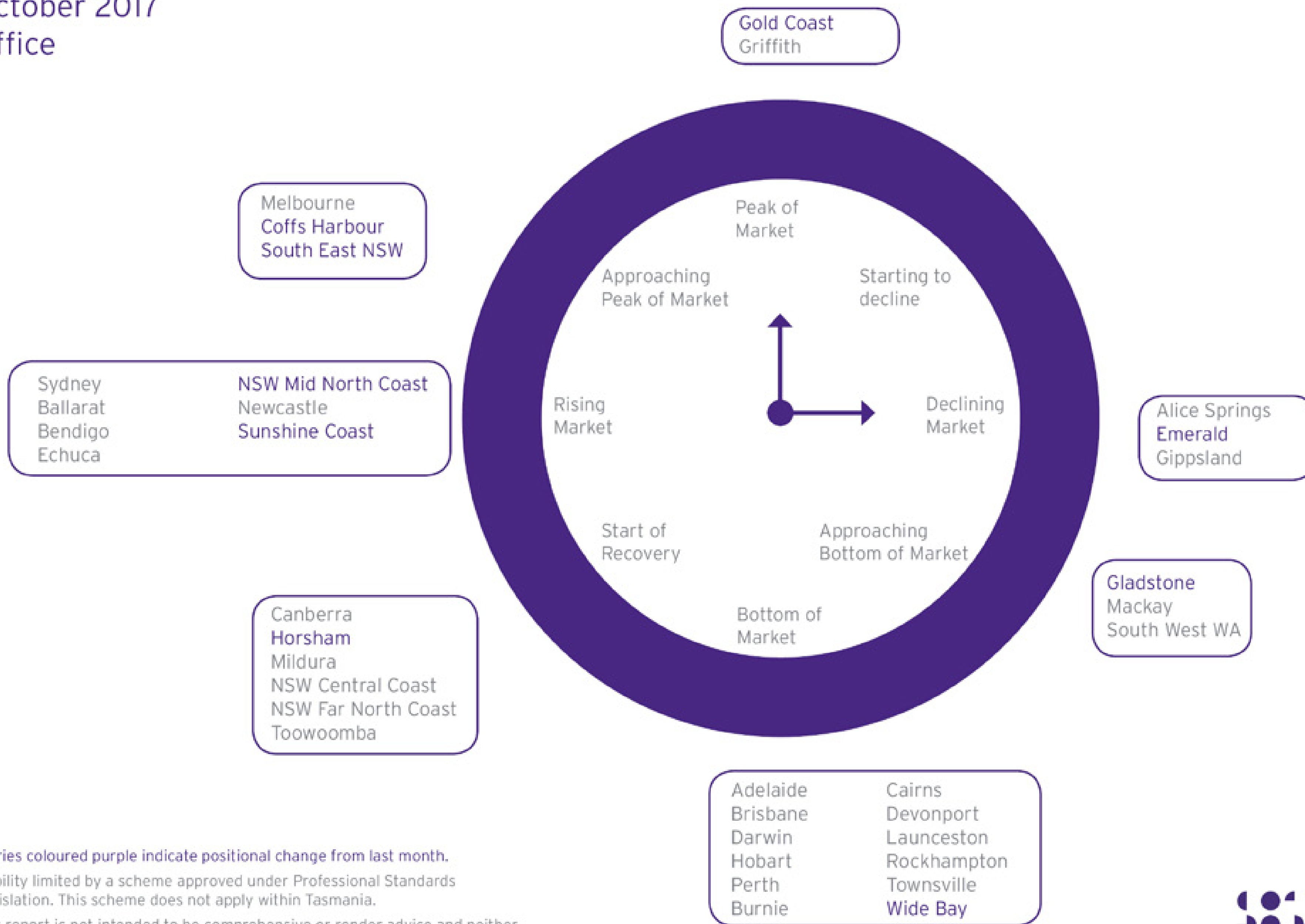
Commercial

HERRON TODD WHITE COMMERCIAL

National Property Clock
October 2017
Office



Entries coloured purple indicate positional change from last month.

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New South Wales

Overview

The commercial property sector is hinged to its income and offices fall firmly within this space.

Office markets across the country are wide and varied and given advancements in communications technology, the time had never been better for tenants looking to set up and operate across borders from wherever the most economical space can be found.

