HERRON TODD WHITE COMMERCIAL

Office

June 2019

National Property Clock: Office

Entries coloured purple indicate positional change from last month.

PEAK OF MARKET
Melbourne
South East NSW
Sunshine Coast

Starting to Decline
Coffs Harbour
Gold Coast
Lismore
Mid North Coast

DECLINING MARKET
Alice Springs
Echuca

Approaching Bottom of Market
South West WA

BOTTOM OF MARKET
Cairns
Darwin
Gladstone
Hobart
Launceston
Mackay
Perth
Rockhampton
Townsville

Start of Recovery
Adelaide
Emerald
Mildura
Toowoomba

RISING MARKET
Ballarat

Approaching Peak of Market
Brisbane
Geelong
Sydney

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New South Wales

Overview

Commercial real estate had mixed results across the country in the past six months, but among the options for buying in this sector, office holdings are considered one of the safer choices.

That said, not all office markets are the same. This month's submissions paint a picture of varying performance so far this year.

Sydney

With Sydney CBD office vacancy tightening to 4.1% as of January (source: Property Council Australia), CBD office rentals have continued to drastically increase over the past two years and remain at record highs.

It is therefore no surprise that owner-occupiers have remained the dominant market participants when it comes to strata office stock, as they attempt to reduce their occupancy costs and invest in what is anticipated to remain a strong market into the foreseeable future.

The combination of owner-occupiers looking to secure office assets combined with the lack of available stock on the market has seen capital values for B and C grade strata office stock continue to increase, with building records continuing to be commonplace.

Noonan Property's April 2019 sale of the 95 square metre Suite 202 at 234 George Street for $1.585 million (reflecting $16,684 per square metre of lettable area) to an owner-occupier who had already missed out on a number of other suites in previous weeks highlights the strength of the market force of owner-occupiers. Prior to this sale, the last suite to sell in this building and a superior overall asset was the 110 square metre Suite 802, which sold in March 2018 for $1.66 million, reflecting $15,091 per square metre.

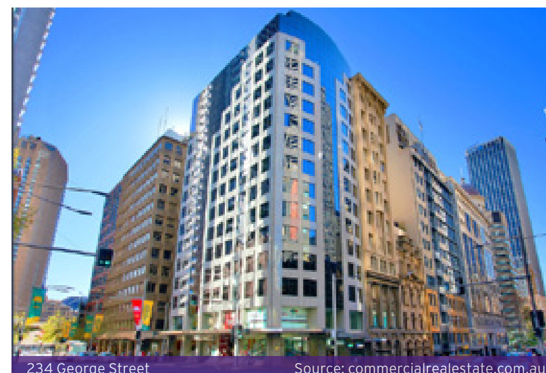
It is therefore no surprise that owner occupiers have remained the dominant market participants when it comes to strata office stock.

OFFICE VACANCY

Sydney CBD **4.1%**

Parramatta **3%**

We anticipate owner-occupiers will remain the driving force of values for strata stock throughout the CBD for the foreseeable future, with rents anticipated to remain strong and supply remaining at a minimum in the short term.



234 George Street — Source: commercialrealestate.com.au

With completion of the Wynyard upgrade and Light Rail project along George Street starting to feel like it might be in sight, construction noise beginning to reduce and hoardings starting to be removed, the future of Wynyard and George Street is beginning to take shape. We consider the face lift to both Wynyard and the overall streetscape of George Street (along with the obvious transformation in accessibility through the CBD) will only further increase the appeal of offices in these precincts.

The southern precinct of the CBD is also anticipated to benefit from increased accessibility following the opening of the Light Rail, seeing the precinct become fully integrated into the prime CBD areas. With vacancy at 6.9% as at January 2019 (source: Property Council Australia) and rents significantly lower than those of the city core, the southern precinct shows the most potential for growth over the short term.

Outside of the CBD, Parramatta remains the best performing secondary CBD in the country, with vacancy at 3% as at January 2019 (source: Property Council Australia), primarily driven by low supply additions and the draw of more affordable rentals than the CBD. While 148,000 square metres is currently under construction across four sites and is all due to come online over the next two years, pre-commitment for this space is at 90%, so vacancy is unlikely to soften significantly.

The opening of the Metro North West Line on 26 May provides a significant increase in accessibility to the secondary office precincts of Norwest and Macquarie Park, as well as an additional line of access to Chatswood, increasing the overall appeal of these secondary precincts.

