	Vac % Dec-16	Vac % Dec-15
Urban Renewal	480,726	47,672	9.9	11.2
Inner South	280,290	32,496	11.6	9.7
Milton	237,527	44,182	18.6	20.5
Spring Hill	133,998	20,077	15.0	13.0
Toowong	76,833	7,750	10.1	10.2
Total	1,209,374	152,177	12.6	12.8

Source: PCA/Savills Research

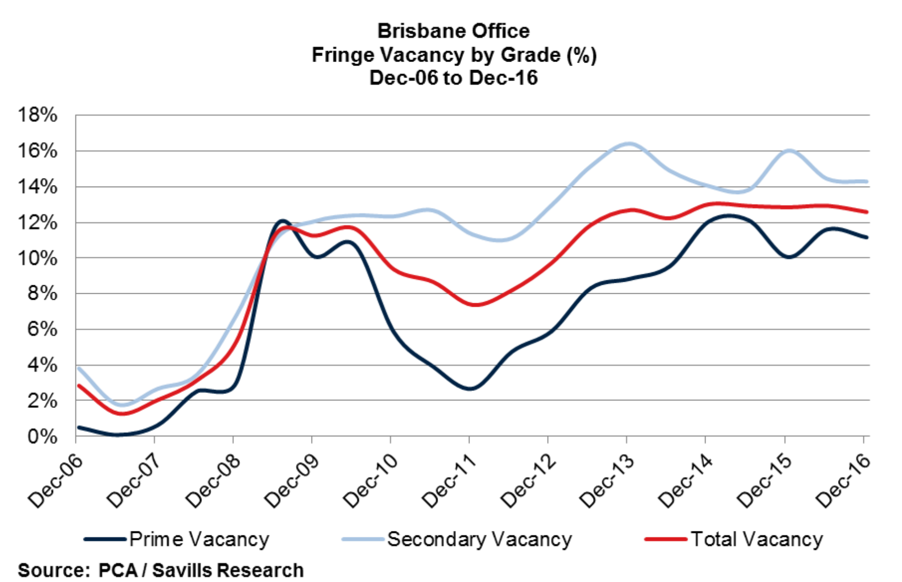
The table above shows vacancy across the Fringe markets, with the overall vacancy rate down 0.2 percentage points to 12.6 as at the end of December 2016, percent compared to 12.8 percent in December 2015.

All precincts recorded a drop except for Spring Hill which increased by 2 percentage points to 12 per cent and Inner South, up 1.9 percentage points to 11.6 percent over the year.

Although the Inner South recorded positive net absorption over the 12 months to December 2016, this was offset by the addition of the fully leased Southpoint Development of 23,500 square metres. An increase in sublease space also contributed to the increased level of vacancy for the precinct.

The greatest improvement was recorded in the 'Milton' precinct, down from 20.5 percent in December 2015 to 18.6 percent in December 2016.

This was on the back of increased leasing activity with a number of new lease deals such as Landpartners taking 916 square metres at 18 Little Cribb St and BGC Consulting securing 650 square metres at 143 Coronation Drive.



The 'Urban Renewal' precinct also continues to see improving tenant demand, with its vacancy rate moving out of double-digit territory to 9.9 per cent.

The last half of 2016 saw a number of office withdrawals with a total of 9,713 square metres withdrawn for conversion to other uses. Three are to be converted to residential, while 164 Wharf St is to be converted to a hotel. The fifth and most significant for the year is the withdrawal of 454 St Pauls Terrace which is to become home to a new NextDC data centre and standby generator. The redevelopment will comprise of some ancillary office accommodation and amenities.

Sales Activity

Savills have recorded approximately $846 million worth of office transactions in the 12 months to December 2016 in the Fringe area. This is up 11 percent from $759 million in the previous year, and up on the five year average of $692 million. During the same period 30 properties were sold, down from the previous year of 39, and up on the five year average of 25.