With this in mind, we've asked our team to consider the rental market in the office realm. Among the next few pages is a comprehensive guide on where rentals sit, and what you can expect in the future.

Sydney

The past 12 months has seen a significant increase in both rental rates and capital values across Sydney CBD strata office stock. We have seen strata office rentals climbing from a typical range of $400 to $600 per square metre to $600 to $900 per square metre depending on location, size and amenity. We consider rising rentals to be intrinsically linked to increasing capital rates and as such, it is hard to consider rents without having regard to the wider office market. In terms of capital values, we have seen rates within the prime city core precinct rapidly increasing past $10,000 per square metre and recent sales reaching as high as $16,000 per square metre.

A surge in demand from owner-occupiers appears to be propelling this strong value growth and for a variety of reasons. The current interest rate environment of record low rates is fuelling borrowing power and market sentiment across the board. The current low cost of money combined with the impact of rising rents has seen a significant increase in the number of tenants looking to purchase to owner occupy. This appears to be a strong driver in increasing capital values as tenants looking to owner-occupy as well as owner occupiers in general are typically less reliant on potential yields and as such, are more willing to pay a premium to secure the property they desire.

The impact on the rental market of tenants continuing to purchase is that investment stock is increasingly being removed from the market, pushing rental rates up as rental supply begins to dwindle. In addition, up to twenty CBD building are earmarked for demolition to make way for the new light rail and Sydney Metro lines, further decreasing available rental stock.

The number of offices being offered for sale recently throughout the CBD also appears to have decreased, with demand outweighing supply. This has further impacted capital values, with agents reporting multiple interested parties for almost every property offered to the market. With many suites recently being taken to auction, this market interest is seeing hotly contested auctions with results reflecting the current demand in the market.

We do have some concern regarding the sustainability of the recent capital values seen throughout the CBD and consider that any significant increase in interest rates will likely see this growth halted.

The Sydney CBD is currently undergoing a significant face lift, with the new light rail and Sydney Metro services aiming to improve commutes and increase connectivity to and throughout the CBD, and the recent and continuing development of Barangaroo and associated works. Although all this development seeks to improve the overall CBD in the long run, current disruptions cannot be ignored. Significant recent road closures, the most obvious being George Street, and road works throughout the whole of the CBD can be considered a huge disruption to day-to-day office users, both owner-occupiers and tenants, who are regularly being impacted by both the decreased CBD manoeuvrability and construction noise. Despite the current impracticalities of the CBD, it appears that purchasers can see the light at the end of the tunnel. Of course, that poses the question of how the market will respond to the completion of the face lift.

Canberra

The Canberra office market is displaying positive signs of reduced vacancy rates and some rental growth in the past few months which is a welcoming change after a number of years of vacancy levels above 10%. As at July 2017 the overall vacancy rate had reduced from 12.6% in January 2017 to 11.4% in July. As a consequence, rents for prime office space have grown by 2.1% to $459 per square metre and secondary space rents grew by 4.5% to $401 per square metre for July 2017.

The strength of the local economy and stable unemployment figures standing at 4.4% have continued to see growth in tenant demand from both the private and government sectors and consequently this has resulted in one of the strongest periods of positive net absorption of 23,431 square metres in the past six months. Recent deals have included the absorption of space in Barton at 4 National Circuit and the take up of 3,059 square metres in Civic. The withdrawal of space for alternative use projects such as hotels and residential conversion is also increasing the downward pressure on vacancy rates. The 1,805 square metre property at 7-11 Barry Drive, Turner was let to ANU for three years at $380 per square metre gross and the 6,915 square metre 7 London Circuit, City was let to Commonwealth Super at $470 per square metre gross. Demand for A grade floor plates over 2,000 square metres is increasing and a dearth of available space is expected to see growth in A grade face rents in the short term. Vacancy rates are anticipated to decline below 8% in the later half of 2019.

Current incentives are fluctuating between 15% and 20% for A grade space in Canberra City. B grade space is indicating incentives between 15% and 25%. Office space in other town centres are also showing incentive levels of between 15% and 20% for A grade space and 15% to 25% for B grade offices. Incentives continue to be offered in the market however these should reduce as demand increases.

