



# Commercial

March 2019

# National Property Clock: Office

Entries coloured purple indicate positional change from last month.



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# New South Wales

## Overview

The office property sector is an excellent measure of a region's overall economic health. With heightened fiscal activity comes increased demand from businesses keen to take on floor space.

This month, our team is looking forward and forming opinions on how our country's various office markets will track throughout 2019. While there are plenty of unknowns yet to come this year, the submissions from our valuers provide a brilliant baseline against which you can judge the year's progress.

## Sydney

The Sydney CBD continued to see growth throughout 2018 with rates for strata offices at record highs and achieved yields on capital investments at record lows. While no dramatic changes to this are expected imminently, it is anticipated that the number of transactions will decrease in line with a lower overall market sentiment fuelled by a tightening of lending restrictions, the fallout from the Banking Royal Commission, the upcoming state and federal elections and the downturn being seen across the residential market.

Growth across the Sydney CBD continued throughout 2018, fuelled by increased demand for good investment assets, significant growth in rental income, stock withdrawals and increased demand from owner-occupiers and self-managed super funds. We expect some of these sentiments to continue to drive demand in 2019, albeit at a



Parramatta CBD

Source: [commercialrealestate.com.au](http://commercialrealestate.com.au)

slower rate.

Sydney CBD office rents continued to grow throughout 2018 on the back of substantial withdrawals, insignificant supply and low vacancy. Vacancy rates are reported by Property Council of Australia (PCA) at 4.1 per cent as at February 2019 and any significant addition of office stock is anticipated to still be three to four years off. Following significant withdrawals throughout 2017 and 2018, rents are not likely to decrease any time soon.

The Southern Sydney precinct of the CBD appears to have bucked the trend otherwise seen across the CBD, with vacancy currently sitting at 6.9 per cent. That said, the opening of the light rail (anticipated for May 2020) will see increased accessibility to this precinct, making it more fully integrated to the prime CBD areas. This may, in turn, see this often overlooked precinct increase in popularity for office tenants and purchasers alike.

In terms of secondary CBD precincts, North Sydney currently has two premium grade buildings under construction and a third on the way, which will





provide new high-grade options for tenants looking to remain close to the CBD without the burden of a CBD rental. The appeal of Chatswood and the Crows Nest and St Leonards precinct also remain strong with decreased vacancy overall.

In the west, the Parramatta CBD has been the best performing secondary CBD in the country, with current vacancy rates at three per cent (PCA). The draw of Parramatta will continue to grow throughout 2019, with its overall connectivity, expanding university presence and 160,000 square metres of stock to be supplied over the next two years. Further, the requirement for high grade office space in Sydney's west will only continue to increase with the development of the airport at Badgerys Creek.

Macquarie Park has seen a revival of sorts, with record low vacancy rates at 4.8 per cent (PCA) which will likely see further tightening following the opening of the North West Rail Link this year. The rail link will provide a connection between the north-western suburbs through to the CBD and then in the future, out to Bankstown. This link will also provide significant connectivity to the Norwest business precinct, increasing its appeal in the market.

Opportunities for tenants looking for high grade and secondary office space will likely be seen throughout the secondary office precincts with an increase in supply not being seen in the Sydney CBD any time soon. Lower rentals will also be a draw card that has already seen premium grade occupiers moving out of the CBD, seeking more affordable but equally connected locations.

Overall, we expect the office market to perform well in 2019, although we do anticipate a slower market compared to 2018. There will be some great opportunities in the market this year,

particularly in areas where infrastructure improvements are likely to be completed or are nearing completion.

## Newcastle

Recent Property Council of Australia (PCA) data shows that office vacancies have once again reduced.

Currently the headline vacancy rate is 7.1 per cent, which is continuing to decline from nine per cent on 2017 data. There is some conjecture about that figure in that the headline vacancy rate does not factor in some 5,000 square metres of C- and D-grade space removed from the market. Arguably this skews the data to a more positive result, whereas there is a feeling that the result is due to increased demand for office space due to a sound local economy. The C- and D-grade office spaces closer to the centre of the CBD are more often being utilised for residential conversions.

There is a direct relationship between the migration of office projects west along Hunter Street and the completion of the Newcastle Transport Interchange. With the heavy rail line now ending at Newcastle West, it stands to reason that tenants would migrate this way to



Newcastle Interchange

Source: newcastletransport.info

make access easier as the light rail has reduced parking in the CBD. In addition, access is easier with three major projects comprising approximately 30,000 square metres of new A-grade office space almost completed or in early stages of construction. There is 9,000 square metres of office accommodation known as the Gateway 2 building to be tenanted by Newcastle City Council, which is moving from its existing base in the Civic precinct. Along with this is 16,000 square metres of commercial space by the Doma Group at the Newcastle transport interchange, as well as a further 11,000 square metres of commercial space at 723 Hunter Street. All of these developments are within easy walking distance of the Newcastle transport interchange.

