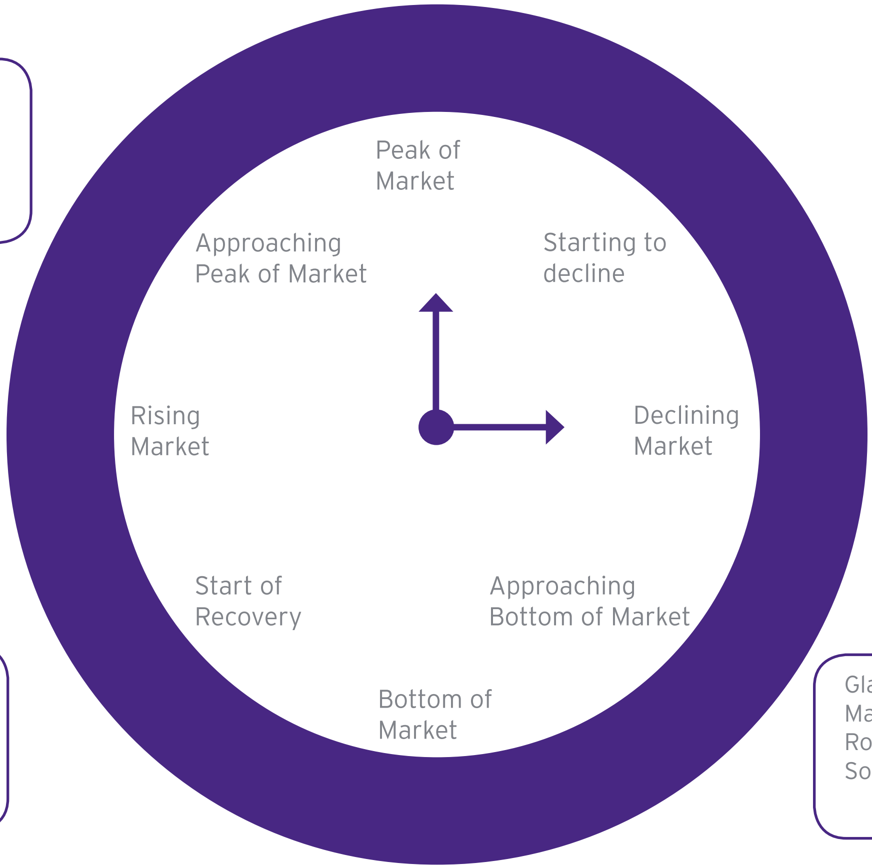
Commercial

HERRON TODD WHITE COMMERCIAL

National Property Clock
May 2018
Office Space

Gold Coast
Melbourne

Coffs Harbour
Far North Coast
Newcastle
South East NSW



Ballarat
Cairns
Canberra
Echuca
Sunshine Coast
Sydney
Mid North Coast

Alice Springs
Emerald

Central Coast
Toowoomba

Gladstone
Mackay
Rockhampton
South West WA

Adelaide
Brisbane
Darwin
Hobart
Launceston
Mildura
Perth
Townsville
Wide Bay

Entries coloured purple indicate positional change from last month.

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HERRON TODD WHITE COMMERCIAL

New South Wales

Overview

There's been some exciting movement in the world of office real estate as big fund investors look to take advantage of opportunities where yields are healthy and long-term growth seems certain.

When looking for a gauge on market health it's useful to discuss new developments in locations throughout the nation. Whether it's fresh construction or refurbishment of older space, new square metres highlight where demand is being driven.

This month, our team give you a rundown of new office space projects around Australia.

Sydney

The cons office market in Sydney has been through substantial growth over the last 12 months as a result of increased demand for good investment assets, growth in rental income, stock reduction and generally lower vacancy rates.

There has been significant office stock removed either temporarily or permanently from the market. The main reasons for this are the Sydney Metro, residential conversions and redevelopment. Office stock withdrawals are set to outweigh new supply over the next 24 months.

Whilst the Sydney Central Business District is considered the prime location and is often the most reported on, we have seen an uplift in prices, an increase in rentals and a tightening of yields over the past 18 months in the North Western office markets, such as Chatswood, Macquarie Park and Norwest as well as other key office locations such as North Sydney and Parramatta. We expect these areas to remain buoyant into 2018 as demand remains strong for good quality office space.

New development is currently centred around Parramatta, Norwest and Macquarie Park with improvements in infrastructure and continued growth and demand driving the market. These areas have substantial new office developments underway or in the planning stages. The result of which is that new stock will be added to the market from next year onwards.

Opportunities in emerging office markets also exist in other areas of Sydney. For example, the commercial centre of Liverpool is considered to benefit from the continued residential development in the southwest, proposed construction of the Badgerys Creek Airport and the extension of the Sydney Metro. Areas that remain in demand and popular with owner occupiers and tenants are the inner city and city fringe areas such as Surry Hills, Alexandria, Woolloomooloo and Pyrmont.

Creative office suites are prevalent within these areas and have been driven by the demand for smaller assets catering to "start-up" companies or established creative and professional businesses. We are also seeing increased demand for serviced office space and the rise of co-working arrangements across several areas of Sydney.

The outlook for Sydney's office market looks positive for 2018 as demand continues to drive the market for both traditional type offices and more non-traditional options as more and more occupiers look for flexible working solutions.

Lismore

The office market within the North Coast region remains relatively stable with limited office developments being undertaken in recent times.

The most notable office development within Lismore has been the recently completed office complex located at 214 Molesworth Street.

214 Molesworth Street

This development has resulted in an additional 3,500 square metres of high quality office space that has not been available to potential tenants in more recent times. We understand a large portion of the building is leased and it has achieved very strong gross rents in the vicinity of $400 per square metre.

