Savills Research

Briefing
Canberra Office

April 2018

Highlights

- The total vacancy rate in Canberra rose to 13.1% in December 2017, up marginally from 12.6% a year earlier, following a sharp increase in secondary vacancy rates over the second half of 2017, as a result of tenants moving to Prime grade buildings;
- An upturn in leasing activity is evident, with total leasing activity recorded at 18,047 square metres, compared to 8,000 square metres a year ago;
- Whilst Prime grade vacancy in the Barton precinct fell to 0%, secondary vacancy rates was at a record high of 25.4%;
- Development planning activity has increased with a surge in supply expected in 2019/20.

A Grade Averages	Latest	Yr Change	Outlook
Rental – N.F. ($/sq m)	370	+2.8%	↔
Net Incentives	17.5	-575bps	↘
Rental – N.E ($/sq m)	290	+5.5%	↗
Yield – Market (%)	6.40	-35bps	↘
IRR (%)	8.15	+05bps	↘
Capital Values ($/sq m)	6,800	+19.3%	↗

Demand & Supply	Latest	PCP*
Vacancy (%)	13.1	12.6
Net Absorb. ('000 sq m)	19.6	8.1
Stock U/C ('000 sq m)	15.0	-
- % of market	0.64	-
- % committed	-	-

*PCP = Previous Corresponding Period

Report Contents

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Executive Summary

The Canberra office market consists of just over 2.38 million square metres of net lettable space, split into 26 sub-localities. The largest locality is Civic with 659,034 square metres. By grade quality, A Grade buildings account for the largest proportion of stock in Canberra, representing 46.1% 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.

Traditionally, the Canberra office market is characterised by high net additions, with a 15 year average of 58,990 square metres; however, more recently, we have seen a moderation in new supply with a continuation of this trend expected until 2019. This has been largely as a result of persistent budget deficits prompting the Federal government to implement cost cutting measures since 2014, which has made developers more risk averse as they are reluctant to start construction on any new buildings till pre-commitments are met. With the Government and Community sector the most dominant tenant type in the Canberra office market (making up over 75% of total tenants as at December 2017), easing of the government's purse strings has had a direct influence on the level of new supply with Commonwealth tenants the most likely to pre-commit to new prime stock.

This has had an effect of falling vacancy rates, particularly in A Grade stock. Most notably, the vacancy rate in the Barton precinct was recorded at 0.0% in December 2017. The lack of available space in the Barton precinct will consequently help to drive secondary vacancy rates downwards over the medium term as tenants opt for high quality B grade as an alternative.

PCA Summary Table – Canberra (as at Dec-17)

	Prime	Secondary	Total	AUS CBD
Total Stock ('000)	1,118.8	1,258.4	2,377.1	**17,936.8**
Total Vacancy ('000)	95.1	215.1	310.2	**1,763.3**
Vacancy (%)	8.5 (11.4)	17.1 (12.2)	13.1 (11.8)	**9.8 (8.9)**
Net Absorption ('000)	51.6 (41.0)	-32.1 (-20.6)	19.6 (20.4)	**142.3 (171.8)**
Net Absorption (%)*	5.3 (5.2)	-3.0 (-1.8)	1.0 (1.0)	**0.9 (1.1)**
Net Additions ('000)	41.3 (48.7)	-6.3 (-1.4)	35.0 (47.3)	**-49.4 (303.2)**
- Stock Additions ('000)	41.3	21.0	62.3	**254.4**
- Stock Withdrawals ('000)	0.0	15.0	27.3	**307.9**
Net Additions (%)**	3.8 (5.9)	-0.5 (-0.1)	1.5 (2.2)	**-0.3 (1.9)**

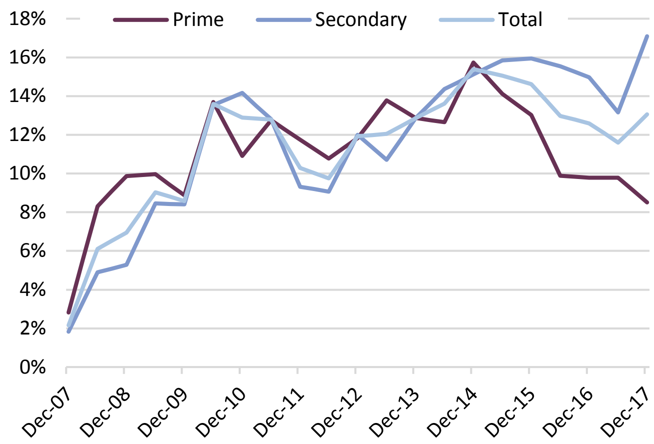
Source: Savills Research (10yr Averages shown in brackets; NB: Secondary Rents shown are for B grade; All rents equivalent to whole floor mid-rise
***As a percentage of occupied stock; **As a percentage of total stock**