Across Sydney, we are seeing strength in the commercial office market that is encouraging given the softening of the residential market. The strength of the market has been primarily driven by limited stock and infrastructure improvements and is anticipated to remain strong for the time being.

Newcastle

Let's not discuss the Light Rail this month. Seriously, we over-report on this somewhat, so we're going to give the whole Newcastle rejuvenation project a rest for the month of June.

Headline figures from Property Council of Australia (PCA) indicate vacancy rates are in a falling pattern, especially for A grade office property which is showing a total vacancy factor of 2.8%. These are updated annually for Newcastle so we're not expecting a change to the published figure in July's Office Market Report.

Larger scale developers have addressed this long-term A grade stock shortage with a number of new office developments in recent years, although the heat in the residential property market has pushed the end product in a residential direction. With 16,000 square metres of gross floor area over 11 floors, Newcastle's largest office building has now been approved by the Joint Regional Planning Panel Hunter and Central Coast as of May 2019. This office property is already pre-committed to Property NSW (Government tenant).

Now that selling rates have slowed significantly in the residential market, we anticipate a further move away from residential development towards office accommodation. The office market right now is subdued.

To be frank, property professionals across our region had been waiting for two things to be over and done with. Firstly, uncertainty surrounding the federal election and slated taxation and funding changes around the property market had many buyers and developers in a holding pattern. Now we know the outcome; the status quo remains. Either way, it appears to be uncertainty that was slowing buying and selling decisions recently.

The other is uncertainty around interest rates and the question of when, not if, they will fall. While lending constraints have been lifted somewhat, this is yet to flow through to a lift in selling levels for residential or commercial property. We anticipate office property will remain subdued throughout the rest of 2019 and into 2020.

Lismore/Byron Bay/ Ballina

The majority of the office space within Lismore is located on the first floor above retail shops, but there are a number of larger multi-level office buildings too.

The Lismore office sector has an increasing oversupply situation particularly in the mid to lower end of the market. There is still quite a large amount of office space to lease within the CBD. The market has a mix of owner-occupiers and investors. We have seen a mixed result for first floor office space within Lismore with recent sales showing returns of between 6.73% and 8.71%.

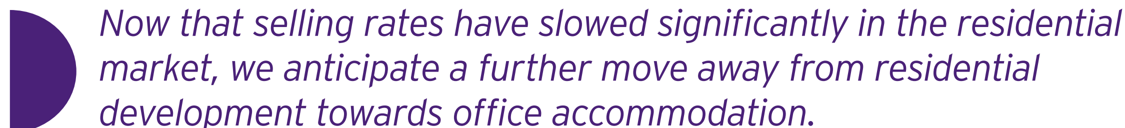
Coastal locations are expected to remain more stable. The Byron Bay office market is traditionally not as strong as the retail market with yields expected to be in the vicinity of one to two per cent higher for office property with traditional retail siting in the vicinity of 4.5% to 6%. There is a continuation of the trend of Byron Bay tenants moving to the industrial estate as it is more affordable, has superior parking and is less congested.

Office space in Ballina is concentrated along Tamar Street with a strong influence from government tenancies, traditionally in the higher quality spaces. There is also a large number of residences that have been converted to office use in this area. This concentration attracts associated private companies and allied health services associated with the ageing population. Supply and demand remain in balance and a resultant stable market is likely, with properties within Ballina tending to be well held.

Rental rates are sitting around $300 to $350 per square metre for office space, with yields at 6.5% to 7%.

Coffs Harbour

The office market should remain relatively stable throughout 2019 with limited leasing enquiry and stable rental levels. The slight oversupply of office space is restricting rental increases. This oversupply is gradually being taken up by the market. Good



Now that selling rates have slowed significantly in the residential market, we anticipate a further move away from residential development towards office accommodation.

quality office space is priced at $350 to $400 per square metre per annum. Secondary office accommodation has proven difficult to lease with rentals in the vicinity of $200 to $300 per square metre depending on size, quality and location.

There continues to be limited demand from the government sector although a recently completed double storey office complex has secured NSW Forestry on a long term lease at $370 for 910 square metres. There has been increased demand for office accommodation from participants in the National Disability Scheme, with a number of organisations establishing locally, however price sensitive demand is slowing.

The direction of yields is dependent upon fluctuations in interest rates and therefore we anticipate continuation of current firm yield trends for property underpinned by secure medium to long term leases.

Looking forward in the second half of 2019, the market should remain in favour of prospective tenants with an oversupply of space allowing negotiation. This will limit rental increases which should track in line with CPI increases.