We note that the New South Wales government is utilising Newcastle as a lower cost alternative for office accommodation outside of the Sydney CBD. As more projects come on line, further opportunities for this to occur are created. We note that a significant project at Hunter Street West is already pre-leased by the government.

Along with larger office tenancies moving west, we are seeing similar activity for smaller office tenancies as they migrate from Newcastle East to the centre of the CBD with the opening of the new law courts precinct. In the past 12 months, there have been limited sales of larger office sites, however we do note that yields for office accommodation are consistent at circa seven per cent and rents, on average, are \$300 to \$350 per square metre.

# 7.1%

vacancy rate  
Newcastle  
office space

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The imminent full operation of the Newcastle light rail will have an impact on the office market, more so at the lower end, as the larger tenants have already repositioned themselves closer to the transport interchange.

## Lismore

The Lismore office market appears to be in a state of flux. To date we have had a relatively stable market, however there appears to be an increasing oversupply situation, particularly in the mid to lower end of the market. There is also a slight oversupply of higher quality space, but given overall volumes, this is likely to be more stable.

The increasing oversupply situation in the Lismore CBD will make 2019 a year of uncertainty for some landlords with leases coming up for renewal. While tenants tend to be less fluid given the cost of relocation, tenants have a stronger bargaining position to negotiate a reduction in rent. The landlord will have to balance the risk of losing a tenant against accepting a lower rent.

Further exacerbating the risk is the increased vacancy within traditional retail space. Tenants have the ability to relocate to traditional retail space as downward pressure on retail rents make street front properties more affordable, albeit that street front properties must contend with the additional flood risk not normally a significant risk for first floor office space.

With the upcoming federal and New South Wales state elections, there is an element of uncertainty which generally leads to a softer market.

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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. A continuation of the trend of Byron Bay tenants moving to the industrial estate is expected as it is more affordable, has superior parking and has less disruption during high peak tourist seasons.

Office space in Ballina is concentrated along Tamar Street with a strong influence from government tenancies, traditionally in the higher quality spaces. This concentration attracts associated private companies and allied health services associated with the ageing population. Supply and demand remain in balance resulting in a likely stable market.

Overall, we expect the office market to be stable to softer throughout 2019.

## 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 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 per annum depending on size, quality and location.

There continues to be limited demand from the government sector although a recently completed

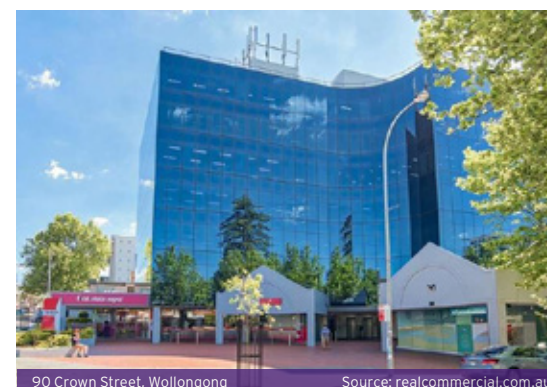
double storey office complex has secured New South Wales Forestry on a long-term lease at \$370 for 910 square metres. There has been increased demand for office accommodation from participants in the National Disability Scheme, with a number of organisations establishing locally, however price sensitive demand is slowing.

The direction of yields in development is dependent on 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, the market should remain in favour of prospective tenants in 2019 with an oversupply of space allowing negotiation. This will limit rental increases which should track in line with CPI increases.

## Illawarra

The commercial property market across Wollongong has exhibited sustained growth over the past three years with continued strong demand across a broad profile of buyers including investors (high net worth individuals and families) and private and second tier funds from Sydney, interstate and overseas.



90 Crown Street, Wollongong

Source: realcommercial.com.au

Investors over this time frame remain enticed to the market by yield arbitrage not typically found in Sydney and other major capital cities and this has pushed yields to low levels by historical standards. This is similar to most regional locations across New South Wales. Price point has become less of a factor with strong demand evident for higher valued assets (\$5 million and above) while there is good demand for secondary and tertiary quality assets that require immediate capital expenditure and intensive management focus to reposition assets.

A record price was achieved in 2018 in the Wollongong CBD office market (90 Crown Street for circa \$50 million-plus purchase price, 7.75% yield and WALE of 3.5 years) and while sales volumes are down overall, local agents are still reporting continued strong buyer interest. This asset class is still attracting capital.

Low interest rates and the increased buyer depth have resulted in strong yield compression with rents largely remaining flat over this period. For the year ahead, we expect to see some upward pressure being placed on rents, particularly for A-grade space. While recent history has been one of high performance, the market is considered to have reached the peak of its current cycle and at this juncture long term investment strategies and value add opportunities are considered prudent.