Vacancy

The total vacancy rate in Canberra rose to 13.1% in December 2017, up marginally from 12.6% a year earlier, following a sharp increase in secondary vacancy rates over the second half of 2017, as a result of tenants moving to Prime grade buildings. This has been due to a combination of increased sub-lease space (with Government tenants consolidating space) and 15,100 square metres of stock additions in 2017. There is a clear disconnect between demand for space in Prime and Secondary grade buildings in Canberra. In particular, whilst Prime grade vacancy in the Barton precinct fell to 0%, secondary vacancy rates was at a record high of 25.4%.

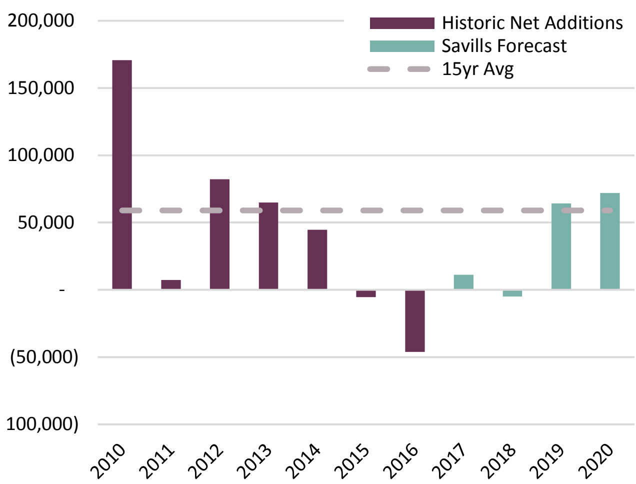
In light of negative net supply over 2018, Savills Research anticipates a gradual tightening in vacancy to continue until a surge of new supply hits the market in 2019/20 helping to alleviate pressure, particularly in the prime market.

Historic Vacancy (Canberra)



Source: Savills Research

Net Supply by Year



Source: Savills Research

Supply

Historically, the Canberra office market has been characterised as having one of the strongest supply pipelines nationally. Over 2015/16, developers have been largely reluctant to build speculatively, following weaker economic conditions and moderating leasing demand driven by cost cutting measures initiated by Commonwealth tenants. Following 2 years of negative net supply, 2017 saw new additions amounting to 51,364 square metres. Improving market conditions and a strengthening economy are providing the impetus for an increase in developments.

Savills Research recorded commencement of two new speculative developments in the CBD, with the developments to add approximately 35,000 square metres of new accommodation in the 2019/20 period. A further 20,000 square metres of space in the CBD and 15,000 square metres in Dickson have been pre-committed by the ACT Government is due to be completed over the same period. Anecdotal evidence from current leasing campaigns on these developments suggest a significant upward revision of rents.

Leasing Activity & Demand

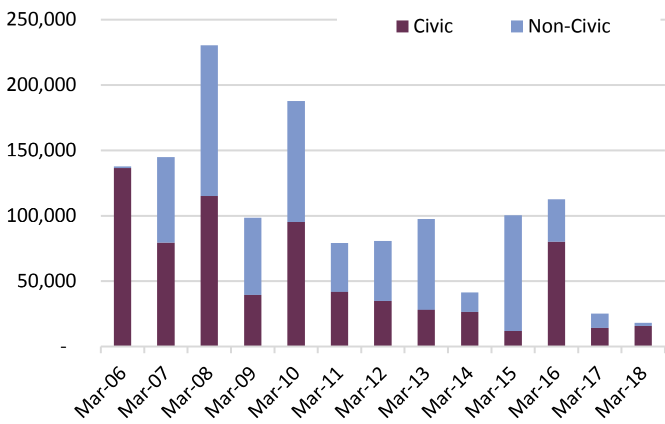
In the 12 months to March 2018 Savills Research identified 18,047 square metres of leasing activity (>1,000 square metres). This is down 28% on the 12 months prior and down on the 10 year average (84,120 square metres). Cost cutting measures initiated by the current government has led to significant reductions in the size of the Commonwealth Public Service.

Of the total space leased in 2017, tenants from the Government & Community sector were the most dominant, leasing 79.5% of total stock. Notably, there has been a trend of increasing demand for space in the sub-1,000 square metre market by the private sector, in response to new outsourcing opportunities created by the reduction in the size of the Public Service.