Dubbo, Orange & Bathurst

Office space sales and rentals have been stable in these three regional centres to June 2019. In the recognised office precincts, office sales greater than $600,000 have met with solid demand from both intending owner-occupiers and investors. Analysed yields in this range have typically been in the 5.85% to 6.25% range, however in a less favourable location, a leased office in Dubbo sold at an analysed yield of 9.85%. Contributing factors in this instance included a rent-back scenario, a keen vendor, a secondary location and rent above market levels.

Illawarra

There are positive signs for the commercial property market across Wollongong to start 2019 with the "Gateway on Keira" office building commencing construction (due for completion circa mid 2020) as well as approval being received for a significant office project on the prominent "Langs Corner" site at the corner of Crown Street and Kembla Street.

The "Gateway on Keira" project is being developed largely on speculation without significant leasing commitments and exhibits strong confidence in this sector. In this instance, we largely concur with the developer's view of 'build it and they will come' given the very low vacancy rate for A Grade stock and that the local market is dominated by small to mid sized businesses that find it difficult to pre-commit to leases on unfinished projects, preferring to see the final product before entering into an agreement.

Rumours also continue to swirl about a large corporate tenant close to pre-committing to a significant office tenancy in Wollongong although details have been kept tightly held. If it does proceed, this pre-commitment will justify construction of a new office building and again illustrate the high level of confidence in the office market.

Sales activity has slowed and most agents are reporting of reduced enquiry levels while also acknowledging the shortage of available stock as most owners are preferring to hold at present. Sales activity may increase through the second half of 2019 as uncertainty surrounding the federal election is removed, while talk of an imminent interest rate cut may spur buyers into action and continue to cement yields in their current low range.

Victoria

Melbourne

The Melbourne office market had a stable first half of 2019. Vacancy rates, in particular in the Melbourne CBD, city fringe and inner east, are lower than the long-term average vacancy levels and are anticipated to further decline in the second half of 2019.

The Melbourne CBD's overall office vacancy rate was at 3.2% in January 2019, the lowest of all of Australia's CBDs, according to the Property Council of Australia's Office Market Report. There is limited new supply and available stock in the market until 2020. The robust leasing market is also being fuelled by healthy tenant demand driving strong rental growth in both face and effective levels.

Due to the rise in CBD rentals, the city fringe precinct continues to gain popularity from the creative, technology and professional services sectors. Tenant demand is also strong in the inner east markets, particularly in highly sought-after suburbs such as Richmond, Cremorne and Hawthorn. The inner east has a vacancy rate of 3.58%, the lowest amongst all of the metro precincts in Melbourne. It is expected that rental growth will continue for the remainder of 2019 in these precincts for well-located, good quality stock.

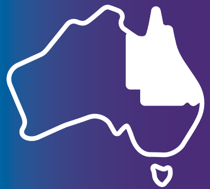
Sales demand is particularly strong for well-located, land-rich investment assets. A circa 1990 double storey office building at 79-83 High Street, Kew sold off-market ahead of the launch of an EOI campaign for $19 million in April 2019, reflecting a passing yield of approximately 6.2%. The property comprised 19 strata units with a total lettable area of approximately 3,361 square metres situated on a 3,760 square metre Commercial 1 zoned land allotment. The building had 10% vacancy and was sold to fund manager, Terraplex, with intentions to refurbish the building and potentially add extra floor space.

Developers are intending to deliver commercial office projects instead of apartment projects.

In the outer suburban market, the sale at 347-351 Burwood Highway, Forest Hill represents the largest metropolitan office transaction this year. The property was sold to an adjoining owner, a Melbourne based developer, for $45.85 million in April 2019. The property is situated opposite the Tally Ho Business Park and comprises a 2.62 hectare Commercial 1 zoned allotment improved with two office buildings with a combined net lettable area of approximately 10,692 square metres. The property is approximately 70% leased to a variety of tenants including NEC, Bolton Clarke and Hamilton Morello. We highlight that the purchaser elected to purchase the property as is without a 30% rental guarantee from the vendor and without deduction of outstanding incentives. The property has a WALE (by income) of 3.4 years and a reported reversionary yield of approximately 7.32%. The relatively low yield for an asset of this nature with sizeable leasing risk demonstrates the confidence buyers currently have in the Melbourne metropolitan office market.

Melbourne CBD's overall office vacancy rate, the lowest amongst all of Australia's CBDs.