Address	Commence Date	Term (Years)	Options (Years)	Area (m2)	Gross Rental (P.A)	Rate ($/m2)
Molesworth St	01/03/2018	4	4	308	$107,555	$349
Molesworth St	01/02/2018	N/A	N/A	189	$69,930	$328
Molesworth St	01/07/2017	3	3	221	$27,400	$124
Molesworth St	01/03/2017	3	3+3	590	$180,000	$305
Molesworth St	01/06/2017	1		134	$29,741	$222
Molesworth St	01/07/2015	2		156	$25,527	$164
Molesworth St	01/02/2018	10	2	343	$132,055	$316

The more established office market in Lismore has been affected by the recent oversupply of space. However, rents within the main commercial precinct have remained relatively stable with steady to modest increases in rental levels (generally in line with CPI) since 2015. A cross section of recent office rental evidence within the main Lismore office precinct of Molesworth Street is as follows:

In order to meet the changing requirements of some tenants, there has been an increase in shared offices with owners leasing out individual offices with shared amenities and reception. These properties are achieving higher rents than if offered to the market as a whole and in doing so, are adapting to the needs of tenants.

For landlords to secure a new tenant there remains evidence of lease incentives being applied in Lismore. This has been in the form of lease-up allowances or contribution to fit-out.

There is a restricted market for office space in the strongly performing residential coastal precinct of Ocean Shores, which is located to the north of Byron Bay. Rates being achieved for smaller sized office space currently range from $375 to $450 per square metre gross. Historically, office rents in this precinct have been relatively stable with extended lease-up periods which can exceed six months, however leasing for available office space is currently considered good.

In regard to larger office space, the market in the coastal township of Ballina relatively stable with modest demand and modest levels of supply resulting in stable rents. However as with Lismore, lease incentives are still required to attract new tenants.

The broader commercial office market within Ballina has been relatively stable. While retail leases have experienced some variation from year to year, the commercial office market has experienced modest levels of supply and stable levels of demand with tenants tending to retain tenancies for extended periods with modest increases in line with CPI.

Large, high quality office space in the North Coast coastal region is best suited to government tenants looking for a large space of an above average quality with good security features. New developments are typically done on demand and projects are traditionally only undertaken once tenants have been secured. New projects are more commonly driven by government or semi-government entities. Local businesses tend to move within existing spaces with significantly more modest refurbishment programs.

As to yields, commercial yields tend to be slightly higher than traditional retail rates unless the properties have national tenants with strong lease covenants which will result in similar yields to retail properties, albeit 1% to 2% lower than local tenanted properties.

Coffs Harbour

The office market in Coffs Harbour features a slight but reducing oversupply, limited enquiry for leasing at stable rental levels and incentives for new leases.

There are a number of office project developments that have commenced after pre-leasing agreements. These projects range from smaller strata title office projects to larger developments. The eastern precinct of the CBD remains prime with rental levels at $330 to $400 per square metre. We understand there is a strong pre-lease to a major tenant for the office component of the new Gowings development.

Secondary or dated offices remain difficult to let. The impacts of reduced government spending, limited availability of grants and the retraction policies are clearly evident in the Coffs Harbour regional office market. Rental levels remain sensitive at from $200 per square metre for lower quality to $280 per square metre for average secondary located space.

There is a lack of sales and leasing transactions within the office sphere of the market. Generally yields within Coffs Harbour remain firm based on the prevailing low interest rate climate. Leasing activity is restricted with serious owners having to offer lease up incentives or rent free periods to attract quality tenants.

Newcastle

This month, we are discussing major office projects in our area. Firstly, let's look at The Gateway 2 development which will be the new home of Newcastle Council on completion in 2019.

According to the Newcastle Herald, in October 2017 Lord Mayor Nuatali Nelmes announced the 2019 move aligned with the strategic relocation of Newcastle's city centre under its urban renewal strategy and Council's plans for Wickham and the West End.

"As well as providing ratepayers a more attractive place to come and deal with Council, this move is about consolidating our administrative staff in a single building to increase productivity and provide even better services," Councillor Nelmes said.

"Our new base will utilise the best modern design to enable staff to meet the growing demands of a rapidly developing city while offering easier access for people with mobility challenges and a more inviting foyer.

The new building also sits inside the city's future digital precinct, where our staff and other businesses will have high-speed internet connections under Council's Smart City Plan."

Council has entered into an agreement for a 15 year lease on 5,550 square metres of office space at the 12 Stewart Avenue site known as Gateway 2, for its location at the CBD's entry point. Currently under construction, the Core Project Group development is situated on the corner of the prominent intersection of Hunter Street and Stewart Avenue in Newcastle West.

The dual frontage site incorporates a contemporary commercial twin tower building connected through a glass linkage, with an adjoining multi-deck car park at the rear. According to the developer, "Following on from the successful Stage 1 project, the design and construction of Stage 2 consists of 150 carparks and in excess of 9,000 square metres (total) of Grade-A office accommodation. CPG have managed the development on this landmark site in consultation with award winning international architect PTW."

According to the latest Property Council of Australia Office Market Report, Gateway 2 is the only larger office development under construction in Newcastle. There are two mooted projects which are DA approved, being the Civic West Car Park development at 291 King Street, approved for a 9,600 square metre office building, which remains in the development pipeline and unlikely to be added until pre-commitment is secured. Honeysuckle Central is still listed as a potential addition of 22,000 square metres of office space in the market, however this land has been sold to Newcastle University and this development will be replaced and expanded by the Newcastle University Hub. Council has now voted to re-zone a section on the disused rail line to enable this development to move forward.