Growth in demand for office space is expected to continue in the short term with 40,000 square metres anticipated to be released onto the market that is predominantly pre-committed and this is supported by the Tuggeranong Office Park. Vacancy levels are expected to tighten in the next six to twelve months. A number of government lease expiries are to occur between now and 2019 resulting in over 55,000 square metres of space being negotiated in the market. Incentives will decline and face rents will increase along with demand seeing effective rents continuing to rise.

Illawarra

Commercial office leasing conditions in the Illawarra region have improved over the past one to two years with local leasing agents reporting increased enquiry levels and reduced vacancy periods for well-placed tenancies in good quality buildings with good off street parking availability. Incentives remain common with discounts of between 10% and 20% of gross annual rent typically required to attract a new tenant on a five plus year lease term. This incentive is usually in the form of a free rent period.

While rents have remained stable over the past five years there are signs that future growth will occur given the low A grade vacancy rate and strong local economy. Some leasing agents are of the opinion that there is appetite for A grade rents in the plus $500 per square metre gross range which would set a new benchmark if achieved and may justify new construction. The leasing market for large floor plates is still largely driven by government departments at both state and national levels. Large global and national corporations (head offices) are not active in the local market.

The latest Property Council of Australia Office Market Report dated January 2017 surveys the Wollongong office market as having a total vacancy rate of 11.2%, which is a decrease from the 12.2% vacancy rate reported in January 2016. Demand remains the highest for A grade space with a total vacancy rate of 5.7%, significantly lower than the 16.7%, 15.1% and 27.6% vacancy rates for B, C and D grade spaces. However, these vacancy rates are skewed by the exclusion of Innovation Campus and Coniston from the survey.

Newcastle

Market conditions are currently strong in the Newcastle office market and property is selling well, at tight yields, for ever increasing rates per square metre. This is due to equity being available from the good residential property market, the low interest rate environment and the Newcastle Rejuvenation project, which is producing all sorts of construction and infrastructure action in town. Let's examine now whether the local rental supply and demand fundamentals are in line with the current capital market growth. This is one way to determine whether we are indeed currently in a market bubble or whether the market growth is more sustainable over a longer time frame.

According to the Property Council of Australia the Newcastle office market suffered a negative net absorption over 12 months in 2016 of 17,841 square metres. In 2017 however, stock withdrawals and take up in the CBD has reduced vacancy rates across all grades with a positive net absorption of 12,504 square metres. The majority of this office take up has been in A grade where 12,183 square metres of net absorption has occurred. This has been primarily in the new construction in the Honeysuckle precinct.

We'll have to wait now until 2018 for the completion of The Gateway Stage 2 on the corner of Stewart Avenue and Hunter Street before we see any more A grade additions, further increasing upward pressure on A grade face rents.

In fact we've seen vacancy rates fall across all office grades in 2017, the biggest mover being D grade, tightening from 25% in 2016 to 7.1% in 2017. This limiting pressure on rental supply has placed upward pressure on gross face rental growth in the CBD across the board. We expect a continuation of this rental growth in the Newcastle office market in the short term while pipeline construction remains relatively limited and rental enquiry remains strong.

Victoria

Melbourne

According to the Property Council of Australia's Office Market Report, Melbourne CBD's overall office vacancy rate has stabilised to 6.5% over the 12 months to July 2017 from 7.1%. Melbourne continues to host the second lowest vacancy rate amongst all Australian CBDs, second only to Sydney. A net absorption of 21,430 square metres in the CBD was recorded in the six months to July 2017 and a total of 18,939 square metres of new stock is due to enter the market in 2017. The stabilisation of the vacancy is mainly due to the high net absorption rate of prime Melbourne CBD office stock. Tenant migration in pursuit for building quality or location, underpins the demand for prime office space within the CBD, while a large amount of secondary space has been withdrawn from the market for refurbishment or redevelopment which improves the vacancy rates.

The Eastern Core and Docklands precincts have the lowest vacancy rates at 2.6% and 2.1% respectively, while vacancy rates rose in the Civic and Flagstaff precincts.