Due to the slowdown in the residential market and tightening lending criteria, demand for development sites within the inner suburban region has declined somewhat, however we are aware of ongoing, albeit subdued demand from developers seeking to secure well located sites to establish mixed use developments within close proximity of neighbouring retail strips, amenities and public transport. It is uncertain when residential market conditions will begin to recover and purchasers are cautious that any future downturn in economic activity may lead to a reduction in demand and market value, however we note that demand for commercial development sites, particularly sites with holding income, is strong in inner city areas such as Richmond, Cremorne and South Melbourne where developers are intending to deliver commercial office projects instead of apartment projects in the current market to capture the strong office leasing and sales conditions.



Queensland

Brisbane

For many years, the Brisbane commercial market has largely gone under the radar in comparison to its southern counterparts...until now.

Brisbane is on the cusp of a major transformation, albeit that it will be a five-year project on the pathway to transformation into a world class city.

This fact is being increasingly recognised in the commercial markets where there are increasing levels of interest in high quality commercial properties within Brisbane from Australian and international investors. This has been evidenced by yield compression and strong capital growth over the past three years. Yields which were solidly in the 6.75% to 7.25% range previously are now pressing downward into the 5.5% to 6.5% range, whilst capital growth of up to 30% has been recorded against some prime quality properties.

13%

Total vacancies in the CBD have contracted to a five year low as at January 2019.

Against this backdrop however, the market is still plagued by persistently high vacancy rates, particularly in the B grade category and below. This is holding back real rent growth and significant change in rents is not likely until Prime and A grade vacancies push lower into the single digits.

Brisbane is on the cusp of a major transformation, albeit that it will be a five-year project on the pathway to a transformation into a world class city.

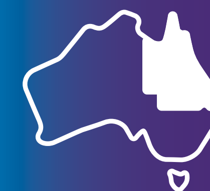
Recent leasing statistics released by Property Council of Australia have indicated that total vacancies in the CBD have contracted to a five year low of 13% as at January 2019. Prime and A grade vacancies however are now at 10.4% and 9.9% respectively, and heading down.

Gross face rents have stabilised with some assets seeing effective rents increase as incentives very slowly start to wind back, however vacancy rates remain high for secondary stock and face rents will continue to be flat as vendors compete to secure tenants. It is likely we will see a further widening in rentals between Prime or A grade and secondary accommodation.

The fringe CBD leasing market is now largely dominated by the prime office precincts of Fortitude Valley (RNA, King Street precinct and Ann Street), Newstead (in and around Gas Works) and South Brisbane. Vacancy rates for fringe markets overall remain stubbornly high at circa 14.8% but the better regarded precincts of South Brisbane and the Urban Renewal area are doing better at 10% and 14.2% respectively. On the whole, fringe markets have been impacted by high vacancies in the CBD, but the Urban Renewal area is likely to continue to dominate the larger leasing and sale transactions.

On the rental side, gross face rents appear to be increasing for premium buildings with some new leases reported at above $650 per square metre gross face. Incentives are also stabilising for prime assets. Conversely, secondary fringe CBD leasing markets are still oversupplied as tenants seek newer accommodation that is within close proximity of transportation and good retail amenities. Milton and Spring Hill commercial precincts continue to remain out of favour with tenants as vacancy rates continue to be the highest recorded for the fringe (21.5% and 17% respectively). These vacancies may present opportunities for re-purposing of some buildings in these areas.

There have been a significant number of good quality commercial office listings in the first half of this year across the CBD, fringe CBD and inner-city areas. Whilst many transactions are yet to transpire, there is reportedly strong interest being generated for well leased investment assets on both a local and interstate level. We believe some of these assets will likely achieve strong sale prices, as interstate investors priced out of Sydney and Melbourne see exceptional value in Brisbane (broadly speaking, there is a 150 to 250 basis point differential between Sydney or Melbourne versus Brisbane).



At the lower end of the market, there is a real shortage across Brisbane of good quality investment office assets in the $1 million to $3 million price category. Commercial assets that offer the right fundamentals (close to transportation and retail amenities, good on-site parking, redevelopment upside or value add opportunities) are in high demand and it's likely that this market will continue to perform strongly.

The owner-occupier segment of the market (sub $1 million) largely remains buoyant on the back of the low interest rate environment. Capital values appear to have stabilised in the first half of this year and will likely remain stable in the second half of the year. There are sporadically some good buying opportunities in some of the mid-suburban locations.

