Savills Research

Briefing
Canberra Office

February 2019

Highlights

- The total vacancy rate in Canberra fell to 12.5% in June 2018 from 13.1% in December 2017;
- Prime grade office space demand remains evident, complemented by major infrastructure investments particularly in the Civic precinct;
- Increasing domestic and foreign investor appetite within the Canberra office market has been driven by affordability and security of government tenants;
- Development planning activity has increased with a surge in supply expected in 2020/21.

A Grade Averages	Latest	Yr Change	Outlook
Rental – N.F. ($/sq m)	370	+0.0%	↔
Net Incentives	17.5	-400bps	↘
Rental – N.E ($/sq m)	290	+0.0%	↔
Yield – Market (%)	6.25	-15bps	↘
IRR (%)	7.90	-25bps	↘
Capital Values ($/sq m)	7,300	+7.4%	↗

Demand & Supply	Latest	PCP*
Vacancy (%)	11.0	12.5
Net Absorb. ('000 sq m)	0.5	-29.1
Stock U/C ('000 sq m)	65.2	51.6
- % of market	2.8	2.2
- % committed	74.2	-

*PCP = Previous Corresponding Period

Report Contents

Shrabastee Mallik
smallik@savills.com.au
Director
Research & Consultancy

For our latest national reports, visit
savills.com.au/research

To join Savills Research mailing list, please email
research@savills.com.au

Executive Summary

The Canberra office market consists of just over 2.32 million square metres of net lettable space (as at December 2018), split into 26 sub-localities. The largest precinct is Civic (Canberra's CBD) with 659,034 square metres. By grade quality, A Grade buildings account for the largest proportion of stock in Canberra, representing 48.3% of the market.

The performance of the Canberra office market is often counter-cyclical to the other major office markets in Australia, and has historically been driven by elections and subsequent fluctuations in the size of the public sector.

With the Government and Community sector the most dominant tenant type in the Canberra office market, (making up over 70% of total tenants as at December 2018) recent volatility in federal politics has caused consumer and business confidence to fall, which may have a tempering effect on leasing activity over the short to medium term.

PCA Summary Table – Canberra (as at Dec-18)

	Prime	Secondary	Total	AUS CBD
Total Stock ('000)	1,113.2	1,204.7	2,317.9	**17,902.6**
Total Vacancy ('000)	57.9	196.1	254.0	**1,482.7**
Vacancy (%)	5.2 (11.2)	16.3 (13.3)	11.0 (12.3)	**8.3 (9.4)**
Net Absorption ('000)	35.2 (41.0)	-34.6 (-18.0)	.5 (23.0)	**230.7 (181.3)**
Net Absorption (%)*	3.4 (5.0)	-3.3 (-1.6)	0.0 (1.2)	**1.4 (1.2)**
Net Additions ('000)	-5.6 (39.7)	-53.6 (-5.0)	-59.2 (34.7)	**-46.2 (257.6)**
- Stock Additions ('000)	6.8	19.9	26.6	**317.8**
- Stock Withdrawals ('000)	12.3	73.5	85.8	**364.5**
Net Additions (%)**	-0.5 (4.5)	-4.3 (-0.4)	-2.5 (1.6)	**-0.3 (1.6)**

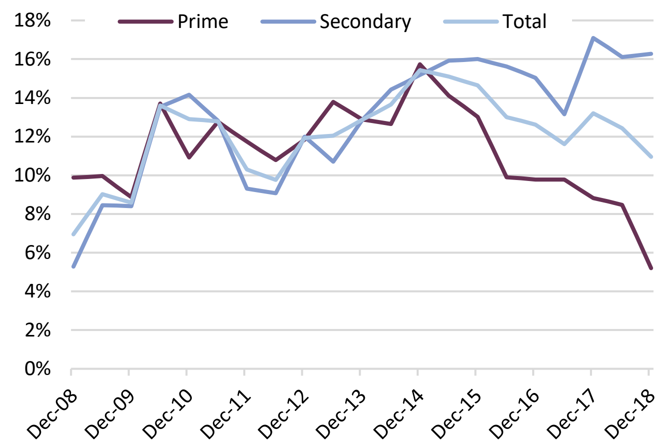
Source: Savills Research (10yr Averages shown in brackets; NB: Secondary Rents shown are for B grade; All rents equivalent to whole floor mid-rise
*As a percentage of occupied stock; **As a percentage of total stock