Illawarra

The Illawarra commercial property market has shown clear signs of improvement over the past three years with an increase in sales volumes, demonstrating improved confidence after a prolonged period of static conditions post the GFC. Investment transactions have increased as investors are enticed to the market by yield arbitrage not typically found in Sydney and other major capital cities. For investment grade assets at higher price points yields tend to hover in the 8% to 8.5% range while sitting in the 6% to 8% range for lower valued assets that have a broader pool of buyers.

Record prices were achieved in 2017 in the Wollongong CBD office market. In addition to local buyers, the region is attracting investors (private and second tier funds) from Sydney, interstate and overseas. Low interest rates and the increased buyer depth have resulted in strong yield compression despite rents largely remaining stagnant over this period. Low interest rates are a significant driver of the property market.

Commercial leasing conditions in the Illawarra region have improved with local agents reporting increased enquiry levels and reduced vacancy periods for well-placed tenancies in good quality buildings and with good off street parking availability. However, incentives remain common with discounts between 10% and 20% of gross annual rent typically required to attract a new tenant.

This incentive is usually in the form of a rent free period. While we expect rents for B and C grade space to remain flat, upward pressure is expected on rents for A grade space due to the low vacancy rate and an increase in appetite from certain businesses to pay the required A grade premium.

Construction will commence on Wollongong's first new office building since 2013 when the purpose built ATO building was completed. This is a large A grade office building that will house IMB's head office. Other large scale office projects are proposed in the Wollongong CBD including Langs Corner and 25-27 Denison Street although it is our understanding that approvals and leasing pre-commitments are still being sought for both proposals. If completed it is likely that the rents achieved will set a new benchmark in the local market.

Dubbo

The location of Dubbo office accommodation has diversified significantly in recent years with the development of a number of business park precincts, exemplified by the Blueridge Business Park in East Dubbo and Riverview Business Park in North Dubbo. Both offer single ground level office unit accommodation and have drawn a divergent range of office users to these areas.

These business park developments offer the particular advantage of onsite parking and purpose built amenity. Older CBD office space, particularly those without lift services in multi floor buildings, struggle to attract leasing enquiry. This can be compounded where car parking is limited. As a consequence, office users who don't rely on physical client contact have gravitated to periphery CBD locations or the aforementioned business park developments.

On the other hand, government and allied agencies that require face to face dealings with the public need to be located within easy access to public transport and other support services.

This necessity has confined these agencies to within the Dubbo CBD and they are the major source of leasing demand for larger, modern, publicly accessible and NABERS compliant office space.

Recent Dubbo sales evidence is:

- 165 Brisbane Street, Dubbo. New 2 level, CBD building with ten year and seven year lease terms to a credit union and a health practitioner. Sold September 2017 for $3.695 million on an analysed yield of 6.37% or $4,060 per square metre.
- 23-29 Hawthorn Street, Dubbo (poor IN2 industrial zoning), expected to be very difficult to lease on termination. Currently leased to Western NSW Local Health District (NSW Government) until June 2021, 1 x five year option. Sold February 2017 for $6.6 million on an analysed yield of 10.12% or $2,213 per square metre.
- 5/12 Blueridge Drive, Blueridge Business Park, Dubbo. B7 zoning. New strata unit in six unit office complex - vacant possession. Sold February 2018 for $340,000 plus GST on an analysed yield of 7.25% or $2,208 per square metre.

Lease evidence:

- Wingewarra Street - 589 sqm ground floor office, 5 + 2 + 2 yr term $287/sqm gross pa to semi gov entity.
- Brisbane St - 649sqm ground & 1st-floor office, 10+5+5 yr term, $316/sqm gross to a credit union
- Riverview Business park - 217sqm ground floor office, 5 yr term, $290sqm gross.
- Blueridge Business Park - 140sqm ground floor office, 3 yr term, $200/sqm gross pa to semi gov't agency.

Albury

New commercial property in Albury is sparse. In a period when economic consolidation is a leading business attribute, the office market in general has softened.

The result of firms being more aware of the cost of space is that some of the older and larger office areas are not being taken up as swiftly as newer, smaller office space. Incentives to keep existing tenants are being seen and will often match those on offer to attract new tenants. The cost of moving is also an important factor.

Victoria

Melbourne

According to the Property Council of Australia's Office Market Report, Melbourne CBD's overall office vacancy rate has reduced to 4.6% over the six months to January 2018. Melbourne CBD is now level with Sydney CBD, together showing the lowest vacancy rates amongst all of Australia's CBDs. The reduction in the vacancy is mainly due to the high net absorption rate of prime Melbourne CBD office stock. The North-Eastern and Docklands precincts have the lowest vacancy rates at 1.5% and 1.2% respectively, while vacancy rates are highest in the Western and Spencer precincts, reflecting vacancy rates of 6.6% and 8.2% respectively. There is limited new prime office supply in the CBD due for completion over the next two years before the large deluge of supply forecast for 2020. Therefore, it is anticipated that vacancy rates will continue to fall over 2018 and 2019 before rising again in 2020. Correspondingly, we expect to see potentially sharp rental growth over the next two years as well as a decline in incentives, before levelling out again from 2020.

On the buy side, strong demand is continuing for good quality office properties and properties with value-add or redevelopment potential within the Melbourne CBD, Metro and St Kilda Road office markets. This is primarily due to the lack of suitable stock on the market and sheer weight of capital seeking limited investment opportunities in this segment of the market. The two recent sales in the CBD this year, 470 Bourke Street and 454 Collins Street, both achieved strong results. 470 Bourke Street, the headquarters of The Law Institute of Victoria, sold subject to a short-term leaseback for more than $35 million.