Leasing markets in most mid and outer suburban markets remain challenging with no rental growth and some extended periods of vacancy in second tier areas.

Gold Coast

In a general sense, the low interest rate environment continues to be the catalyst encouraging investors across all sectors of the commercial property market here on the Gold Coast, but this is commonplace on a national front.

We have felt that sentiment within the Gold Coast commercial marketplace has been in disruptor phase for some time now. Of late, we consider this has expanded due to other national issues such as the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and the ramping up of the federal government election campaign. Local agents active in the Gold Coast commercial market somewhat agree, but being generally a positive bunch, tend

We have felt that sentiment within the Gold Coast commercial marketplace has been in 'disruptor' phase for some time now.

not to dwell on such thoughts, although the general consensus is that conditions are tougher now than six or 12 months ago. Certainly, the prospect of buyers getting across the lender finance line is a current talking point. The perception is that post the Royal Commission, there is perceived extra depth to bank scrutiny of any deal placed on the table. Whilst this is a source of frustration, it is a situation that is likely to soften over time.

There have been several sale campaigns for larger ($7 million plus) Gold Coast office buildings run since late 2018. Our sources indicate that interest has been reasonable, particularly from southern based investors. They appear to be chasing returns or yields, which are certainly higher here on the Gold Coast than in their own back yards. Further, the improving vacancy level (11.6% based on PCA January 2019 data), limited prospect of any new buildings and a positive outlook for rental growth moving forward are attractive motivating factors for any prospective buyer.

Based on these potential sales, our consensus on common ground for analysed yields is in the 7.5% to 8% range. In our view, this points to a possible softening of yields from 12 to 24 months ago, but we also consider it reflects a settling of yields for the market going forward over the medium term, provided no major disruptors or outside influences arise.

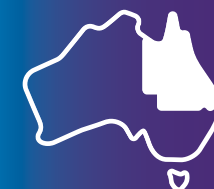
Lakeside 1 - Bermuda Point Source: CBRE Information Memorandum

A significant office building sale that has concluded is Lakeside 1, Bermuda Point, located at Lot 1101/1 Lake Orr Drive, Varsity Lakes. Initially put to the market under an EOI campaign in mid 2018, public record indicates the property sold in March 2019 for $25.1 million (source: CoreLogic). Lakeside 1 comprises a volumetric title, contemporary designed, A grade office building with 6,114 square metres of lettable area and 190 undercover car parks. It has a reported circa 96% occupancy and is returning a net passing income in the order of $2.285 million. Based on these metrics, passing yield would be in the order of 9% with a lettable floor area rate at circa $4,105 per square metre, although we consider the passing rental level full.

7.5% - 8%

Consensus on common ground for analysed yields.

Whilst the Gold Coast office market may be indicating signs of a slowdown, agents also suggest that owners are reluctant to dispose of assets as there are limited opportunities for reinvestment. As a consequence, the balance between supply and demand is possibly widening as a result of difficulties in securing quality assets for sale.



We would hope to be able to report further on the office buildings currently under due diligence when we next discuss the office market sector in the Month in Review later in the year.

On the rental front, agents are reporting an uplift in rates, in particular, for A grade space of higher quality or that has been extensively refurbished. Such space would fall between $475 and $600 per square metre gross plus car parking for the former and $400 to $450 per square metre for the latter. B and C grade buildings are exhibiting less signs of rental rate increases unless they are of higher quality or refurbished. This space would fall between low $300 to low $400 per square metre gross plus car parking. As the vacancy level has reduced, so has the level of incentives offered by landlords. The commonplace range is now 8% to 15% of the initial lease term rental, although there are instances where levels up to 20% are still offered.

Overall, we consider conditions will generally remain similar over the second half of 2019.

Toowoomba

Leasing demand for commercial office accommodation in Toowoomba was subdued in early 2019 which continued the trend from the previous couple of years. As a result there has not been a significant growth in rentals and there is evidence that some lease incentives may be required to secure tenants.

Owner-occupier demand has continued to be strong, particularly for premises with floor areas of up to 300 square metres. There has been a reduced supply in this market segment, which has resulted in some sales achieving premium prices.

Following years of limited new office development in Toowoomba, construction has almost been completed on a new building located on the corner of Campbell and Raff Streets in the northern fringes of Toowoomba's CBD. The building will be multi-level and will contain a food/café tenancy on the ground level. This project appears to be driven by multiple owner-occupiers and will be strata-titled.