Select Brisbane Fringe Office Sales to December 2016

Date	Property	Price ($m)	NLA (sq m)	$/sq m	Yield (%)
Apr-16	100 Skyring Terrace (50%), Newstead	93.00	24,665	7,541	6.43
Jun-16	26 Commercial Road , Newstead	13.25	2,195	6,036	7.86*
Jun-16	433 Boundary St, Spring Hill	25.10	5,992	4,189	10.45
Jun-16	10 Browning St, South Brisbane	65.50	11,214	5,841	7.75*
Aug-16	41 O'Connell Tce (& 37 O'Connell), Bowen Hills	52.00	7,643	6,804	6.38
Aug-16	40-52 Mcdougall St, Milton	94.90	20,823	4,557	7.61
Sep-16	505 St Pauls Tce, Fortitude Valley	205.50	17,618	11,664	5.88*
Oct-16	252 Montague Rd, West End	5.50	1,625	3,385	VP
Oct-16	454 St Pauls Terrace, Fortitude Valley	22.75	3,790	6,003	VP
Dec-16	35 Boundary St, South Brisbane	51.20	8,050	6,360	7.74

Source: Savills Research. VP – vacant possession, *Equated market yield # Part of a portfolio sale. ~ circa

The 'Urban Renewal' precinct continues to record the greatest volume of sales activity during the 12 months to December 2016 with $509 million worth of office transactions, contributing to 60 percent of total sales for the period. This is down on the previous year of $627 million, yet up on the five year average of $401 million.

2016 Brisbane Fringe office sales up 11 percent...

Savills Research

Sales within the '$2 - $25 million' price range with a total $132 million worth of transactions accounted for the majority of deals with 21 sales reported for the year ending December. This is down on the previous year of 31 sales totalling $194 million.

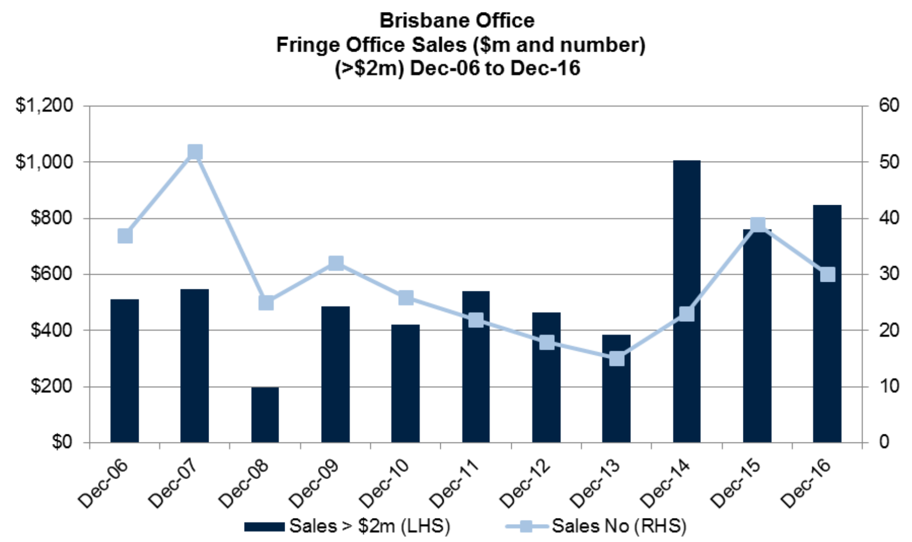
As noted earlier, sales activity during 2016 was up in the $50-million-plus price range, which saw 7 properties exchange hands with the most notable transaction being the sale of Green Square South Tower which sold for $205.5 million.

This sale contributed to the 'Foreign Investor' purchaser category being the most active in the investment market for the year ended December 2016, purchasing 42 percent of the stock sold (or $357 million worth of office transactions).

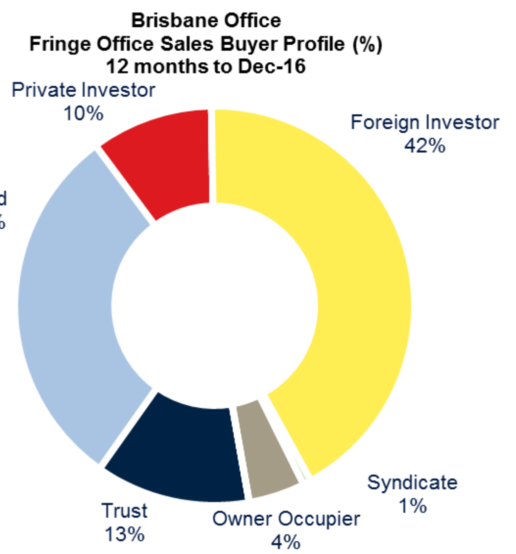
Shayher's purchase of Kings Row Office Park in Milton, for $94.9 million was also one of the largest during the year. While the site has long term potential for residential redevelopment, the asset is to be retained in its current form for the foreseeable future.