# Victoria

## Melbourne

According to the Property Council of Australia's Office Market Report, Melbourne CBD's office overall vacancy rate has reduced to 3.2 per cent over the six months to January 2019. Melbourne's CBD is now below Sydney's CBD and has the lowest vacancy rate amongst all of Australia's CBDs. The north-eastern and eastern cores have the lowest vacancy rates at 1.3 per cent and 1.9 per cent respectively, while vacancy rates are highest in the western and Spencer precincts, reflecting vacancy rates of 5.4 per cent and five per cent respectively.

Tenant demand also continues to rise in the city fringe. The highly sought-after office locations such as Richmond and Cremorne in particular have recorded the strongest increases.

According to online research reports, the office leasing market within the city fringe and inner east was strong over the past 12 months as tenants, especially from the creative, technology and business service sectors, actively competed for well-located and high quality fit out assets. Vacancy rates in the city fringe, inner east and outer east are below long term average vacancy levels.

There is solid sales demand from both owner-occupiers and investors for whole strata office floors within the Melbourne CBD. The strong



Melbourne CBD

Source: realcommercial.com.au

competition for CBD strata assets is also fuelled by the limited stock available on the market. Central CBD located investment assets are keenly sought after by higher net worth private investors and syndicates. We anticipate that the CBD office market will continue to perform well in 2019 as capital growth is driven by increasing market rents.

Statutory revaluations were conducted in January 2018 and valuations have now been released as part of the FY2018/19 council rates notices. The 2019 land tax assessments are

based on the 2018 revaluations. We understand that council site values 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 landlords, especially where properties are subject to gross leases and fall under the Retail Leases Act.

Overall, we expect the commercial office market in Melbourne to be stable in 2019 however we are cautious on the short to medium term outlook as we consider the market has potentially reached its peak. Low interest rates and high competition for assets has resulted in significant market activity throughout most sectors of

**Melbourne's CBD is now below Sydney's CBD and has the lowest vacancy rate amongst all of Australia's CBDs.**





the commercial property market over the past two years. Overseas buyers are prevalent and competition for well-located investment assets is high. Due to recent declines in the domestic residential market and uncertainties in the global macro environment, we caution that any uplift in interest rates or tightening of lending in the commercial space may potentially reduce buyer demand which may correspond to a reduction in commercial property value.

### Echuca-Moama

It's generally tough in the office market for the time being at a local level with limited business growth on the back of a challenging 2018 for the agricultural sector.

There appears to be a slight oversupply in the market with some discounting and relatively short rent-free periods periodically on offer to attract tenants. The market is still largely dominated by owner-occupiers with relatively few investor type transactions, although periodic sales continue to suggest yields in the order of seven per cent. Ongoing challenges are likely to include static economic conditions locally and water security which has traditionally underpinned the local economy.





# Queensland

## Brisbane

There are a number of macro and micro factors that will influence not only commercial office markets in 2019, but the broader Australian property market.

The overall property credit environment, which was already tightening, will come under further pressure as banks and politicians respond to the recommendations of the Hayne inquiry. Additionally, the forthcoming federal election is likely to (as usual) dampen market activity. With significant property market impacts likely if there is a change of government, uncertainty is likely to increase over the next three months.

In the current environment, we consider that the Brisbane office market for 2019 is likely to stabilise in the CBD and prime fringe CBD precincts, whilst secondary fringe and suburban markets will remain sluggish. Brisbane as a whole is still labouring under sustained high levels of oversupply in all office markets and is undergoing a slow recovery phase from the market depths.

Recent Property Council of Australia vacancy statistics show that vacancies in the Brisbane CBD market contracted in the six months to January 2019 to a five year low of 13 per cent. This vacancy reduction has been somewhat artificially enhanced however by tenant relocations from the Brisbane Transit Centre (to be demolished as part of the \$5.4 billion-dollar Cross River Rail development). This has seen approximately 16,000 square metres of lettable stock removed from the market, with a number of major tenants such as Australia Post,



DHL, Sonic Health Care and Queensland Rail needing to be relocated.

On the supply side, there is one major new building to be delivered in mid-2019, being 300 George Street. This will add a further 48,000 square metres of NLA to the market. Beyond this point, there is no significant new stock to be delivered before 2022.

Based on the dynamics of the Brisbane market, we consider that both rents and incentives for prime and A-grade buildings are likely to remain stable in the CBD throughout 2019.

Secondary and tertiary sub markets (C- and D-grade) are performing poorly as tenants seek modern, functional and contiguous

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accommodation. There was a sharp increase in vacancy for D-grade office accommodation in the six months from July 2018 (13.7 per cent) to January 2019 (20.8 per cent). This accommodation is now becoming redundant and owners of such buildings may potentially need to look at either significant refurbishments or re-purposing. Gross effective rents will be volatile as incentives remain high.