There is limited new prime office supply over the next two years before a large deluge of supply is forecast for 2020. Therefore, it is anticipated that vacancy rates will continue to fall over 2018 and 2019 before rising again in 2020. Correspondingly, we expect to see potential sharp rental growth over the next two years as well as a decline in incentives, before levelling back out again from 2020. Notwithstanding, leasing incentives continue to be relatively high with 25% to 30% net incentives being offered for longer lease terms across larger tenancies. With respect to secondary office stock, landlords are finding it challenging to secure tenants within B and C grade buildings due to the large volume of competitive stock on the market, particularly in precincts situated on the fringe of the CBD. Smaller tenants are exhibiting a preference for existing fitted and refurbished space.

There is significant growth in tenant demand from the Education and Training sector recording an increase of 226% over the past 12 months, especially education institutions which account for approximately 75% of total Government and Community sector leases in the first half of 2017. Pre-commitment activity was also at a record high since June 2011. For example, Deloitte pre-committed to occupy approximately 22,000 square metres of office space on a 12 year lease at 477 Collins Street which is due for completion in June 2020.

St Kilda Road contains approximately 684,000 square metres of lettable space. It is reported that the office stock has shrunk by approximately 20% from its peak in 1992. Research shows approximately 18,014 square metres of office space was withdrawn from the St Kilda Road market over 2016. There are significant withdrawals of office accommodation as many developers are buying existing older style office buildings with the view to converting or redeveloping them for residential purposes.

This reduction in stock and displacement of tenants has given a slightly false take on the St Kilda Road market, as tenant demand is still some way off historically high levels pre GFC. The market has also seen a flight to quality, with the A grade buildings performing better than their B grade counterparts. Those owners that are investing in the building services and end of trip facilities are being rewarded by a reduction in the letting up periods and stronger rents. Due to the Melbourne Metro Rail project, traffic along St Kilda Road will be severely restricted for the coming two to three years. Discussions with local leasing agents reveal that some existing tenants are attempting to take advantage of this situation by using it as a lever for better deals on renewals,

particularly around negotiating shorter lease terms. Smaller tenants up to 500 square metres are showing a strong preference for either existing fitted space or space where the landlord has speculatively built a fit out. This type of space is leasing relatively quickly and achieving good rents with minimal incentives required on top of the fit out.

The city fringe office vacancy rate also fell to a record low of 3.47% in March 2017 from 4.96% in September 2016 due to strong demand and limited supply. We are witnessing strong tenant demand for modern boutique style office space within inner suburbs such as Richmond, Cremorne and Collingwood. The strong demand has driven both face and effective rental growth within this sector. Secondary space within the city fringe also records a year-on-year growth of 10% with average incentives of 18% which is significantly lower than the incentives offered in the CBD.

Echuca

A broad range of $200 to $300 per square metre seems to apply for all but the very small tenancies where a rate per room might apply, older stock and stock at secondary locations or first floor accommodation. This is likely to continue although several larger developments have been mooted which are likely to bring additional supply onto the market.

At a local level it will be interesting to see what the impact of the project management team for the proposed second bridge will do to both the office and residential rental markets.

South Australia

Adelaide

The South Australian Economy has faced a protracted period of poor performance typified by the General Motors car manufacturer shutting its doors in October 2017, ending 60 years of construction in Australia. The decision by General Motors, and the Federal Government's policy shift in supporting the industry, exemplifies the problems facing almost all forms of general manufacturing in South Australia which is having flow on effects across the entire economy. The South Australian unemployment rate remains the highest in the country at 6.9%.

Secondly, South Australia is currently faced with the country's highest electricity costs which is exacerbating a contracting commercial market, illustrated by the closure of the Thebarton Coca Cola plant. The state Labour government's persistence with renewable clean energy over coal fired-power is the major contributing factor and it's unknown what positive impact, if any, the proposed construction of the world's largest lithium battery in Jamestown with tech billionaire Elon Musk will have.

A positive has been the securing of Defence construction contracts. After the completion of the Air Warfare Destroyer (AWD) the Future Frigates programme will commence in 2020 with an estimated spend of c$35 billion. Following this in 2022 is the Future Submarine project, comprising 12 submarines at an estimated spend of circa $50 billion. The projects are expected to provide over 2,000 jobs.

However, these positive signs have done little over the past 12 to 18 months to improve demand within the CBD office sector. The South Australian Vacancy rate remains the third highest in the country and at 16.1% and is close to the 18 year high of 16.2% recorded in January of this year (PCA Jul 17).