The nine-storey office building with excess land to the rear was purchased by an offshore investor with a capital value rate of circa $10,500 per square metre which reflects the balance land of 368 square metres. 454 Collins Street, an 11-storey C grade building situated at the corner of Collins and Williams Streets, was sold to a Macau investor for $40.1 million on a sharp fully leased yield of 4.21%. The property was sold subject to a single-tenant leaseback to Robert Christie's national co-working business on a ten year term.

454 Collins Street Image (source: Metaxas Architects)

The property was sold subject to a single-tenant leaseback to Robert Christie's national co-working business on a 10-year term. Recent sales activity suggests that market yields are firming for well-located investment grade assets exhibiting sound fundamentals, such as strong lease profiles and limited capital expenditure requirements. Investor demand is particularly strong for assets in the vicinity of $5 million to $50 million within the CBD and inner suburban locations.

The new statutory revaluations will be conducted as at January 2018 and valuations will be released as part of the FY2018/19 council rates notices and 2019 Land Tax assessments. It is anticipated that council site values will continue to increase across the CBD owing to strong capital growth over the past two years since the last Council revaluation in January 2016. The potential rise in site values implies higher council rates and land tax costs which may impact upon the cash flow of landlords, especially where properties are subject to gross leases.

Co-working office space is one of the fastest-growing segments of the commercial leasing market. Research reports show the number of co-working spaces in Australia grew by 297% between 2013 and 2017, occupying 193,190 square metres across six cities. Melbourne has the largest concentration of co-working spaces with 49% followed by Sydney with 38%. We expect this segment of the market to continue growing strongly.

Gippsland

New office construction has slowed considerably throughout the Wellington and Latrobe Shires. Late 2016 and early 2017 saw completion of two new office and car park facilities, however the generally subdued state of the market has meant that developers are stepping back and waiting for an improvement in conditions. Rental yields for new or modern office space generally range between 6.5% and 7.5%, however this is heavily dependent on the quality of the tenant and the overall lease covenants.

South Australia

Adelaide

This month, let's do our usual overview of the office sector but add in the angle of growth zones. Where within your service area are new office construction or major refurbishment projects occurring? Perhaps it would be better to discuss particular projects in your case? What sort of new office space is being developed, and how is it adapting to the needs of tenants? Is there a rise in the appeal of one type of office space over another? Why? What are the rent levels and yields like with new office space?

There has been a limited amount of new office construction within the Adelaide CBD. Due for completion in Q3 2019 is the GPO Tower, situated at 2-10 Franklin Street and 145-149 King William Street. Planning consent has been granted for two office towers of approximately 24,500 square metres and 12,500 square metres plus refurbishment of the heritage GPO building, whilst also accommodating for approximately 3,000 square metres of retail space. The State Government has committed $80 million to the extension of the AdeLINK tram network to the City's East End. This project will deliver a 1-kilometre extension of the tram line along North Terrace, from King William Street to East Terrace. In response to this extension, Commercial & General and Le Cordon Bleu have proposed a joint venture for the redevelopment of 200 North Terrace. The $260 million redevelopment would add a further 26,000 square metres of office space and 4,000 square metres of retail space. Once approved the project would expect to be completed by 2020.

Expected to be completed by 2019 is the Festival Plaza, a $1 Billion project by the Walker Corporation, which will provide 40,000 square metres of premium office space, a two storey precinct featuring restaurants, cafes, luxury retail outlets and a new car park to accommodate 1,500 spaces.

Notable refurbishment projects include 74 Pirie Street, a 7 storey office building, with a restaurant to the ground floor, which was purchased by the Maras Group in 2014 for redevelopment. The Maras Group reports the building will be completely remodelled and upgraded to provide leading edge and innovative commercial office accommodation with whole floor plates of approximately 250 square metres.

The Property Council of Australia has recorded Net Absorption of 14,320 square metres and reduction in premium grade vacancy rates, as shown in the tables below. The limited amount of proposed office space is likely to start the slow process of lower grade buildings to be either refurbished or fall out of the market. Some analysts are reporting South Australia to be quite slow, in comparison with other States, in refurbishing or converting buildings into alternative uses, for example, apartments.

Adelaide CBD Office Market Summary as at January 2018:

	Stock sqm	Total Vacancy sqm	Vacancy Rate %	Net Absorption sqm (12 mnt)
Core	1,115,473	183,313	16.4	18,739
Frame	308,709	36,535	11.8	-4,419

(Source: PCA and Herron Todd White research)

Adelaide CBD Office Vacancy Percentage by Grade:

	Jan '15	Jul '15	Jan '16
Premium	10.7	9.4	7.7
A Grade	12.1	11.8	12.8
B Grade	10.7	11.1	11.1
C Grade	17	17.2	17.9
D Grade	19.2	19.7	20.6

Jul '16	Jan '17	Jul '17	Jan '18
8.3	8.3	10.2	9.3
14.6	15.4	14.1	14.7
14.4	15.6	16.7	14.6
17.1	18.1	18.4	17.3
20	20.1	19.5	18.4

As the supply of new space to the market is expected to be low incentive use may begin to reduce in the later part of 2017 and more significantly over the next two years, however it is likely to remain a lessee's market over the next 12 months or longer. We are aware of some leasing agents who are reporting incentives are so high within lower grade premises that the face rents have declined for ease of negotiation. This has the potential to place downward pressure on values and investors, who should be wary of impending market renewals and be aware of alternative uses and/or the potential for conversion or upgrades.

The question for the CBD office market is what will stimulate a large uptake of the space currently vacant. In absence of significant growth in the local economy any change is likely to be small.

Queensland

Brisbane

The overall CBD office leasing market continues to struggle on the back of stubbornly high vacancy rates (16.2% as at January 2018) which have risen to an 18 month high. However, there are prospects for ongoing improvement in the Prime and A grade sectors with the possibility that vacancy rates may get to the landmark 10% level for the first time in some years. Gross face rents and incentives are therefore predicted to remain fairly stable for Prime and A grade accommodation, however the secondary market (B, C and D grades) is likely to remain turbulent as tenants look to upgrade to newer, well located office buildings.