In the fringe markets, total vacancies have crept up slightly to 14.8 per cent on the back of 25,000 square metres of new supply (primarily in two new buildings). There is however no further supply anticipated in the next two years and expectations are that the vacancy level will start to fall back.

The fringe leasing market is dominated by the urban renewal (Fortitude Valley, New Farm, Teneriffe, Newstead and Bowen Hills) and inner south (South Brisbane, West End, Highgate Hill, Woolloongabba and Kangaroo Point) sub precincts. A-grade gross face rents range between \$400 and \$550 per square metre of NLA, whilst B- and C-grade rents range between \$300 and \$400 per square metre of NLA. Incentives typically range between 30 per cent and 45 per cent, and in some instances, incentives are above 45 per cent for large, secondary tenancies.

Milton and Spring Hill still have the highest recorded vacancy rates at 21.5 per cent and 17 per cent respectively and we will continue to see these sub markets perform poorly. There is a likelihood of incentives increasing in order to entice tenants to these areas.

Newstead, Teneriffe and South Brisbane still remain the favoured fringe CBD hubs and strong demand from investors and owner-occupiers will continue in 2019 as there is a lack of good quality stock available on the market.

The suburban leasing market is likely to remain patchy with some select locations such as North Lakes and Upper Mount Gravatt likely to outperform other suburban areas. Leasing in mid-suburban areas is slow and will continue to be driven by high levels of incentives. No rental growth is likely in the near future.

On the investment side, there have been a number of high priced sales in both the CBD and fringe markets in particular. Yields for A-grade offices that are well leased typically range between six and seven per cent, whilst secondary B- and C-grade offices range between 7.5 and 8.5 per cent. There is a growing disparity between prime and second tier properties. Yields on the whole are now stable but could soften for second tier assets over the next 12 months.

### Gold Coast

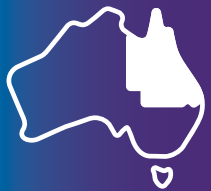
The highlight for the Gold Coast in 2018 was the Commonwealth Games that ran very successfully during April. It's fair to say that the direct impact on the Gold Coast commercial property market was less than expected. Notwithstanding this, the legacy of the new or improved infrastructure associated with the event has certainly produced positive sentiment for our region that will have all manner of benefits in the future.

The Gold Coast office market remained buoyant over the first three quarters of 2018. Tenant enquiry remained reasonably good, more so for A- and B-grade stock, influenced by the fact that there have been no new office buildings in the market place for several years and there is no shovel-ready construction in the immediate pipeline. The C- and D-grade stock sector, and more particularly older buildings or those in secondary or fringe locations, has however, exhibited an increasing number of "for lease" signs throughout 2018 to date. Property

Council of Australia (PCA) office vacancy data for the Gold Coast for the six-month period to 30 June 2018 was 12 per cent. This was up 1.4 per cent over the level of 10.6 per cent at 31 December 2017, and slightly higher than the level twelve months ago of 11.3 per cent at 30 June 2017.

Rental levels for A- and B-grade space moved up over the course of 2018 to more commonly fall within the range \$400 to \$550 per square metre per annum gross. Rental levels for C- and D-grade categories remained steady, although more recently appear to be experiencing downward pressure due to tenants being prepared to move to and pay higher rental for better quality space. Rentals for this floor space category more commonly fall within the range of \$300 to \$400 per square metre per annum gross. The level of incentives across the board has remained fairly static, at circa ten per cent of the first term's rental.

Notable sales of larger office buildings concluded over the course of 2018 to date include: Icon Energy at 4 Miami Key, Broadbeach in February for \$7.81 million (reflecting an analysed yield of 6.2 per cent and \$5,416 per square metre on lettable area); Southport Chambers at 56 Nerang Street, Southport in April for \$6.973 million (reflecting an analysed yield of 6.7 per cent and \$3,467 per square metre on lettable area); and 140 Bundall Road, Bundall in August for \$7.05 million (reflecting an analysed yield of 7.5 per cent and







50 Cavill Avenue, Surfers Paradise

Source: commercialrealestate.com.au

\$2,243 per square metre on lettable area, however circa 44 per cent of the area was vacant).

In the latter portion of 2018, we noted that several further office buildings were listed for sale. Possibly this is a reflection of owners seeking to capitalise on the more buoyant conditions that have prevailed within the Gold Coast office sector over the past few years. At the time of writing, these included:

- **154 Varsity Parade, Varsity Lakes** - 3,994 square metres lettable area.
- **50 Cavill Avenue, Surfers Paradise** - 16,625 square metres lettable area.
- **1 Bellvue Drive, Varsity Lakes** - 3,764 square metres lettable area.
- **169 Varsity Parade, Varsity Lakes** - 3,364 square metres lettable area.



