



#### MARKET DEFINITION

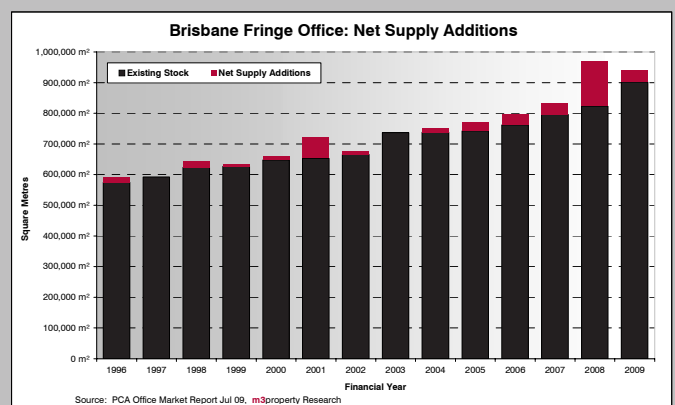
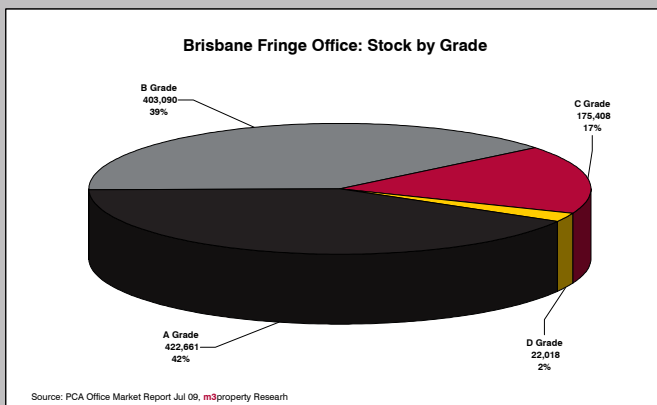
The Brisbane Fringe office market broadly encompasses the suburbs immediately surrounding Brisbane's CBD however, is more explicitly defined as comprising Spring Hill; Milton (incorporating Petrie Terrace); Toowong; the Urban Renewal areas (i.e. New Farm, Teneriffe, Fortitude Valley, Bowen Hills and Newstead); and the Inner South (i.e. West End, South Brisbane, Greenslopes, Wooloongabba, East Brisbane and Kangaroo Point).

The Property Council of Australia (PCA) Office Market Report for July 2009 states that the Brisbane Fringe office market comprises 1,023,177m<sup>2</sup> of floor space. This figure is just over half of total Brisbane CBD floor space and represents the largest discrete non-CBD office market in Australia, comprising around 7% of the total office space monitored by the PCA nation-wide.

#### SUPPLY

Net supply additions (new stock additions less withdrawals) have been strongest in recent years. Totalling 422,000m<sup>2</sup> since 1996, this represents a 65% increase from the opening stock level (see chart lower right). Last financial year, supply additions were a record 146,537m<sup>2</sup>, the result of substantial new supply within the Urban Renewal precinct.

Recent completions in the Fringe have been well absorbed with over 90% of total area leased and new supply under construction similarly almost fully pre-committed. Over 100,000m<sup>2</sup> is due for completion by the end of 2010 with the largest project being FKP's Newstead Riverpark Stage 2B at 33 Breakfast Creek Road (28,600m<sup>2</sup>). Over 70% of new construction is within the Urban Renewal precinct.



#### DEMAND

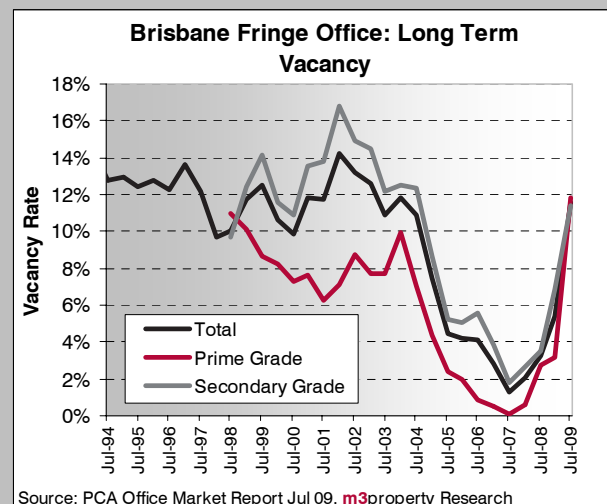
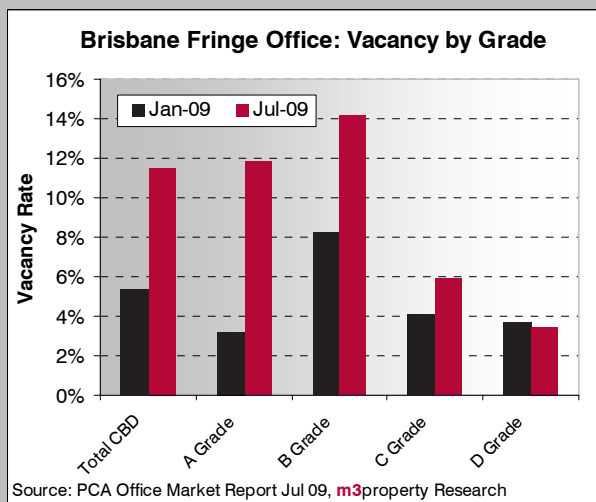
The combination of strong tenant demand and new supply recently completed has underpinned high absorption levels. For the 12 months to January 2009, net absorption was a record +110,432m<sup>2</sup> arising from an extraordinary supply-led office cycle. In contrast, negative net absorption recorded over the six months to July 2009 (-28,900m<sup>2</sup>) resulted in a large fall of the annual 2009 figure (+32,310m<sup>2</sup> as at July 2009) when compared to the previous year. An annual average of +48,812m<sup>2</sup> has been accounted for since 2004.