Adelaide CBD Office Market Summary as at July 2017:

	Stock (sqm)	Vacancy (sqm)	Vacancy Rate (%)	Net Absorption (sqm)
Core	1,116,208	195,420	17.5	4,459 (12 months)
Frame	308,225	32,448	11.2	1557 (12 months)

(Source: PCA and Herron Todd White research)

Adelaide CBD Office Vacancy Percentage by Grade:

	Jan -14	Jul - 14	Jan - 15	Jul - 15	Jan - 16	Jul - 16	Jan - 17	Jul - 17
Premium	6.3	11.6	10.7	9.4	7.7	8.3	8.3	10.2
A grade	12.9	13.1	13.6	14	15.1	17	17.6	15.8
B grade	15.2	16.2	11.7	10.8	11	14.8	16.3	17.8
C grade	12.8	18.6	21.4	21.6	19.9	19.2	21.2	21.4
D grade	18.1	19.5	20.8	20.9	21.9	21.6	21.9	20.3

(Source: PCA and Herron Todd White research)

As can be seen in the table above the vacancy rate sits predominantly in the lower grades, however remains 7.6% higher for B grade accommodation than for premium grade assets.

The practical implication of the above statistics is that vacant space is difficult to lease and effective rents have reduced.

Agency based analysts are reporting incentives are on the rise. Knight Frank research is reporting that incentives have increased from 29% to 35% and Savills has reported B grade incentives between 30% and 40%.

Savills is also indicating that in the past 12 months Net Effective Rents have decreased by 8.8%.

Overall, there is evidence to suggest that office rents have decreased within the Adelaide CBD between 5% and 10% over the past 12 months and the situation continues to worsen given the state's economic uncertainty.

Queensland

Brisbane

The Brisbane office market generally remains oversupplied with CBD vacancies running at 15.7% overall and fringe market vacancies overall running at 14.4%. This level of oversupply continues to depress the rental markets generally with incentives for Prime and A grade buildings running at between 35% and 40% in both fringe and CBD markets.

A hiatus in supply for both markets is likely to see effective rents start to improve but this is unlikely to be significant for at least another 12 months when the level of competition for tenants starts to decrease and vacancy levels drop back to near single digits.

The only sectors of the market to buck the general trend are in Prime and A grade CBD markets where the cheapest effective rents for many years have enticed fringe tenants back into the CBD. This has seen vacancy rates for Prime accommodation fall from 21.1% to 11.8% in the past 12 months. Similarly, vacancy rates for A grade tenancies have fallen from 13.9% to 11.6%. This diminution in vacancy rates is starting to see some movement in effective rents for this accommodation only. This is initially being evidenced by a fall in incentive levels.

Suburban markets generally remain oversupplied with sluggish leasing markets, stubbornly high incentives and very limited appetite for new development. Lettability is strongly driven by quality of location, parking availability and access to transport and retail amenities.

General rental ranges for Brisbane are as follows:

Market	Gross Face Range ($/m²)	Incentives Range (%)	GrossEffective Range ($/m²)
CBD Prime	675-800	35-40	440-480
CBD A grade	550-675	35-40	360-405
Fringe A grade	500-600	30-40	350-360
Fringe B grade	400-500	30-40	280-300
Suburban	300-400	10-25	270-300

Toowoomba

Leasing demand for commercial office accommodation in Toowoomba continues to be subdued. This has resulted in limited growth in rentals over the past three years and has also resulted in the introduction of some lease incentives to secure tenants.

Prime office buildings with good car parking can achieve rentals of up to $400 per square metre per annum gross. The most popular office precincts are positioned within the fringes of the CBD and offer a combination of a good central location and easy access. A small premium can sometimes be achieved for medical suites, especially in the precinct surrounding St. Vincent's Hospital.

Rentals for secondary office tenancies can be significantly reduced. Factors that can decrease the achievable rental include:

- Secondary quality of office accommodation;
- Poor location (lack of exposure, semi-industrial area);
- Poor access (inner CBD properties for example can be difficult to access during peak traffic times);
- Lack of sufficient car parking (considered a key driver);
- Lack of access for people with disabilities (for upper level tenancies);

Properties burdened with a combination of these factors can be difficult to lease, with the achievable rental reducing accordingly. There are examples of properties negatively affected by all of these factors (often poor quality inner CBD first floor tenancies with no car parking or access for people with disabilities) achieving rentals of under $100 per square metre.