154 Varsity Pd, Varsity Lakes

Source: commercialrealestate.com.au

50 Cavill Avenue in particular will be a litmus test for market sentiment. This A-grade office building was purchased in early 2016, at which time it had a reported vacancy of circa 45 per cent. Following significant refurbishment and a leasing campaign, the building is now reported as 97 per cent leased reflecting a WALE of 4.21 years and

an income stream of circa \$7.6 million per annum net (fully leased).

In 2019, we anticipate economic and political influence (both domestic and international) is likely to be more prevalent on the Australian commercial property sector. In particular, the financing environment (interest rates, borrowing conditions, etc) are likely to become more difficult.

This may result in a higher incidence of commercial property being placed on the market, particularly investment property, as owners seek to realise capital gains that have been created by firming yields in more recent times.

In respect to the Gold Coast office sector, we consider that the above mentioned pool of office buildings currently listed for sale is an early indicator of this scenario for our region.

In respect to other metrics, despite a slight upward tick in the vacancy levels reported in the PCA July 2018 Office Market Report, the general downward trajectory of vacancy levels on the Gold Coast that has prevailed over the past few years is anticipated to continue. The rate of growth in rental levels is coming off a base that has been recalibrated (generally downward) over the past few years. Therefore, going forward, based on these suppositions and observations, positive annual rental growth is likely achievable, but in a more controlled mode. However, a more difficult borrowing environment (including higher interest rates), may result in a softening of yields and investment returns. Overall, taking into account all of these elements, we consider the net effect for 2019 will be that value levels will remain reasonably consistent with those demonstrated in office building sales concluded during 2018.

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## Toowoomba

Leasing demand for commercial office accommodation in Toowoomba has been considered moderate for a few years with this trend likely to continue in 2019. As a result there is not expected to be a significant growth in rentals and it is possible that some lease incentives may be required to secure tenants.

Rentals can vary greatly depending on factors such as:

- quality of office accommodation;
- location (most popular areas are the CBD fringes);
- access (inner CBD properties for example can be difficult to access during peak traffic);
- inclusion of car parking (considered a key factor);
- access for people with disabilities (PWD) for upper level tenancies.

Rentals 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 are several potential commercial redevelopment sites in Toowoomba ready to be developed. The reduced leasing demand however has delayed most projects with an owner-occupied driven development in Campbell Street being the only project to have commenced construction. It is unlikely that any other project will proceed in 2019 unless significant lease pre-commitments can be secured. The projects will also likely need to achieve

market leading rentals to make projects feasible.

The low interest rates have resulted in strong demand for commercial properties by investors. Office buildings with good lease profiles however have been tightly held with very few investment sales over the past few years. There are however a few quality investments currently on the market which should result in sales in early 2019.

Strong demand from owner-occupiers will likely continue into 2019, particularly for premises with floor areas of up to 300 square metres. There currently appears to be a reduced supply in this market segment, which may result in some sales reflecting a premium price. It appears that the inclusion of good car parking is a major factor for buyers.

## Townsville

The year ahead for the office market is likely to continue along the same path as it did throughout 2018 with interest underpinned by national investors for property offering strong investment returns with long term leases or national tenants, combined with counter cyclical purchases.

There is positive sentiment in the market on the back of major projects underway including the North Queensland Stadium, Haughton Pipeline duplication and the port channel widening, along with the recently announced projects including the \$300 million Sun Metal zinc refinery expansion and improving confidence in the mining sector. To date market reaction to these developments has been relatively subdued, although is gaining traction, albeit at a very slow pace.

Leasing activity is likely to remain flat with a current over supply of available property relative to current demand creating no real stimulus for rental growth. Incentives by way of contribution to

fit-out and rent-free periods for new office leases are likely to remain throughout 2019 with fierce competition from landlords to secure leases for premium tenants.

## Sunshine Coast

The Sunshine Coast office market has had a significant level of supply added to the market over the past two years. Circa 42,000 square metres of space was added to the market during 2017 and 2018, which has increased the overall vacancy level from 6.9 per cent in January 2017 to 15 per cent in January 2019. Circa 12,000 square metres of stock has been absorbed in that time, which is slightly up on the long term trends in this market.

This large increase in stock is likely to continue in 2019. The Suncentral development is likely to have the first two office buildings commence development in the latter half of the year; the Sunshine Coast Council is likely to commence development of its new chambers; and development company EvansLong will begin Foundation Place, which is to be circa 4,500 square metres of office space.

While this increase in overall office space is of concern, there are other factors at play which allow some level of optimism within the office market.