Whilst there is still uncertainty surrounding the CBD leasing market, demand remains very strong for well leased, prime commercial office assets. Whilst we cautiously suggest that yields may have bottomed, there is still a strong weight of capital both domestically and internationally, creating downward pressure for high quality assets. We also highlight that the yield differential between Brisbane and southern markets, the shortage of good quality stock, and the significant near city infrastructure is driving positive sentiment.

By way of contrast, secondary older style investment stock is not keenly sought, given the inherent leasing risks, ongoing maintenance costs and high statutory outgoings associated with such assets. Accordingly, yields are likely to stay flat in 2018 unless there are good value add opportunities.

Major infrastructure projects including Queens Wharf, The Howard Smith Wharves, Brisbane Live, Cross River Rail and Brisbane Metro will positively transform the CBD and will provide a strong base for improving confidence and economic conditions within the Brisbane market.

Fringe Office Market

As expected, the release of the January 2018 PCA figures have continued on from a disastrous 2017 which saw vacancies hit a ten year high in July 2017 (14.6%). The total vacancy rate fell slightly in January 2018 (14.1%), however we are unlikely to see any significant improvement in the near future.

Of the principal precincts, the worst performing markets are Spring Hill and Milton with vacancy levels sitting at 17.6% and 17.1% respectively. Newstead, Fortitude Valley and South Brisbane (Urban Renewal and Inner South precincts) remain the favoured areas for tenants given their close proximity to the CBD, public transport networks and high quality amenities available. The majority of the proposed office developments are within these fringe precincts. Rents and incentives are likely to remain fairly stable in 2018. Demand for prime investment grade fringe CBD assets remains high and there is still downward pressure on yields for well leased assets, especially in the Newstead, Fortitude Valley and South Brisbane precincts where supply is limited.

Poorly leased commercial office assets with high vacancies will continue to perform poorly and yields will remain soft as investors will look for alternative investments that only require passive ownership. Such assets however can provide medium term value add opportunities, especially for underdeveloped assets, for proactive and experienced investors.

Suburban Office Markets

Suburban office markets are likely to remain patchy with some select locations such as North Lakes and Upper Mount Gravatt performing to an acceptable level.

Leasing in mid suburban areas is however slow and will continue to be driven by high levels of incentives. No rental growth is likely in the near future.

Sales activity in suburban markets is subdued. There is a reasonable owner occupier market for good accommodation in the sub $3 million market, but thin depth for poorly leased assets thereafter.

Commercial Development

There is only one major CBD commercial project currently under construction, Brisbane Quarter at 300 George Street, and two city fringe projects being 900 Ann Street, Fortitude Valley (Consolidated Properties) which is nearing completion and 25

King Street, Fortitude Valley (Lendlease) due for completion in late 2018. There are plenty of new commercial office projects in the pipeline, primarily focused around the CBD and the Urban Renewal precincts. These areas remain the favoured precincts amongst tenants given the high level of retail amenities and transportation networks.

The major projects that are approved or mooted are as follows:

62-80 Ann St, Brisbane City

Development group Mirvac has submitted a development application to build a 75,339 square metre, A grade, 32-storey commercial tower with ground floor retail located at 80 Ann Street.

360 Queen St, Brisbane City

A development application has also been submitted for a new 50,000 square metre, A grade 40 storey commercial tower located at 360 Queen Street within Brisbane's Golden Triangle. Proposed by a joint venture between Charter Hall and Investa Commercial Property Fund, the development will replace four older existing low rise buildings.

The project will include:

- New 40 storey, 5-Star Green Star office tower
- An 'open' publicly accessible podium comprised of several landscaped terraces and vertical landscaping
- Three sky parks at different levels within the tower

801 Ann St, Fortitude Valley

Walker Corporation has lodged plans for a 26 storey, A-grade commercial tower on Ann Street, Fortitude Valley. The tower will be prominently located, sitting on a full city block bordered by Ann, McLachlan, Connor and Morgan Streets. It will deliver 44,000 square metres of office accommodation upon completion.

11 Breakfast Creek Rd, Newstead

A joint venture between Charter Hall and John Holland has lodged a development application for a 16 storey, commercial office building that will provide 20 000 square metres of A grade accommodation. The proposed development is positioned directly opposite GasWorks.

Whilst it may appear sentiment for the commercial office market is positive, these projects are unlikely to get off the ground without any significant pre-leasing commitments.

Some of the major tenants that these projects are vying for are: Suncorp, currently seeking between 30,000 and 40,000 square metres of space; the ATO, seeking 24,000 square metres; and QSuper seeking a further 15,000 square metres. More recently, the co-working sector has been very active and industry sources advise that these groups still have large space requirements.

Sunshine Coast

As we have discussed in previous months, the office market on the Sunshine Coast is heavily oversupplied due to a number of projects completed in 2017, predominately in the Maroochydore area.

This has led to a reduction in rental levels generally across the Sunshine Coast market over the past 9 month period for new tenants and also on review.

We have generally seen all but the most prime tenancy areas in quality buildings with good views have reductions in effective rentals of circa 10% - 30%. Effective rents within A grade style premises on the Sunshine Coast were from circa $400/m² gross pa to circa $480/m² gross pa, though have now fallen and the market remains volatile.

This has begun to impact on the traditional owner-occupier strata titled market, which generally has a value range from $3,500/sqm to $5,000/sqm depending on the location, size of the strata and overall quality. We have noted sales over the past 12 months have begun to slow for this market as business owners have begun to look at the cost of owning or leasing and the quality of space that is available.