Major office buildings in Toowoomba have been tightly held over the past five years with very limited investment sales of note. This drought appears likely to end soon with a number of office investments currently under contract. These potential transactions include the following:

- **146 Herries Street, Toowoomba City** – This is a two level building with a net lettable area of 1,615 square metres and 60 on-site car parks. The building is fully leased to two government tenants with a reported passing net income of circa $600,000 and is reportedly under contract with a passing yield of circa 8%.

146 Herries Street, Toowoomba City Source: www.realcommercial.com.au

- **70 Neil Street, Toowoomba City** - This is a single level building with a net lettable area of 948 square metres and 26 on-site car parks. The building is fully leased to a legal firm and Darling Downs Radiology with a reported passing net income of circa $335,000 and is reportedly under contract with a passing yield of circa 7%.

Townsville

To date in 2019, the office market has followed on from the previous year with interest underpinned by national investors for property offering strong investment returns with long-term leases or national tenants, combined with counter cyclical purchases.

The most recent high-end sale within the Townsville office market settled in December 2018. This was for a nine-level CBD office building constructed in 2013 and leased to blue chip tenant Ergon Energy with National Australia Bank occupying the ground floor. The property sold at a reported $63.5 million with a passing yield of 7.3% and weighted average lease expiry of 9.6 years. The property was purchased by a property fund and in our opinion, reflects a bullish transaction for a regional market.

Average yields for commercial and industrial property have nudged down over the past four years due to a continuing flight to quality, as investor sales increasingly focus on properties with strong lease covenants, tenant profiles and lease periods. While the majority of sales that take place are now analysing in the 7.5% to 9.5% range, sales are very sensitive to their fundamentals and the yield spread remains wide.

The leasing sector remains soft with better quality A grade stock appearing to be holding value levels, although new tenancies to non-government and multi-national tenants are still seeing high levels of leasing incentives in the 15% to 25% range. Lower quality B grade product is continuing to see downward pressure.

Rental rates for the market as a whole appear stable as a result of the market correction that occurred over the past few years, however market

corrections are very much property specific with downward pressure still occurring in some leases.

Sunshine Coast

It is half time for 2019 and time to reflect briefly on the office market across the Sunshine Coast.

As we discussed at the beginning of the year, there has been significant stock added to the Sunshine Coast market over the past two years and at the start of the year, the Property Council of Australia figures indicated that overall vacancy sat at 15% given the increase of 42,000 square metres of stock in the market over 2017 and 2018. As a result, we indicated that there would be downward pressure on rental rates during 2019 for both the new stock and existing tenants.

This has been the case through the first part of 2019. While the cost of moving office is very high for companies, it is a genuine option in the market currently with high levels of incentives seen for established local and larger companies. Incentives are a mix of fit out contributions and rent-free periods and are typically up to 25% in the current market. This has placed downward pressure on effective rents and is likely to remain the case until overall vacancy levels drop below 10%.

While this has happened in a broad sense, there is still a premium for well-located stock in central Maroochydore with water views. Landlords in these precincts, while still seeing some increased incentives, are generally keeping tenants in place and there appears to be a gap opening up for these properties compared to other good quality offices in other locations.

The strata market is also active currently with good quality stock seeing activity in the $4,000 to $5,000 per square metre range. Stock of good quality buildings in secondary locations is seeing activity more in the $3,400 to $4,000 per square metre range. This is of significant interest as the first proposed complex within the Suncentral development is a proposed high quality strata titled complex. Reports indicate that there is circa 40% pre-commitment to date and there is generally a low level of high quality strata stock in the Maroochydore area currently.

While there is still concern around the overall level of stock in the office market, there are increasing levels of business activity generally, as the overall population grows and as a result, the white-collar workforce increases. Coupled with the broadband submarine cable to be connected in 2020, giving the Sunshine Coast the fastest connection speeds to Asia from Australia, this may continue to help fill the current and proposed stock in this market at consumption levels above previously noted levels.

Incentives are a mix of fit out contributions and rent-free periods and are typically up to 25% in the current market.

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 major new developments in the pipeline.

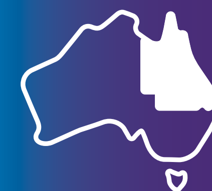
Most new office space leasing demand is for smaller areas and for modern, good quality green star rated premises, however there is only a handful of such buildings in Cairns. These buildings achieve high levels of occupancy and are experiencing stable rent levels, typically of $350 to $450 per square metre per annum gross. 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 $300 per square metre per annum rental range. These conditions have placed downward pressure on secondary rents and seen the emergence of incentives.