In 2018, the Sunshine Coast Council secured the new international broadband submarine cable to

**42,000 sqm**

**of office space**  
was added to the  
market during  
2017 and 2018.  
This has increased  
the overall vacancy  
level from **6.9%**  
in January 2017  
to **15%** in  
January 2019.





land on the Sunshine Coast. This cable will enable the Sunshine Coast to have the fastest connection speeds to Asia and the second fastest to America from Australia. Modelling of the economic impacts for this cable is for circa 860 new jobs and up to circa \$920 million in new investment. It will allow Queensland businesses to bypass Sydney internet connections and connect direct internationally.

The Council is hoping that this will now give the Sunshine Coast an added advantage over other locations for large IT and data intensive companies. This is currently being marketed along with the benefits of the Suncentral development, which is a greenfield CBD development. The cable is due to be completed in early 2020 with all rights secured for its establishment.

Notwithstanding the above, it is still likely that there will be increased downward pressure on effective rental levels for landlords, particularly for those with space in secondary style buildings or locations. Over the past 12 months we have seen significant incentives of up to 25 per cent in the market and this is likely to continue during 2019 for secondary style stock. Prime locations and complexes appear to be maintaining both their high level of occupancy and overall rental levels currently in the market.

## Rockhampton

More positive market sentiment and some green shoots have been seen in Rockhampton's residential market in recent months and we are hopeful that 2019 will see these positive indicators flow on to the commercial market. It is unlikely that there will be any substantial value

risks, but decreased vacancies, new development, and increased activity in general may be seen.

Rentals have remained relatively stable over the past 12 months, indicating a range of about \$225 to \$300 per square metre gross for the average semi-modern or modern office space within the CBD. Secondary tenancies are likely to continue to prove difficult to lease.

There have been some good opportunities for owner-occupiers in recent years and we anticipate that activity by this buyer type will continue throughout 2019 given that interest rates remain at record lows. Owner-occupiers of office accommodation are likely to continue to remain most active in the sub \$750,000 price bracket.

If purchasing an office building, we generally call attention to some of the following items:

**Car parking** - is there ample on-site car parking? Car parking is slowly becoming a substantial factor in office leasing and if you don't have any to provide to prospective tenants, then your property will become difficult to lease and you may need to accept lower rental rates.

**First floor walk-up only:** properties that have a first floor accessed only by a stairwell may also be problematic as these areas are not only becoming increasingly difficult to lease, but do not comply with requirements for disability parking.

## Gladstone

We consider that 2019 will be a watch and see year for the office sector in Gladstone. There are some positive signs in the residential sector (such as

tightening vacancy rates and increasing weekly rentals) indicating a potential market recovery and we hope that this indicates a positive flow on effect for the office market.

Whilst market sentiment may improve, any improvement in market conditions is likely to be slow and we therefore anticipate conditions in Gladstone's office sector will remain relatively flat for 2019. There is likely to be a continued stabilisation of rents, however incentives are likely to remain until vacancies decrease.

Most of the office sales activity over the past 12 to 18 months has been to owner-occupiers in the sub \$700,000 price bracket. Local business owners recognise that it is a perfect time to secure their own premises as a result of low interest rates and the stage of the property cycle, and we anticipate that this activity will continue throughout 2019 where opportunities exist.

## Wide Bay

The Wide Bay's office markets are currently quite stable across the three major towns (Bundaberg, Hervey Bay and Maryborough). The sector has been largely influenced by medical uses with the health precincts being situated in the more prominent localities outside of the city centres.

## Bundaberg

In 2018, a variety of office stock was put to the market and subsequently sold within Bundaberg. At the lower end of the market, 32 Crofton Street, Bundaberg Central sold subject to a new three-year lease for \$397,500 or circa eight per cent. At the top end of town, 70 Barolin Street, Bundaberg South sold subject to an extended lease term of five years for \$2.13 million - circa seven percent.

These sales demonstrate a reasonable level of investor demand within the Bundaberg market

**Owner-occupiers of office accommodation are likely to continue to remain most active in the sub \$750,000 price bracket.**

which has been heavily driven by owner-occupiers over the past few years. Owner-occupiers still appear to be the dominant buyer profile, particularly within the sub \$1 million price range. Overall, the 2018 office market was relatively slow with a low volume of sales occurring throughout the year.

The leasing market in 2018 was somewhat slow, with a low volume of new office leases established. Office tenancies within the more prominent locations typically achieve in the order of \$250 per square metre and \$350 per square metre gross for better quality tenancies and \$200 per square metre to \$275 per square metre gross for lesser quality tenancies.

In 2019, we anticipate a low volume of office sales accompanied by limited gross rental growth prospects.

### Hervey Bay

There was a low volume of office sales in Hervey Bay in 2018. The rental market was also relatively quiet with gross rents in prominent locations ranging in the order of \$250 to \$320 per square. Vacancies within the office sector are reducing, however, remain somewhat elevated.