Vacancy

The total vacancy rate in Canberra fell to 11.0% in December 2018 from 12.4% in June 2018. The secondary grade markets in Canberra, recorded a slight increase in vacancy to 16.3% remaining close to the record high levels that were seen in December 2017 (17.1%). The Canberra A grade market has mirrored the total market vacancy movements with the vacancy rate now sitting at 4.9% from 8.5% in January 2018. This is mainly due to the Airport achieving a reduction in A grade vacancy of 21.4% to 12.5%, the lowest levels since July 2006. CBD A Grade space reduced further to 1.7% in January 2019 and could now be considered under supplied until new developments reach completion in 2020-21.

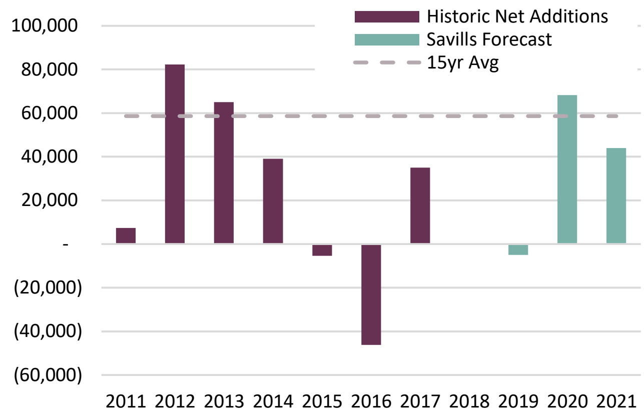
Developments currently under construction will present the market with the first stages of a major supply cycle on completion mostly within 2020/2021 however, until then Savills anticipate a gradual tightening in vacancy to continue. Furthermore, as a result of major infrastructure projects including the light rail network, it is expected that vacancy rates particularly within prime assets will continue to fall as demand for high quality office space remains strong.

Historic Vacancy (Canberra)



Source: Savills Research

Net Supply by Year



Source: Savills Research

Supply

Historically, new additions have been a key feature of the Canberra office market with a 15 year average of approximately 58,000 square metres. However, this has not been the case since 2015 as a result of cost cutting measures by Commonwealth tenants, the effects of which are still being felt. Canberra's supply pipeline is expected to return to historical norms in the 2020, when projects such as 'Civic Quarter' (27,600 square metres) enters the market.

Despite this next wave of supply that will hit the market in the next two years, much of the developments are already pre-committed from major tenants including Minter Ellison, KPMG and Access Canberra. Looking forward, it is highly unlikely that speculative office development will occur outside of the CBD and the Barton/Forrest precinct in the forthcoming few years without leasing pre-commitment.

Leasing Activity & Demand

In the 12 months to December 2018 Savills identified 111,803 square metres of leasing activity (over 1,000 square metres) within the Canberra office market. This figure was significantly higher than the 12 months prior however behind the 10 year average of 157,060 square metres. A lack of supply is evident in this market, largely attributed to the long WALE's from Government tenants.

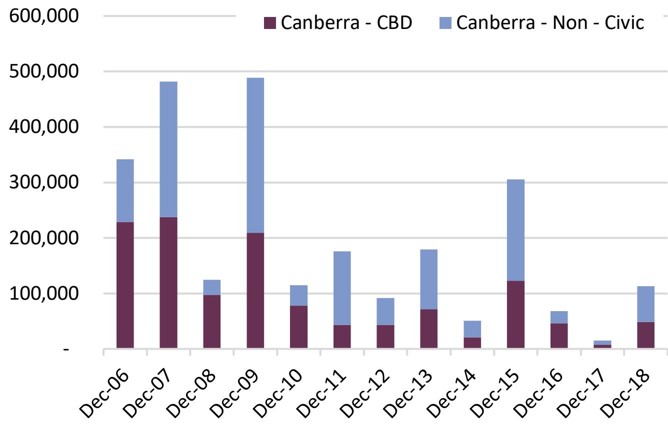
The majority of transactions in 2018 were above 10,000 square metres with over 60% of activity being seen within this category. This was largely due to the renewal by the Department of Health and Ageing at 23 Furzer Street in Phillip. They renewed for a further 10 year period over the 44,896 square metres at a gross rental rate of $510 per square metre.