The low interest rate environment continues to attract owner occupiers with 6 sales reported for the year ending December, totalling $39 million. This is up from $19 million across 4 transactions reported during 2015.

The 'Private Investor' category also remains active with 9 transactions in the Fringe market reported for 2016.



Source: Savills Research



Source: Savills Research

Sales volumes strengthen within the '$50m-plus' range...

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Key Market Indicators

Average gross face rents in the Brisbane Fringe continue to show a slight upward trend, however gross incentives have also marginally increased. As at December 2016, gross face rents typically range from $515 to $610 per square metre per annum for A Grade buildings, and between $375 and $475 per square metre per annum for secondary grade buildings. The average A Grade gross face rent is $563 per square metre per annum, a 4 percent increase over the year.

Average incentives for A Grade stock have remained in the 30-35 percent range for over two years now, whilst B Grade stock is somewhat higher at around 40 percent on average. While incentives have looked to have peaked, slight increases in outgoings has contributed to the softening in net effective rents.

Capital values in the Brisbane Fringe as at December 2016 typically range between $5,650 to $6,950 per square metre for A Grade buildings, and between $3,100 and $4,500 per square metre for secondary grade buildings. Average A Grade capital values are currently $6,255 per square metre, a 9.5 percent rise over the year.

Market yields in the Brisbane Fringe as at December 2016 typically range from 6.50% to 7.25% for A Grade buildings, and between 7.25% and 8.75% for secondary grade buildings. The average A Grade yield is currently 6.88%, an 87.5 basis point firming over the year.

Key Market Indicators – December 2016

Brisbane Fringe	A Grade		B Grade	
	Low	High	Low	High
Rental – Gross Face ($/sq m)	515	610	375	475
Rental – Net Face ($/sq m)	410	450	270	330
Rental – Net Effective ($/sq m)	225	230	120	140
Outgoings – Operating ($/sq m)	75	110	75	100
Outgoings – Statutory ($/sq m)	30	50	30	50
Outgoings – Total ($/sq m)	105	160	105	150
Typical Lease Term (years)	3	10	3	7
Yield – Market (% Net Face Rental)	6.50	7.25	7.25	8.75
IRR (%)	7.75	8.50	8.50	9.25
Cars Permanent Reserved ($/pcm)	250	375	180	300
Office Component Capital Values ($/sq m)	5,650	6,950	3,100	4,500

Source: Savills Research

Rental rates reflect a gross face rent on a single, whole floor in the mid-rise of a building unless specifically otherwise stated. Discounts and premiums exist for low and high rise space and for significant occupiers.

Outlook

In line with the CBD, the Fringe office market looks to have turned a corner with improved leasing activity over the 2016 calendar year. Looking forward it is expected that this level of tenant demand will slowly gather momentum with flight to quality remaining the predominant trend. This may encourage developers to begin to consider office development projects as the residential market reaches its peak. With little new stock due for completion in the next two years, occupancy levels are expected to continue to improve.

With this in mind, it is likely that the current level of incentives have reached their peak and gross face rents will continue to slowly trend upwards. The gap between gross face and net effective rents has broadened due to high incentives and a reluctance for lessors to reduce face rents.

The positive outlook for the Queensland economy is encouraging more businesses to reconsider their office space needs, whether it be to consolidate into one premises or find more efficient accommodation, which will likely contribute to continued positive net absorption across the Fringe office markets. Increased tenant activity around the Fringe is also expected to continue with a number of large leases expiring over the next two years.

Given the amount of office space still available across metropolitan Brisbane, smaller tenants in particular are likely to continue to take advantage of the competitive rental environment in the CBD with quality fitout a key consideration. Larger tenants on the other hand will typically continue to source quality product with preference for the Fringe. Tenants from suburban areas are also likely to continue to consider relocating to the Fringe or CBD for this same reason.

Investor interest in the Brisbane office market is set to continue, particularly for assets which have repositioned themselves through improved office amenity and occupancy levels. As a result firming of yields is expected, with assets with long term WALE’s and quality tenants highly sought after.

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