The Cairns office market overall has experienced little change thus far during 2019 and is expected to maintain little change moving forward in the short term.

Mackay

There is very little to report on the office sector in Mackay. With the exception of a mixed office and residential flats property on Sydney Street, there have been no sales so far this calendar year. An older, 726 square metre, double storey office requiring refurbishment at 1 Romeo Street was the last office property to be sold in Mackay – that was in December 2018. It was vacant at the date of sale and was purchased for part owner-occupation.

1 Romeo Street, Mackay Source: blacksrealestate.com.au



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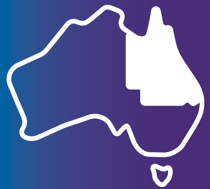
Agents report that there was steady rental enquiry before the federal election was called, but this all but ceased while prospective tenants awaited an outcome.

Earlier in the year, the greatest level of enquiry was for offices with net lettable areas of between 150 and 200 square metres. Businesses associated with the National Disability Insurance Scheme had been actively seeking offices to rent, however these tenants have particular requirements for disability access and facilities which many older tenancies in Mackay can not meet.

The local office market still has a fairly high level of vacancy and rental levels are cyclically low. This, combined with ever increasing local authority rates and building insurance premiums are reducing investment returns and consequently limiting value growth



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South Australia

Adelaide

The current economic landscape remained volatile throughout the country as the nation headed to the polls for the federal election. Recent interest rate decisions means the cash rate is again on hold at 1.5%, however sentiment amongst economists has shifted after the Reserve Bank of Australia's meeting in May this year, with many now predicting the next direction for interest rates will be down instead of up. An interest rate cut is predicted to occur between June and August as the RBA may attempt to stimulate the economy. Whether this potential rate cut is passed on by the banks however will remain to be seen.

In the current environment, bank lending and residential property values declined over the first half of 2019. In contrast, office vacancy rates in the Adelaide CBD decreased from 14.7% to 14.2%, led by reductions in both the core and fringe sectors of the Adelaide market. Premium and A grade vacancy has been recorded at 2.6% and 14.3% respectively. That 2.6% premium grade vacancy figure seems very low, however there is a limited amount of premium space on offer in the Adelaide CBD so that should be taken into account.

These vacancy figures support the nation-wide push for more efficient and more sustainable office spaces as climate change discussions continue to dominate the political landscape.

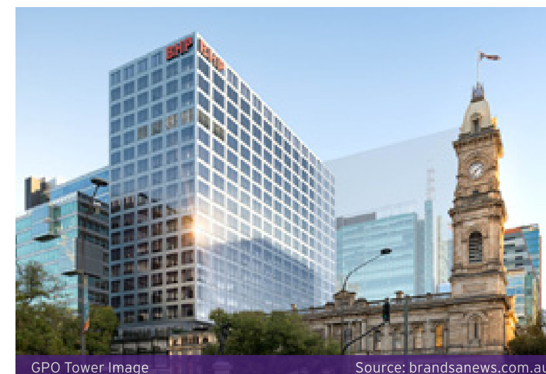
As a result of the reducing vacancy rates, office property yields have remained solid, with A grade space in the Adelaide market recording yields of 6% to 8%. In comparison, Sydney and Melbourne

There are some significant developments that will buffer the supply side of the office market throughout the second half of 2019.

A grade office properties are fetching 4.5% to 5.5%, however the eastern states are recording higher levels of rental growth compared to the Adelaide market. Gross face rents for prime space in the Adelaide office market are currently around $550 per square metre while A grade space is fetching $370 per square metre.. The latest figures from the PCA have analysts predicting 2% to 2.5% growth for premium space in Adelaide over the next few years. In addition, the current incentive levels for premium and A grade office spaces are expected to decline over the next two years to a level around the 25% to 30% mark.

Recent market transactions have been scarce as sales are down from the record levels set in 2018. There are however some major offerings currently on the market, most notably 25 Grenfell Street, locally known as the black stump, which is currently listed for sale just two years after being purchased by Credit Suisse for $125 million.