Approximately 60% of all leases were in A grade buildings with the remainder in B grade office space. This is in line with the year prior indicating continued leasing demand for prime grade office stock, particularly coming from the Government & Community sector.

Total net absorption for the 12 months to December 2018 was recorded at 517 square metres, which was attributed to a positive net absorption of 35,158 in Prime grade assets combined with a negative net absorption in Secondary grade buildings of 34,641.

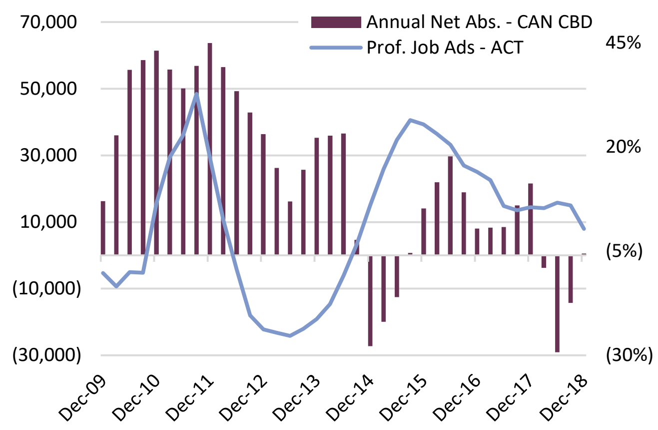
Growth in professional job advertisements in Canberra remained relatively flat over the year to December 2018. This is an indicator of the shifts in demand for office space in this market. We have already seen demand shift from larger office spaces (greater than 5,000 square metres) towards smaller occupiers in the 1,000 to 5,000 square metre market, particularly with ongoing promises to increase outsourcing of public sector jobs.

Leasing Activity by Precinct (> 1,000 square metres)



Source: Savills Research

Net Absorption vs. Growth in Professional Job Ads



Source: Savills Research

Recent Notable Leases (by Area Leased)

Tenant	Property	Date | NLA (sq m)	Type | Rent | Term
Commonwealth (Health & Ageing)	23 Furzer St, Phillip	Dec-18 | 44,896	Renewal | 510 (G) | 10
Commonwealth	23-25 Constitution Ave, Canberra	Jul-18 | 9,747	Renewal | 420 (G) | 10
Commonwealth (National Audit Office)	19 National Circuit, Barton	Jun-18 | 6,924	Direct | 435 (G) | 12
Commonwealth Super	7 London Cct, City	Jan-18 | 6,915	Direct | 470 (G) | 6
The Commonwealth of Australia	1 Dairy Rd, Fyshwick	Jul-18 | 6,872	Direct | 325 (G) | 10
NHMRC	16 Marcus Clarke St, Canberra	Feb-18 | 4,020	Direct | 480 (N) | 11
Leidos	53 Wentworth Ave, Kingston	Dec-18 | 3,861	Renewal | 501 (G) | 5
Regis	121 Marcus Clarke St, Canberra	Jul-18 | 1,427	Direct | 480 (G) | 10
Doc Shop	306 Anketell St, Tuggeranong	Feb-18 | 1,168	Direct | n.a | 5
Adore Building	40 Blackall St, Barton	Nov-18 | 1,009	Renewal | 390 (G) | 1
The Boston Consulting Group	16 Marcus Clarke St, Canberra	Jul-18 | 1,005	Direct | 480 (G) | 7

Source: Savills Research

Sales

Savills Research recorded approximately $274.5 million of office transactions (> $5 million) in the 12 months to December 2018. This is a significant drop to the 12 months prior ($657.8 million) and the ten year average ($353.1 million). Despite this, the transaction numbers were up, with 10 assets exchanging over the period. This indicates that there has been a shift away from the sale of premium grade assets with majority of transactions being secondary grade in the year to December 2018.

Activity within Canberra's office market was dominated by domestic 'Funds' and 'Trusts' which collectively accounted for close to 60% of transactional activity within the year.