The largest of these developments, Kon Tiki in Maroochydore, is a mixed-use development with a range of retail uses to the ground level and medical uses within one of the two towers. This mixed-use style development is the first of its type on the Sunshine Coast and while take-up of the office space has been slow, the majority of the lower level retail space is now taken up with the medical space also mostly taken up.

The new CBD development within Maroochydore will see further construction of large office complexes and likely further development of these types of mixed-use complexes will enter the market. This is more in line with the mixed-use nature of developed CBD rather than the business park style developments that have been developed on the Sunshine Coast over the past 15 years.

Gold Coast

The hype leading up to the Commonwealth Games on 4 April 2018 has been the main catalyst driving positive sentiment in our region for some time now. With the Games now over, market conditions will no doubt settle down, although the legacy of the new or improved infrastructure associated with this event will be felt on the Gold Coast hopefully for many years to come. Here's hoping that "GC on the world stage" encourages plenty of visitors to our stunning enclave and to south-east Queensland in general.

As with all commercial property sectors, the Gold Coast office market remained buoyant over the first quarter of 2018. The trend of good tenant enquiry has continued, primarily because local economic conditions have seen local businesses continue to grow. Demand for office space continues to outstrip supply, underpinned by the facts of no new building construction, nor any shovel ready in the immediate pipeline. The Property Council of Australia office vacancy data was recently released for the six month period to 31 December 2017. For the Gold Coast, the overall vacancy rate came in at 10.6%, a reduction of 0.7% from the level for the previous release to the end of June 2017. This continues a downward trend and augurs well for the overall health of the office sector going forward. Rental levels have generally remained static, although commercial property agents are anticipating this will change, with rental increases expected. Similarly, the level of incentives has remained fairly static at circa 10% of the first term's rental.

There have been two notable office building sales concluded over the quarter, being Icon Energy at 4 Miami Key, Broadbeach for $7.95 million reflecting a very strong analysed yield of 6.2%, and Southport Chambers at Nerang Street, Southport for $6.93 million reflecting an analysed yield of 6.7%. We are also aware of an under contract strata office unit at Varsity Lakes at $3.38 million to an owner occupier, reflecting a value rate of $3,841 per square metre on surveyed floor area of 880 square metres and an analysed yield of 6.5%.

Where and what are the growth zones for the Gold Coast office sector?

In terms of likely new office buildings, we are aware of a large site at Oxenford with a design concept for three building totalling 12,000 square metres.

This is in the northern growth corridor of the M1 Pacific Motorway. Drivers for this development are a generally limited supply of office space in an area experiencing significant residential expansion and anticipated expansion of required government services.

Robina and Varsity Lakes have available sites for office buildings and their land cost is at a level that would enable financially viable development. This is in contrast to the traditional office precincts of the Gold Coast (Southport, Surfers Paradise, Bundall and Broadbeach) where the underlying worth of the land would result in a far more marginal outcome. Further, sites in these areas are also sought by developers of apartment projects; presently they seem to be reasonably active in the market.

In our view the Gold Coast has a reasonably active market for strata offices for owner occupation. Sites in more fringe business areas would offer viable development opportunities, particularly if the end product was pitched at the sub $1 million sector.

There is opportunity to refurbish older buildings in established office areas, particularly Southport and Bundall. A good quality renovation can lift C grade space to B or possibly A grade level, but at competitive rental or value levels (if strata unit conversions) in comparison to a site development requiring construction of a new building. Further, some of the older buildings have very good car parking ratios and the worth (rental or value) of basement car parks on the Gold Coast has shown low compound growth over the past decade.

However, today's office space tenants are seeking good internet/multimedia connectivity and floor areas that offer flexibility in design. The modern office tenancy would likely be open plan for hot desking or collaborative group work areas, coupled with quality amenities and breakout areas to ensure a relaxed staff work environment.

Such features can be more readily achieved in a new building as opposed to an older building where some design features are already set, so it is important when considering any building for recalibration into a modern office premises that the initial homework is undertaken, including partnership with leasing agents active in that market sector, architects and building facility managers.

Cairns

The Cairns office market is relatively shallow and experiences limited sales activity. The market has also experienced limited new development, with the last large office building constructed in Cairns being the State Government office tower that was completed in 2010. There are no known new developments in the pipeline.

Commercial property sales in Cairns, inclusive of retail and/or commercial office premises, remain well below the peak levels achieved in the 2005 to 2007 period. Prices paid for secondary strata titled premises have been relatively stable since 2010 at around $2,500 to $3,000 per square metre of floor area.

Most leasing demand for new office space is for smaller areas and for modern, good quality green star rated premises, however there is only a handful of such buildings in Cairns. These buildings achieve high levels of occupancy and are experiencing stable rent levels typically of $350 to $400 per square metre per annum. Demand for lesser quality space remains limited and there is a large oversupply of good quality non-inner CBD and well exposed secondary space in the $200 to $275 per square metre per annum rental range. These conditions have placed downward pressure on secondary rents and seen the emergence of incentives.

Overall the Cairns office market is expected to see little change during 2018.

Toowoomba

Leasing demand for commercial office accommodation in Toowoomba continues to be subdued. This has resulted in limited growth in rentals over the past three years and has also resulted in the introduction of some lease incentives to secure tenants. Rents can vary from under $100 per square metre gross (often poor quality inner CBD first floor tenancies with no car parking or PWD access) to $400 per square metre gross for modern premium accommodation with good car parking.

A small premium can sometimes be achieved for medical suites, especially in the precinct surrounding St. Vincent's Hospital.

There were no new major office building developments in Toowoomba during 2017 or early 2018. Any leasing demand during this period has been fulfilled by existing stock.