Net absorption for the 12 month period to December 2017 was recorded at 19,579 square metres. It is important to note that net absorption in the last six months of 2017 was recorded at 148 square metres, providing evidence that the market may have stalled in late 2017.

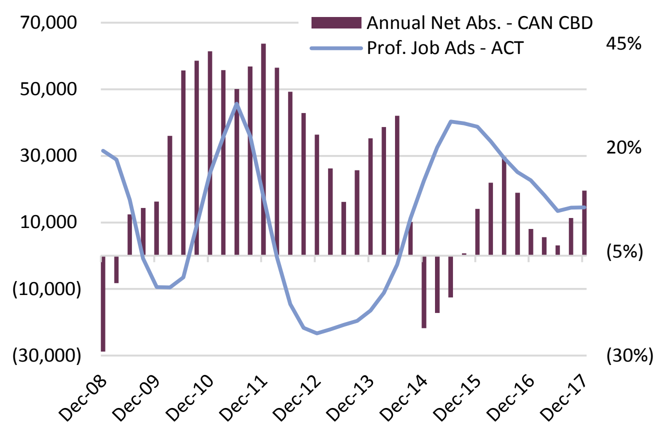
An upturn in professional job advertisements in the latter half of 2017, showed growth of 5.7% over the year to December 2017. With professional job advertisements shown to be a lead indicator for future net absorption, it appears likely that net absorption of 2018 will be strong. This is supported by the latest Federal Budget, which outlined no more forecast cuts to public sector jobs over the next 12 months.

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	Type | Rent | Term
Commonwealth Super	7 London Cct, City	Jun-17 | 6,915	Direct | 470 (G) | 6
NHMRC	16 Marcus Clarke Street, City	Dec-17 | 4,020	Direct | 480 (N) | 11
Lockheed Martin	8 Brisbane Av, Barton	Jun-17 | 2,257	Direct | 385 (G) | 6
ANU	7-11 Barry Dr, Turner	Jun-17 | 1,805	Direct | 380 (G) | 3
Mills Oakley Lawyers	121 Marcus Clarke St, City	Sep-17 | 1,050	Direct | 385 (N) | 10
National Aboriginal Community Controlled Health Organisation	2 Constitution Av, City	Sep-17 | 1,000	Direct | 450 (G) | 3
National Aboriginal Community Controlled Health Organisation (NACCHO)	2 Constitution Av, City	Aug-17 | 1,000	Direct | 450 (N) | 3

Source: Savills Research

Sales

In the 12 months to March 2018, Savills Research identified approximately $111.1 million worth of office transactions (greater than $5 million) in the Canberra office market.

Following last 2017 record year in sales ($646 million), were activity was well beyond the ten year average of $416 million and can be traced to a single transaction; the sale of 50 Marcus Clarke Street, City. The asset was sold for $321 million to South Korean asset management firm, Mirae Asset Global Investments at an equated yield of 5.75% by Malaysian vendor CIMB Trust & Malaysian Employees Provident Fund. It is important to note that traditionally, these larger assets are tightly held with only four traded in the past five years.

Another noteworthy transaction was the sale of 44 Sydney, Forrest in November 2017 for $64.70 million on an equivalent yield of 6.24%, purchased by Australian based fund manager Charter Hall.

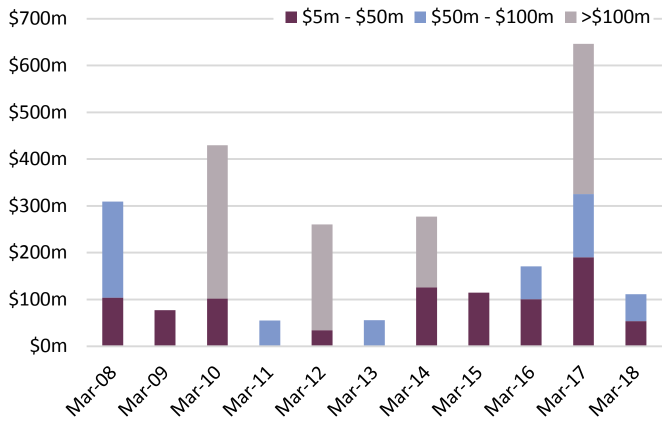
There was a notable increase in local institutional funds and private investors purchasing office assets in Canberra. This increase in interest was primarily driven by the attractiveness of long WALE's to secure government tenants.

Anecdotal evidence is suggestive of increasing demand for new or new-near buildings with long-WALE's, with current owners of such properties reluctant to divest themselves of their properties.