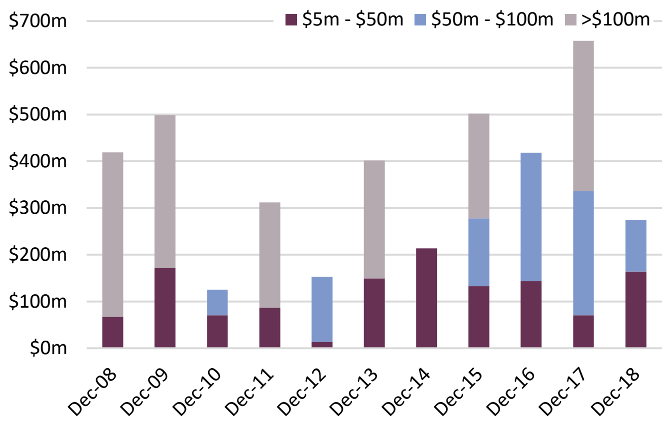
In November domestic fund Marprop Pty Ltd acquired the two office buildings at 14 & 17 Moore Street in the CBD. The A grade asset at 14 Moore Street was purchased for $59 million, reflecting an equated yield of 6.64%. 17 Moore Street sold for $20.65 million on an equated yield of 8.10%. The B grade asset was 84% vacant at the time of sale.

Another notable sale was at 14 Mort Street in Canberra CBD. Ascot Capital sold their A Grade asset for $51 million in June 2018 to Singaporean investor Soilbuild REIT, in conjunction with the sale of Inghams Burton in Adelaide. The asset was an attractive entrance for Soilbuild to the Australian market as it is fully leased to the Government with a WALE of 6.4 years and represented an equated yield of 6.35%.

Market yields in Canberra Civic, as at December 2018, are estimated to range between 5.50% and 7.00% for A grade, and between 7.00% and 10.00% for B grade buildings. The average yield for A grade office buildings in the quarter to December 2018 is 6.25%, representing a 15 basis point firming over the year.

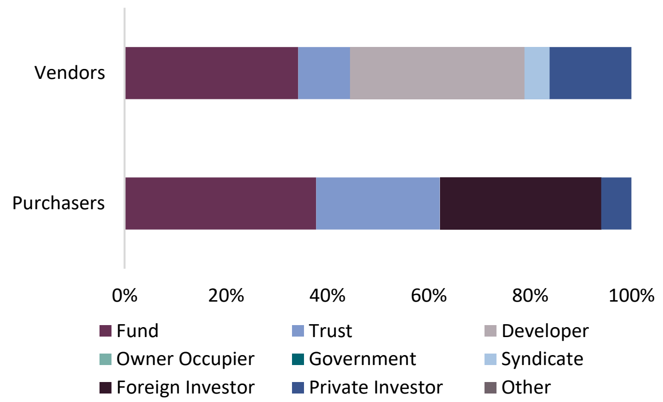
Capital values in the Civic precinct in Canberra, as at December 2018, are estimated to range from $6,000 per square metre to $8,500 per square metre for A grade buildings, and between $4,000 per square metre and $6,000 per square metre for B grade buildings. Average A Grade capital values grew 6.9% over the 12 months to December 2018.

Sales Activity by Size (>$5 million)



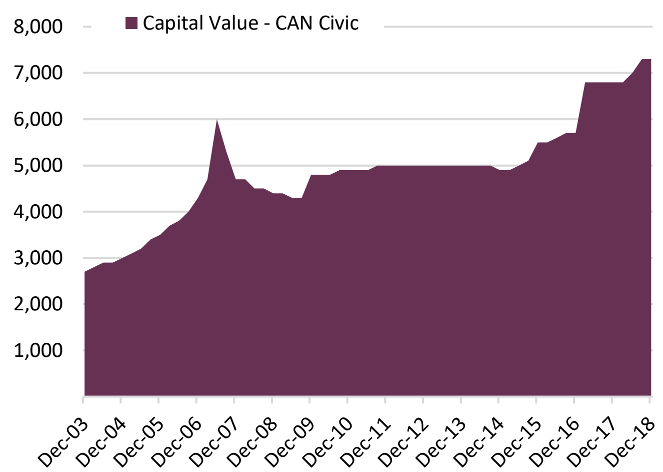
Source: Savills Research

Vendor & Purchaser Type (>$5 million)



Source: Savills Research

Capital Values ($/sq m)



Source: Savills Research

Recent Notable Sales (by sale price)