There are several vacant commercial sites in Toowoomba ready to be developed. The reduced leasing demand however has delayed most projects. It is unlikely that any project will proceed in 2018 unless significant lease pre-commitments can be secured. The projects will also likely need to achieve market leading rentals to make projects feasible.

A new office building has been proposed on the corner of Campbell and Raff Streets in the northern fringes of Toowoomba's CBD. The building is to be multi-levelled and will contain a food/café tenancy on the ground level. This project appears to be driven by multiple owner occupiers.

Wide Bay

Notable office developments in the Wide Bay markets are projects targeted to the medical market providing specialist suites or medical offices. Yields for well located medical suites that would typically be situated close to a hospital have ranged between

7% and 8% with rental ranges between $300 and $400 per square metre net. Investment stock in this market segment is low and properties subject to long term leases are receiving strong interest from investors.

In a broader view, the office market in the Wide Bay has been reasonably stable with the exception of good quality investment stock receiving strong interest and strong indicative yields when sold through portfolio auctions.

The upcoming auction of 70 Barolin Street, Bundaberg, a modern office property leased to a global engineering firm, will provide a test for the office market in Bundaberg.

Mackay

There have been no new office developments or major refurbishments in Mackay. Tenant demand is slow but improving as the local economy recovers from the mining downturn. Most demand is for ground floor tenancies of less than 200 square metres, preferably with good car parking.

Vacancies remain high. It is difficult to accurately assess market rent because ground floor rentals range widely from around $175 to $250 per square metre gross. We are aware of a particularly cheap recent lease in Victoria Street at $110 per square metre gross. Demand for older first floor tenancies remains weak.

Recent sales at 77 Gordon Street and 62 Victoria Street demonstrate net yields of just under 9%. Local office yields have risen in recent years because of an oversupply of office space limiting prospects of rental and capital growth.

Gladstone

The office market in Gladstone has been in a recessionary phase in the past few years, with increasing vacancies and downward pressure on rentals. Many businesses that occupied office space in Gladstone during peak conditions have either left the Gladstone market (no longer requiring office accommodation) or have downsized their tenancies as their staffing numbers have decreased.

As a result, the market is still oversupplied with office accommodation and there is no immediate demand for new accommodation, deterring any development of new office accommodation.

Rentals have now decreased and stabilised at more affordable levels and many leases that were negotiated during peak conditions have now either expired or are nearing expiry.

As a result, tenants who were previously in secondary office locations have been able to relocate to either more modern accommodation or accommodation more suited to their needs and wants.

Rental rates are still varying across the board, however generally speaking for the better quality stock we have seen rentals for a standard semi-modern/modern office tenancy (about 200 to 350 square metres) falling within the $225 to $275 per square metre gross range (inclusive of outgoings). Smaller tenancies have been seen at a higher rate, up to about $350 per square metre gross for modern offices sub 150 square metres.

Vacant modern office accommodation is still available for rent in the Gladstone market and until such time as this stock is absorbed, it is unlikely that we will see any new office development commence.

Rockhampton

The office sector in Rockhampton has been relatively flat in recent years, and without any significant demand for new office accommodation there has been very little development on this front. The last major new office construction was the NAB anchored office building on the corner of East and Fitzroy Streets, which was completed in 2012.

Since this time, market conditions have softened and vacancies have increased which has deterred development of any new modern office accommodation.

Focusing on the modern office accommodation, rentals have stabilised and generally speaking, range from about $300 to $400 per square metre gross (including outgoings) for modern, well located tenancies, with a floor area up to about 300 square metres. For larger, modern tenancies, we have seen most leasing activity in the $250 to $275 per square metre gross range for these better presented tenancies. There has been relatively weaker demand for these larger tenancies as few local businesses require a floor area of this size.

We have seen investors fairly active in the sub $1 million price point for well presented office buildings that have a strong local tenant leasing the property with generally three to five years remaining on the lease.

Yields for these properties generally range from 8% to 10% depending on a variety of factors. Owner occupiers have also been active (generally in the sub $700,000 range), often picking up a dated building and investing capital to convert to modern accommodation as an alternative to renting. This has been an attractive option in recent years given the combination of low interest rates and market conditions.

We anticipate no major uplift in conditions for the remainder of the year, however acknowledge that there are some positive signs that the market has bottomed and that conditions may slowly improve.

Townsville

There is currently limited new office construction or major refurbishment projects occurring in the Townsville office market, with the most recent new office space additions in the CBD have come about through refurbishment and redevelopment projects.

Vacancy rates in the inner city office market remain high with excess stock available relative to the current demand. There are a number of inner city office buildings that are prime targets for refurbishment projects however demand is not driving this outcome.

Public sector business typically seeks very high quality, efficient, technologically advanced office space that maybe unviable for refurbishment projects due to the outlay required to meet these standards, along with the functionality provided by these older buildings.

It is likely that construction of a new office building may prove more viable, which would result in increased office space in an oversupplied market.

Furthermore the depth of small private businesses is not providing sufficient demand for office space refurbishment due to the large availability of office space currently on the rental market, including already newly refurbished/redeveloped space.

We are seeing that space requirements from the private sector have decreased over the past five years as organisations downsize from the economic conditions and restructure work spaces to more efficient layouts.

Northern Territory

Darwin

The office market in Darwin remains moribund, with large areas of C and D grade space overhanging the market. Tenants, especially Government, are flocking to the limited amount of A grade space in town. The vacancy level in A grade space is relatively low but the market is affected by the large supply of lower quality space which is available.

The main game in town at present is the new Health House development which is a new nine level dedicated office building to be constructed on the site of Cavenagh House at the corner of Knuckey and Cavenagh Streets. The proposal also involves a significant upgrade of Energy House including improving its green credentials, addition of a child care centre and provision of additional car parking at the rear in Litchfield Street.