**\$250 to \$320**

per square metre  
gross rents in  
prominent locations  
in Hervey Bay

It is anticipated that 2019 will see construction commence on a new community titled office development along Torquay Road. We would expect a low rate of sales throughout the year with gross rental growth prospects remaining low.

### Maryborough

Maryborough had a typical year in 2018, with a low volume of sales and a low volume of leases established. A notable sale was 312-314 Kent Street which sold subject to a new one-year lease to Council for \$445,000 or circa nine per cent.

2019 is expected to be much the same for Maryborough. Sales activity should be stable and slow with gross rents expected to remain stagnant throughout the year.

### Mackay

Office rents and values remain flat despite a moderate improvement in market sentiment caused by an improving local economy.

A contemporary style double-storey office at 22-24 Wood Street, Mackay with net lettable area (NLA) of 2,031 square metres sold in December at \$3.5 million after being on the market for several years. It was occupied by the Department of Natural Resources and Mines and the Department of Housing and Public Works on two-year lease terms which both expire in February 2020. Our preliminary analysis shows a passing yield of between 14 and 15 per cent with a WALE of 1.19 years which is much higher than other local property investment sales. This sale also shows \$1,723 per square metre of NLA which is well below replacement cost.

Outgoings including local authority rates and building insurance premiums have risen considerably in Mackay over the past ten years to diminish investment return from the weaker office rental market which has fallen by around 25 per cent in recent years. This is offset to some degree by a reduction in land tax liabilities due to a reduction in statutory land values of over 40 per cent since the 2008 peak.

Leasing activity is beginning to improve, however office vacancies in Mackay City remain fairly high. Most spaces available for rent are generally old and not well presented for lease. There is a level of unsatisfied leasing demand for good quality and well-presented offices with efficient and reliable air conditioning and NLA of 100 to 200 square metres.

Moving off topic from the office sector, we could not let this edition of the Month In Review go past without commenting on several major transactions in the central Queensland accommodation sector in the recent past. These are:

► **Mackay Grande Suites** at 64 Wood Street, Mackay which sold in August 2017 with a delayed settlement. This is a seven-storey complex with 91 guest rooms and suites, a reception and lobby area, conference facilities with seating for 200 delegates, indoor swimming pool and gymnasium, AM Bar, bistro and gaming room with 45 EGMs, Cactus Jack's Bar and Grill, manager's unit and 34 car parking spaces. It sold for \$20 million, a record price for an accommodation property in Mackay.

► **Travelodge Rockhampton** at 86 Victoria Parade, Rockhampton which sold in October 2018 for \$5.8 million. This is an older style, four-star, ground floor and eight upper level accommodation hotel. The complex provides 74 guest rooms, non-operational restaurant, conference rooms, gym and ground floor breakfast and dining room. An adjacent site at 83A Bolsover Street is an older style, two-level building comprising a ground floor commercial laundry and first-floor two-bedroom manager's residence. Additional car parking is also provided on this allotment.

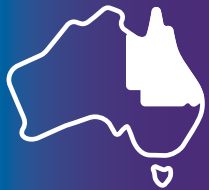




► **Rydges Gladstone** which was reported to be under contract in November 2018 for \$2.1 million and comprises an older style, strata titled, four-star rated, 72-room accommodation hotel with restaurant, bar and conference facilities.

Despite the recessionary market and economic trends in Central Queensland which have prevailed in recent years, it appears as though good quality properties are saleable to counter-cyclical buyers prepared to take a long term view to achieving improved occupancy rates and levels of profitability. Prudent buyers for this type of asset are generally very well informed and realise that while the accommodation market remains subdued, there is an opportunity to purchase properties at prices that represent reasonably good value. The transactions mentioned above

are all considered to be typical of such counter-cyclical investment opportunities. We are aware of another major motel property in Mackay which is under contract of sale and fits into the same category.



# South Australia

## Adelaide

Green shoots is the catch phrase from the Property Council's recent report on the status of the Adelaide CBD office market after four consecutive quarters of reducing vacancy. What's more, this reduction was uniform across all grades with only B-grade remaining essentially flat. Similarly, incentives are also coming down from the historic highs of only 12 months ago.

That said, there remains approximately 203,000 square metres of space vacant in the CBD, meaning there is space left to be absorbed. Hence green shoots or baby steps - not a boom. This is Adelaide after all, but still, shoots or steps is in the right direction.

In terms of returns (yields), the dynamic affecting the Adelaide office market is consistent with the whole property sector - low yields fuelled by the low interest rate environment. Despite the sluggish economic conditions affecting South Australia and the poor rental growth, yields are low, in fact very low when considered in the context of the vacancy rate.