Market yields in Canberra Civic, as at March 2018, are estimated to range between 5.50% and 7.25% for A grade, and between 7.50% and 10.50% for B grade buildings. The average yield for A grade office buildings in the quarter to December 2017 is 6.40%, representing a 35 basis point firming over the year.

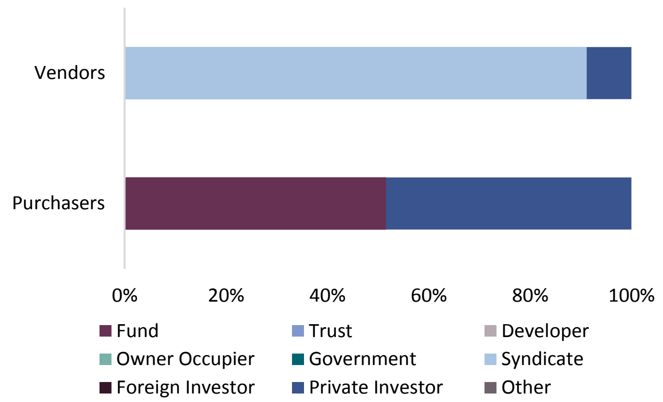
Capital values in the Civic precinct in Canberra, as at December 2017, are estimated to range from $5,265 per square metre to $8,350 per square metre for A grade buildings, and between $3,500 per square metre and $5,400 per square metre for B grade buildings.

Sales Activity by Size (>$5 million)



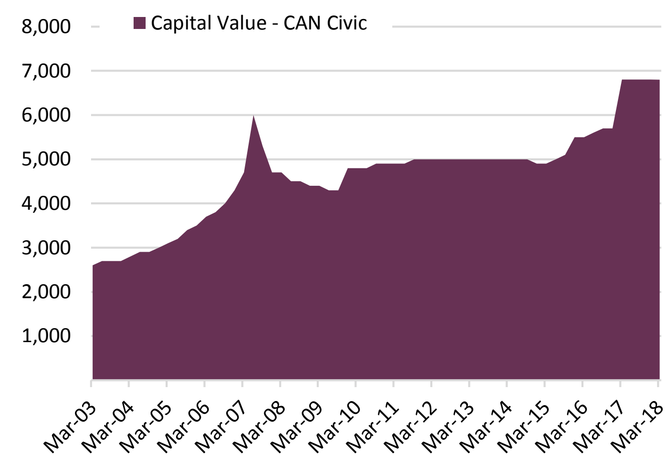
Source: Savills Research

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
44 Sydney Avenue, Forrest	64.70 | Nov-17 | 9,948	6.24 | e | 6,504
82 Northbourne Av, Braddon	57.33 | Jun-17 | 6,979	5.85 | e | 8,214
11 Moore St, Canberra	44.00 | Jul-17 | 8,663	7.20 | e | 5,079
39 Brisbane Avenue, Barton	16.50 | Aug-17 | 4,796	9.15 | e | 3,440

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

Rents

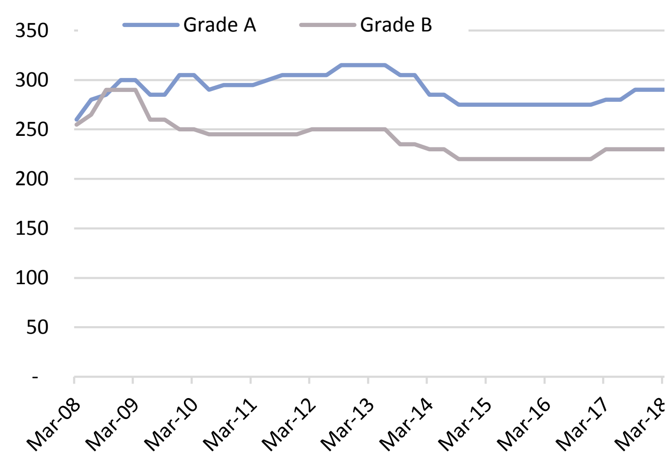
Rents for new and near-new 'A' Grade stock have been maintained at a stable level, with a small level of face rent growth at the top end of the market. The level of incentives on offer for this class of property have stabilised, and are trending down gradually in those areas with low vacancy rates, which should result in a rise in effective rents in this market sector. Rents for lower grade stock are forecast to continue to be under pressure during 2018, with continued pressure on the level of incentives required to secure tenants for this class of property

Net face rents in the Canberra Civic precinct range from $340 to $400 per square metre per annum for A Grade and from $290 to $325 per square metre per annum for B Grade, as at March 2018.