The NT Government's finances are in a parlous position and once again in the lead-up to the Territory budget, the prospect of introduction of a land tax has been raised. The eventual makeup of the budget will not be known until next month, however some revenue raising measures have already been flagged.

One of these is the possible introduction of a Derelict and Vacant Property Levy for the CBD. It is proposed that a 1% levy will be applied to improved properties in the CBD with a vacancy rate of greater than 50%, and a 2% levy will be applied to undeveloped land. The stated aim of this levy is to encourage revitalisation of the CBD. Landowners will have a strong financial incentive not to have property lying idle within the CBD, however the challenge to landowners will be in finding an economically viable use for their land. Realistically this is a selective land tax which will penalise CBD landowners who are stuck with land that is not economic to develop in the current climate.

Western Australia

Perth

The most recent Property Council of Australia figures for the Perth CBD office market indicate the total vacancy rate decreased from 21.1% to 19.8% in the six months to January 2018. The total vacancy rate in West Perth however rose 1.7% to 16.7% for the same period.

Whilst there is some positive news with vacancy rates reducing overall, Perth's CBD still has the second highest vacancy rate of all capital cities in Australia.

The reduction in the overall vacancy rate can be attributed to a "flight to quality" phenomenon with the level of vacancy in the Premium and A Grade buildings being significantly less compared to that shown for B, C and D Grade space.

With a glut in the office leasing market and a 'flight to quality' occurring, building owners of B and C Grade buildings are looking for conversion opportunities to residential, educational and even hospitality uses.

The significant deterioration in the Perth CBD and West Perth office leasing markets during 2016 (mainly as a result of reduced demand from resource sector tenants) coupled with historically low occupancy costs for office space in these traditional office districts, has caused a rise in tenant migration from peripheral office precincts but also in tenants up-scaling to better quality accommodation.

Property owners have had to become proactive in trying to entice existing tenants to recommit and also in order to attract new tenants. This has resulted in substantial incentives being offered in the market place.

Furthermore Landlords are providing their existing and prospective tenants with bespoke floor plates, flexible work spaces, meeting hubs, refurbished foyers, some featuring concierge services, gymnasiums / wellness centres with some more innovative Landlords looking at child care / minding facilities within their buildings, in addition to the obligatory 'end of trip' facilities, bike storage rooms and in some cases bike repair shops.

Despite the recent findings from the PCA Office Market Report discussions with real estate agents active in this sector confirm a generally soft office leasing market with downward pressure still being exerted on asking rental rates with a large volume of space available coinciding with a lack of demand, particularly for secondary premises. In many cases tenancies are being listed for extended periods and with multiple agents.

In terms of capital transactions demand for office property in the Perth CBD has been felt predominantly from institutions and foreign (south-east Asian) buyers seeking counter-cyclical acquisitions of secondary assets with good prospects for re-positioning.

A total of seven (7) major CBD office buildings have transacted during the last 12 months with one of the more recent being 45 St Georges Terrace which was bought for just over $53Million in December 2017.

Sales activity has however almost ceased within West Perth over the last 12 months. The lack of quality office stock with medium to long term WALEs, combined with subdued economic conditions has affected transaction activity.

The outlook for the Perth office leasing market is to see a stabilisation in rental incentives and rents over the short term and no significant new building activity until at least 2020. We anticipate that vacancies in the Perth CBD will stabilise and that vacancies in West Perth will increase further as tenants look to relocate back to the Perth CBD.

As tenants make the 'flight to quality', a two-tier market may eventuate with less attractive, lower grade buildings increasing in vacancy and those more attractive Premium and 'A' grade assets in good central locations showing a decrease in vacancy.

Australian Capital Territory

Canberra

The construction of new office space throughout 2018 appears to be most prominent within Canberra's CBD, owing to upgrading infrastructure and tightening vacancy rates for CBD office space. Other areas of Canberra such as Canberra's inner south do not appear to have levels of development comparable to the CBD, but sales and market evidence would imply that there is demand for office space outside of the CBD.

One of these examples is the sale of 6 Sydney Avenue, Forrest in November 2017 for $56.8 million. The property was constructed in 2003, extensively refurbished in 2016 and features a total of 9,948 square metres of A grade office space. The property was sold with a WALE of 7.92 years and was 100% leased, with 78% of this space being occupied by the Commonwealth of Australia.

An example of new office development within the CBD includes Amalgamated Property Group's Civic Quarter development. This is situated along the Northbourne Avenue development corridor which is soon to include the ACT's first light rail system. The development is set to be twelve levels with a total office space area of 18,000 square metres. Amalgamated expects to have this project completed by mid 2019.

Construction has also commenced on a new $300 million development by Capital Property Group. The property, located on the corner of Constitution Avenue and London Circuit in Canberra's CBD, is to feature 20,000 square metres of office space spread across twelve levels. The space is already set to be leased by the government for 20 years, with an option of another five, and will house a total of 1,700 public servants upon completion. Construction of this development began in December 2017 and is expected to be completed by mid 2020.

Listed below are Canberra's market indicators for the six months to January 2018. These indicators provide an overview of the current state of the office market as well as where market growth or retraction has occurred:

- Average vacancy rate for the office market as a whole increased by 1.5% to 13.1%.Total net income: $440,552 per annum
- Lower than average vacancy for A and B grade office space at 8.5% and 11% respectively, higher than average vacancy for C and D grade office space at 21.7% and 19% respectively.
- Gross face rents are between $405 and $480 per square metre per annum for A grade office premises
- Yields for A grade CBD office space are between 5.5% and 7.25%, while yields for A grade office space outside of the CBD are between 5.5% and 8.5%.