Property	Price ($m) | Date | NLA	Yield | Type | $/sq m
14 Moore St, Canberra	59.00 | Nov-18 | 11,047	6.64 | e | 5,341
17 Moore St, Canberra	20.65 | Oct-18 | 5,717	8.10 | e | 3,612
40 Macquarie St, Barton	29.00 | Oct-18 | 5,503	6.70 | e | 5,270
80 Mildura Street, Fyshwick	11.50 | Aug-18 | 3,277	n.a | n.a | 3,509
40 Caeron Ave, Belconnen	23.90 | Jul-18 | 14,900	n.a | n.a | 1,604
165 Canberra Avenue, Fyshwick	11.50 | Jun-18 | 3,277	6.94 | e | 3,509
14 Mort St, Canberra	51.00 | Jun-18 | 9,384	6.35 | e | 5,435
6 National Cct, Barton	37.50 | Feb-18 | 6,171	6.87 | e | 6,077

Source: Savills Research ; Yield Types: i = Initial, r = Reported, e = Equated, v = Vacant, dev = development

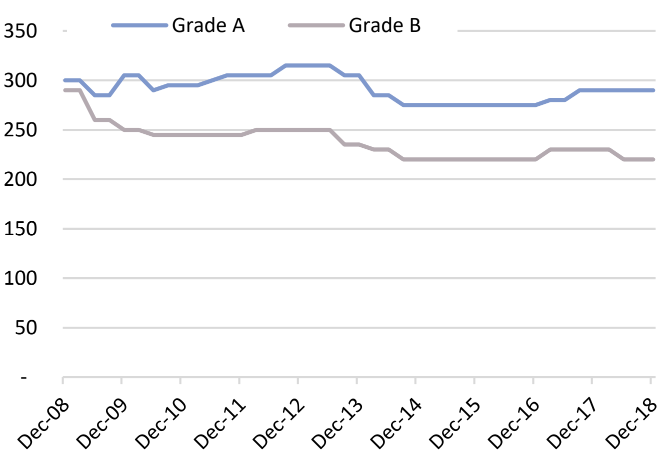
Rents

Rents in Canberra traditionally exhibit lower volatility compared to other Australian CBD's. This can be traced to the typically long-term lease structures of the most dominant lessee, the Commonwealth Government, with terms ranging from 10 to 15 years and fixed annual rental increases.

Net face rents in the Canberra Civic precinct range from $340 to $400 per square metre per annum for A Grade and from $300 to $335 per square metre per annum for B Grade, as of December 2018. Net incentive levels have now eased from the highs seen in 2016 and 2017 with average A Grade net incentives in being recorded at 18% in December 2018 within the Canberra Civic. This has caused effective rents to steady across prime grade assets over the last two years with average A grade rents recorded at $290 per square metre in December 2018.

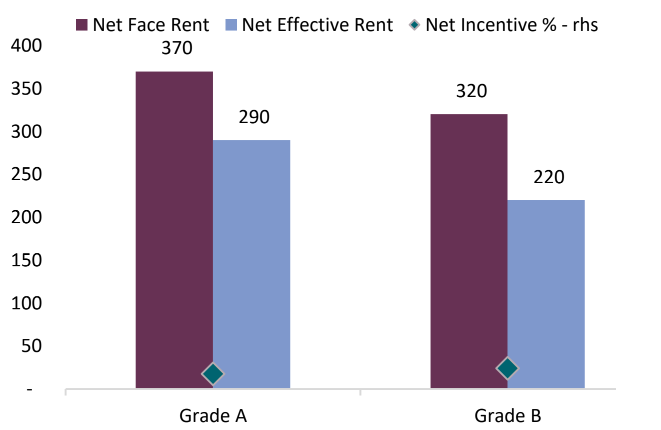
Savills Research anticipates effective rents in both A grade and B grade office accommodation to rise over the next 12 months as conditions remain tight due to scarce supply and strong demand.

Net Effective Rents by Grade ($/sq m)



Source: Savills Research

Net Face & Net Effective Rents as at Dec-18 ($/sq m)



Source: Savills Research

Development

The table below details the major upcomingand planned development projects in the Canberra office Market.