Incentive levels have gradually eased during the year, resulting in modest effective rental growth. A Grade net effective rents now average $290 per square metre, up 5.5% from a year prior, whilst average B Grade net effective rents were recorded at $230 per square metre in March 2018, up 4.6% from a year prior.

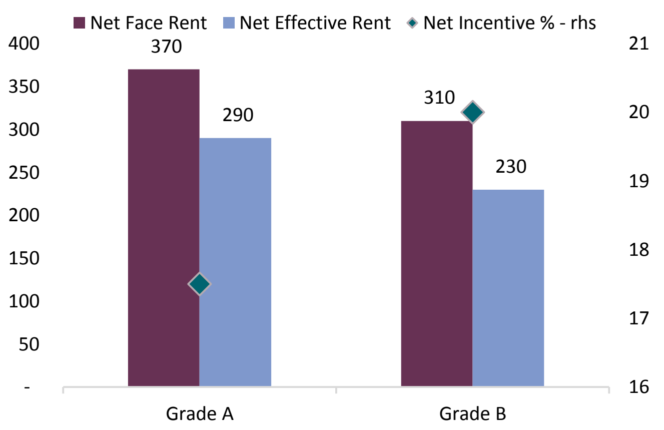
Savills Research anticipates this trend to continue, albeit largely confined to the Civic and Barton precincts. The tight conditions being experienced in these areas is a function of scarce new supply combined with strong demand for both A grade and B grade accommodation. However, new supply expected from 2019 onwards is expected to shift the balance of power back in tenants' favour.

Net Effective Rents by Grade ($/sq m)



Source: Savills Research

Net Face & Net Effective Rents as at Mar-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
44 Thesiger Court	UC	1,235	2018	Deakin	
125 Bunda	DA	41,689	2019	Civic	
Civic Quarter Stg 1, 70 Northbourne Av	DA	15,900	2019	Civic	
Civic Quarter Stg 2, 70 Northbourne Av	DA	11,700	2019	Civic	
London Cct, cnr Ediburgh Av	EP	47,520	2020	Civic	
London Cct, cnr Cooyong St	EP	24,450	2021	Civic	
London Cct, cnr Ediburgh Av	EP	18,870	2021	Civic	
West Block, Queen Victoria Terrace	Mooted	7,677	2022	Barton	
Constitution Place Stg 1	DA	20,000	2020	Civic	ACT Government
Constitution Place Stg 2	DA	9,500	2020	Civic	

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

Outlook

The Canberra office market has over the past few years delivered high levels of stock, against a background of strong net absorption. However, as a result of falling leasing demand from the Commonwealth leading up to, and following from, the election of the Coalition to Government in 2013, the speculative development phase that had been experienced in Canberra ended in 2015-2016.

Most recently however, as a result of falling vacancy rates, signs are emerging of conditions which will support speculative development at the top end of the 'A' Grade market in the two premiere office markets in Canberra (CBD and Barton/ Forrest).

With the current Federal Budget appearing to provide for only limited cuts to the Public Service beyond those provided for in previous budgets, the office leasing market appears to be at, or near, the bottom of the current cycle.

Savills Research anticipate the gradual tightening in vacancy to continue until a surge in new supply in 2019 / 2020 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 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.

Canberra Key Indicators (as at Mar 2018)

	Civic				Non-Civic			
	A Grade		B Grade		A Grade		B Grade	
	Low	High	Low	High	Low	High	Low	High
Rental - Gross Face ($/sq m)	425	485	385	420	410	480	350	390
Rental - Net Face ($/sq m)	340	400	290	325	330	400	260	300
Incentive Level Net	15	20	15	25	15	20	15	25
Rental - Net Effective ($/sq m)	265	315	215	240	260	315	190	220
Outgoings - Operating ($/sq m)	55	60	60	70	55	60	60	70
Outgoings - Statutory ($/sq m)	25	30	25	30	20	25	20	25
Outgoings - Total ($/sq m)	80	90	85	100	75	85	80	95
Typical Lease Term	5	15	3	10	5	15	3	10
Yield - Market (% Net Face Rental)	5.50	7.25	7.50	10.50	5.50	8.50	8.00	11.00
IRR (%)	7.25	9.00	9.25	12.00	7.50	9.50	9.25	12.00
Cars Permanent Reserved ($/pcm)	310	375	310	375	165	230	165	230
Office Capital Values ($/sq m)	5,265	8,350	3,500	5,400	4,775	7,725	3,100	5,000

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

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