Tenant demand over the first half of 2008 was strongly positive for a market of this size and led by the booming Queensland economy. Until the most recent July 2009 recording, the Fringe office market had not witnessed negative net absorption since July 2001 which was evidently offset by strong positive net absorption in January 2002. Negative absorption is expected to be recorded in this market over the next 18 months.

Historically, the strong demand levels recorded in the Fringe office market was due to the spill over of tenants moving out of the CBD because of higher rents or lack of space. Recent deals show some tenants have committed to new Fringe developments simply because they could not find adequate space options, such as CMC, SKM and Hatch.

#### VACANCY

Total office vacancy has risen over the six months to July 2009, now at 11.6% after more than doubling from six months prior. This was an increase of 8.3% from July 2008 or a 10.3% increase from July 2007. The charts below depict vacancy rates by grade. The long term chart (below right) shows the fall from the peak in July 2002, particularly in secondary grade stock which currently stands at 11.4% (A Grade not far off at 11.8%).



Vacancy will continue to increase through the course of 2009-10 with a forecast peak above 15% in mid-2010. This is similar to the peak vacancy levels recorded in July 1992 and again in July 2002. Over the medium term, the shelving of several new speculative developments will assist in reducing vacancy across the Fringe market. This is also expected to be aided by the withdrawal of older stock for upgrade and refurbishment.

## Brisbane Fringe Office Update

September 2009

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### RENTS, YIELDS & SALES ACTIVITY

The level of leasing activity has by far been substantially stronger in the pre-committing market when compared to existing stock. Over recent years, prime office rents have risen sharply but have since corrected in the face of the economic slowdown with indicative average prime gross effective rents of \$350/m<sup>2</sup>, whilst secondary grade stock is closer to \$275/m<sup>2</sup>.

In 2009, asking rents have fallen in the order of 15% to 20% and incentives have increased over the past 12 months to range from 20% to 25% across the market. While the level of incentives is expected to stabilise for prime grade assets, incentives are likely to continue to increase in the lesser grades to attract tenants.

Investment yields have softened by a further 50 basis points during the first half of 2009 to range between 8.25% and 8.75% for prime grade stock.

Over the past five years, strong investor demand in response to rising rents had placed downward pressure on yields. Whilst there has been little market based evidence to fully substantiate the trend, yields have softened as institutional investors and funds look to reduce their portfolios and deleverage.

Like most national office markets, investment sales within the Fringe have been scarce over the past six months above the \$5 million threshold. A notable transaction was the Energex building at 33 Breakfast Creek Road, Newstead, sold to Cromwell Riverpark Trust. The trust will acquire the site on which developer FKP is constructing a 30,904m<sup>2</sup> A Grade commercial and retail building. Construction is expected to be completed in mid 2010.

### OUTLOOK

The performance of the Fringe office market has been underpinned in recent years by historically low vacancy rates within the Brisbane CBD requiring tenants to seek accommodation in alternative locations due to significant rental increases and a lack of contiguous space available for lease.

Brisbane's Fringe office market faces many challenges over the next two years. Approximately half of all incoming supply is pre-committed and this shall place further pressure on vacancy. m3property Research forecasts rates to continue towards the 15% mark by the middle of 2010.

The past six months have clearly seen a slow down of the Fringe market's dominance in terms of tenant demand for prime grade office space. While there are still commercial development opportunities remaining, the pipeline of office space is contracting, nearing the end of the construction cycle. Future Fringe development will take form in other higher and better-use asset classes, such as residential, until the market has absorbed the supply overhang.

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