Ten years ago, in the mire of the post GFC environment (or perhaps right in the confusion of it all), CBD office vacancy was around 3.3 per cent overall (highest for the premium Grade). Prime yields were between 8.5 per cent for premium grade to 10.5 per cent for C- and D-grade. Rents were growing steadily at over eight per cent in the 12 months prior to the first quarter of 2019. Net face rents were at \$335 per square metre for premium grade and \$147.50 for C- and D-grades.

### ADELAIDE'S NUMBERS:

- Vacancy rate **14.7%**
- Prime net face rents **\$420/m2**
- Secondary net face rents **\$250/m2**
- Rental yield **7%**

The local economy has been like a roller coaster over the past ten years - two Premiers (but six Prime Ministers, so we're actually ahead), the Olympic Dam expansion announcement and then its shelving, One Steel liquidation, Holden was staying then it might be going and then it was gone, submarine constructions, three major infrastructure projects on South Road, two new hospitals, and who knows how many blackouts.

*Within the CBD office market there might be higher demand and lower vacancy.*

Ten years on and vacancy is at 14.7% (lowest for premium grade) with the much discussed flight to quality. Net face rents are growing but only just, prime net face rents are \$420 per square metre and \$250 per square metre for secondary. However, yields are sitting below seven per cent.

So where to from here? What does 2019 hold in store for the Adelaide office market?

Well, probably nothing earth shattering - again, this is Adelaide people.

A continued reduction in vacancy rates as premium grades get absorbed, along with incentives returning to more sustainable levels will contribute to an improvement in effective rents. We don't anticipate a significant shift in yields over the next 12 months. So, we face a very interesting situation; the market is improving, the economy is improving, but yields are close to bottoming out and will at some stage experience upward pressure, probably correlated to interest rates. So, are there any of those on the cards? Probably not from the RBA, however the results of the recent Banking Royal Commission will see a significant shift in the operation of banking, a move away from wealth management services and generally higher operating costs. It is not impossible this gets passed on via a rate rise.

It is not impossible therefore that in 2019 we will experience an improved local economy and within the CBD office market there might be higher demand and lower vacancy, possibly growing rents and yet also upward pressure on yields.

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# Western Australia

## Perth

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

The most recent Property Council of Australia figures for the Perth CBD office market indicate that the total vacancy rate decreased from 19.4 per cent to 18.5 per cent in the six months to January 2019. The total vacancy rate in West Perth has also dropped from 15.8 per cent to 14.8 per cent 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 that of B-, C- and D-grade space.

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

Recent leasing deals in the CBD 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.



*Perth's CBD has the highest vacancy rate of all capital cities in Australia.*

Property owners are being 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 (typically between 30 and 55 per cent).

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 or 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.

Looking ahead to 2019, we envisage that the Perth office leasing market will see a stabilisation in rental incentives and rental rates over the short term given that there are no significant building projects in the pipeline until

**19.4%**  
↓  
**18.5%**

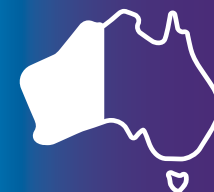
Perth CBD total vacancy rate decreased in the six months to January 2019

2020 and taking into account the continuing revitalisation of the CBD landscape with major infrastructure projects such as Elizabeth Quay. Incentives for quality buildings in Perth's core CBD may even experience 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 during the past 12 months has been felt predominantly from institutions and foreign (mostly 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 seven to 8.75 per cent.

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 has affected transaction activity. We expect these trends to continue in the short term.

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# Australian Capital Territory

## Canberra

The ACT commercial office market is well positioned to undergo a year of stabilisation, fostered by solid employment growth in the capital in both the public and private sectors. Supply levels are expected to increase from the historically low levels of previous quarters. The demand for high quality A-grade stock is set to increase; we note a drop in the total vacancy factor from 8.8 to 5.2 per cent for the 12 months to January 2019.

Across the market, vacancy rates are expected to tighten for A- and B-grade stock. Effective rents are expected to rise in both the primary and secondary markets as traditional incentives decline and continue to move towards an increased demand for specialized and more flexible fit outs. 2019 will see yields continue to compress for core products, with increased investor demand, both domestic and international, when comparing Canberra to other capital cities.

The continued emergence of co-working spaces and buildings with shared facilities to satiate an ever-growing mobile office population that demands more flexible spaces coupled with a move

towards smarter, more energy efficient buildings will see an increased proportion of current B-grade stock undergoing substantial refurbishment and modernization in order to stay competitive and garner local and offshore investment interest.

Going forward, we anticipate lower grade commercial stock (C- and D-grade) will continue to experience subdued capital growth coupled with increased vacancy rates, especially in non-central locations. Commercial rates are also expected to continue an upward trend from historic levels.

8.8%



5.2%

Canberra vacancy rates decreased for the 12 months to January 2019.

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