Furthermore, there are some significant developments that will buffer the supply side of the office market throughout the second half of 2019. GPO Tower is currently under development and will add 24,500 square metres of space to the core market, located at 2-10 Franklin Street. Upon the project's completion late this year, major tenant BHP will occupy 40% of the building and the global mining giant's name will illuminate the Adelaide skyline as they have secured the naming rights of the new office tower as part of the lease agreement. The BHP lease now takes the committed net lettable area of the building to roughly 90%, as the South Australian Attorney General's department has pre-committed to a lease of 50%. The pre-commitment levels mean that although the building is yet to be completed, there will only be roughly 10% or 2,450 square metres of lettable space available when the office building officially opens late this year.



GPO Tower Image Source: brandsanews.com.au

Further additions by way of new development in the Adelaide market will be scarce. The Festival Plaza development at Station Road, which encompasses over 43,000 square metres of lettable area, is not predicted to reach completion until 2021.

73-85 Pirie Street, the old Planet Nightclub site that has lay dormant since 2004, has now been granted

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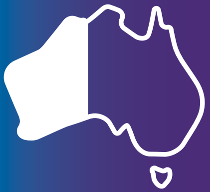
approval for a 21-storey mixed-use building that will add 30,000 square metres of lettable space and office accommodation to the market. CBUS Property purchased the site in 2018 and is hoping that construction will begin in the second half of this year.

Overall, the outlook for the Adelaide office market remains steady as unemployment figures continue to drop and net absorption levels for office properties rise as a result. The low interest rates and potential rate cuts will likely result in stagnant yields for the second half of 2019 and vacancy rates should continue to fall.



Western Australia

Perth

The start of the 2019 calendar year brought some much-needed positive news to the Perth office market on the back of the Property Council of Australia's Office Market Report which indicated the total vacancy rate for office space in the Perth CBD decreased from 19.4% to 18.5% in the six months to January 2019. The total vacancy rate in West Perth also dropped from 15.8% to 14.8% for the same period.

Whilst these statistics are encouraging with vacancy rates reducing overall, Perth's CBD has the 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 B, C and D grade space.

Leasing deals in the CBD during the first six months of 2019 have shown annual face net rents in the range of $300 to $450 per square metre. Face rents in the West Perth office district tend to be lower in comparison and typically fall between $250 and $350 per square metre per annum.

Property owners continue to be proactive in trying to entice existing tenants to recommit and also in order to attract new tenants. Accordingly, incentives are still being offered in the market (typically between 25 and 50%).

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 or child minding facilities within their buildings in addition to the obligatory end of trip facilities, bike storage rooms and in some cases, bike repair shops.

To date in 2019, the Perth office leasing market has seen both rental incentives and rental rates stabilise. There are no significant building projects in the pipeline until 2020 and the revitalisation of the CBD landscape with major infrastructure projects such as Elizabeth Quay continues to move ahead. Incentives for quality buildings in Perth's core CBD have even experienced some downward pressure with early signs of growth in the space needs of particular tenants.

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. Recent sales in the CBD have shown yields in the order of 7% to 8.75%.

As for West Perth, there have only been a handful of sales during the past 24 months. The lack of quality office stock with medium to long term WALEs combined with subdued economic conditions have affected transaction activity. We expect these trends to continue in the short term.

The start of the 2019 calendar year brought some much-needed positive news to the Perth office market.

Australian Capital Territory

Canberra

The Canberra office market maintained a steady pace through the first half of 2019 with a stable market benefiting from low unemployment, continued low interest rates and a strong local economy.

The demand for leasing deals has continued to show strength with good levels of enquiry from tenants evolving into leases at Childers Street and Moore Street in the CBD, both tenants securing sub-3,000 square metres. The A grade market continues to reflect strong demand with a vacancy rate of 1.7% reflecting the quality of space sought in the CBD. Due to a lack of new stock in the short term, the market is anticipated to see a further drop in vacancy levels whilst construction of new premises is underway with completion due in 2020. Rents for A grade space are averaging between $405 and $475 per square metre.

6-8%

Canberra prime office yields.

6.75-10.75%

Canberra secondary grade office yields.

Secondary B grade stock continues to reflect increased vacancy levels, currently at 13.9%, which will rise as a result of the relocation of both Home Affairs to the airport and the ACT Government to the CBD and Dickson with pre-commitments for the new space due in 2020. This provides opportunity for the existing sites to re-purposed in the future.

Recent sales volumes have been down on previous years however demand is persisting mostly from institutional and foreign investors with five-year-plus WALEs and national tenants being features sought after by investors. Yields are 6% to 8% for prime buildings and 6.75% to 10.75% for secondary grade. Secondary space rents are around $300 to $330 per square metre.