Building Address	Dev Stage	NLA	Exp. Comp	Precinct	Tenant
72 Northbourne Av	UC	16,000	2020		
Cnr of Constitution and London Circuit	UC	24,000	2020	Civic	ACT Government
Cnr Constitution and London Circuit	UC	12,000	2020	Civic	Minter Ellison, KPMG, Dixon Advisory, Kingwood Mallesons
90 Denison Street	DA	8,000	2020	Deakin	
Stage 1, 13-15 Challis St	UC	13,200	2020	Dickson	Access Canberra
Crn Cooyong St & Narellan St, City (Sec 96)	Mooted	37,000	2021	Civic	
2 Darling Street	EP	12,000	2021	Barton	
London Cct, cnr Ediburgh Av (Section 100)	EP	40,000	2022	Civic	
70 Northbourne Avenue	Mooted	11,700	2023	Civic	

Source: Savills Research; UC = Under Construction, DA = Development Approved, EP = Early Planning

Outlook

The prospect of a more active Commonwealth Government sector has lifted sentiment in Canberra. Nascent signs of recovery are already emerging, as indicated by the declining vacancy rate and modest effective rental. This follows a two year period of flat rental growth as market activity waned due to savings measures implemented by the Commonwealth Government, which took a toll on market activity and sentiment.

Savills Research anticipate the gradual tightening in vacancy to continue until a surge in new supply in 2020 / 2021 helps to alleviate pressure, particularly in the prime market. Modest growth in effective rents is a likely consequence, although confined to Civic and Barton, where acute vacancy rates (1.7% and 0.0% respectively) and strong demand maintain downward pressure on incentives.

The steady risk-adjusted returns available in Canberra are expected to continue to attract both local and offshore investors, particularly pension funds. Looking further up the risk / return curve, we expect value-add strategies will remain popular with private investors.

An interesting test for the market will be the success of pre-leasing campaigns for new stock in Civic, which are currently asking circa $550 per square metre gross per annum. This represents a premium of approximately 10% relative to existing prime stock in that precinct.

Canberra Key Indicators (as at December 2018)

	Civic				Non-Civic			
	A Grade		B Grade		A Grade		B Grade	
	Low	High	Low	High	Low	High	Low	High
Rental - Gross Face ($/sq m)	440	500	400	435	400	500	365	400
Rental - Net Face ($/sq m)	340	400	300	335	306	405	270	305
Incentive Level Net	10	25	18	30	15	25	18	30
Rental - Net Effective ($/sq m)	265	315	205	230	225	305	180	210
Outgoings - Operating ($/sq m)	55	70	60	70	55	70	60	70
Outgoings - Statutory ($/sq m)	30	40	30	40	25	37	25	37
Outgoings - Total ($/sq m)	85	110	90	110	80	107	85	107
Typical Lease Term	5	15	3	10	5	15	3	10
Yield - Market (% Net Face Rental)	5.50	7.00	7.00	10.00	5.50	8.25	7.75	11.00
IRR (%)	7.25	8.50	8.75	10.75	7.50	9.00	9.00	11.75
Cars Permanent Reserved ($/pcm)	320	385	320	385	175	240	175	240
Office Capital Values ($/sq m)	6,000	8,500	4,000	6,000	4,775	7,725	3,100	5,000

Source: Savills Research NB: All rents equivalent to whole floor mid-rise

Key State Contacts

Valuations
Phil Harding
+61 (0) 2 6221 8293
pharding@savills.com.au

Asset Management
LeeAnne Hobbs
+61 (0) 2 6221 8200
lhobbs@savills.com.au

Commercial Sales
Nic Purdue
+61 (0) 2 6221 8204
npurdue@savills.com.au

Office Leasing
Pip Doogan
+61 (0) 2 6221 8291
pdoogan@savills.com.au

Capital Transactions
Andrew Stewart
+61 (0) 2 6221 8295
astewart@savills.com.au

Project Management
Gavin Boswarva
+61 (0) 2 8215 8935
gboswarva@savills.com.au

The Savills Research & Consultancy team has years of experience, and is supported by our extensive agency, property management and valuation professionals. For national-level consultancy or subscription requirements please contact:

Capital Strategy & Research
Shrabastee Mallik
+61 (0) 2 8215 8880
smallik@savills.com.au

Savills is a leading global property service provider listed on the London Stock Exchange. Trusted since 1855, we have extensive experience across the Asia Pacific, with over 50 offices, and in Australia, we have over 800 staff focused on meeting all your property needs.

savills