Gold Coast

The Gold Coast is a coastal, metropolitan region with an economy primarily driven by tourism, education and construction. The commercial rental market for office properties is heavily underpinned by local businesses inter-related with these key economic drivers. Southport remains a popular locale for the legal profession due to the Magistrates Court being based in the business precinct. The Gold Coast City Council over recent years has acquired several office buildings in Bundall and has now generally relocated all departments to this business precinct. There are several long standing government departments at Nerang as well as some at Robina. Robina and Varsity Lakes have seen the majority of office development on the Gold Coast over the past ten to 15 years and as such, offer a more modern standard of office accommodation in comparison to the older established office precincts of Southport, Surfers Paradise and Bundall. Broadbeach is the fifth office precinct within the Gold Coast market, however represents only a small percentage of the overall supply. There are few dedicated office buildings in Broadbeach, with more recent office supply coming in the form of mixed use developments such as The Oracle, The Wave and Sonata where the office component encompasses the lower floor levels generally above ground level retail floor space.

The office market on the Gold Coast is not terribly large. The five office precincts mentioned above are the subject of the Property Council of Australia biannual office survey. As at July 2017, the sum total supply was 468,648 square metres with a total vacancy factor of 11.3%. Over the past few comparison periods, the vacancy level has been trending downward, albeit only in minor increments.

Disparity remains between different grades of office stock. The lower C and D grade categories that make up 31% of the stock have a vacancy rate of 30.3%. B grade makes up 41% of the stock and reflects an 11.4% vacancy. A grade at 28% of the stock reflects a vacancy of 11.3%. It's noteworthy that the city's total absorption rate continues on an upward trajectory, although for the past six month period only the A grade category reflected positive absorption, whereas the other categories all reflected withdrawals, with C grade the most impacted and B and D grades slightly in negative territory.

The continuing positive absorption and diminution of vacancy across the Gold Coast's office precincts continue to have a positive effect on the rental market. It would be fair to say that all office precincts have demonstrated some degree of rental uplift, with an accompanying generally decreasing level of incentives offered. For the more affordable end of the rental range (D and C grade space), owners continue to offer no or minimal incentives only. For better quality space incentives remain, but now tend to generally range from 7% to 10% (months provided as a percentage of total months of initial lease term), being a far cry from levels of 20% to 25% offered several years ago.

As a general observation, across the board the average rental level for C and B grade stock would appear to fall within the range of $350 to $400 per square metre per annum gross. Car parking is in addition and will range from $100 to $150 per bay per calendar month.

For a smaller and more tightly held precinct such as Broadbeach, rental levels are higher at $435 to $550 per square metre per annum gross.

This space tends to be B grade plus standard. Rentals of up to $600 per square metre have been achieved within The Oracle complex, which would arguably reflect the highest rates for office floor space across the Gold Coast market.

Refurbished office buildings such as 50 Cavill Avenue in Surfers Paradise have been achieving good take-up, with rentals pitched at $450 per square metre per annum gross reflecting a competitive level for a good standard premises.

A variety of alternative office floor space can be found in industrial areas, beachside strip retailing areas (generally upper floors), mixed commercial buildings on marinas and in emerging newer office areas such as Siganto Drive, Helensvale adjacent to the M1 Pacific Motorway.

Office space in the industrial areas and beachside strip retail buildings is generally walk-up and would be expected to reflect rates of $200 to $275 per square metre per annum gross. Availability of car parking, either on-site or in surrounding streets, is often easier to obtain. New office premises in Siganto Drive have only been available over the past few years. Their rental levels tend to be in the order of $400 per square metre per annum gross inclusive of car parking. However, if you want a small office suite in a contemporary building on a marina, then you could expect to pay up to $525 per square metre per annum gross for the views.

Overall, the pendulum for the office leasing sector on the Gold Coast has definitely swung back in favour of landlords.

Notwithstanding all of the above comments, with the cash rate remaining at historically low levels and the Gold Coast having a high percentage of strata office premises, we continue to see owner occupiers actively seeking to buy their own premises rather than lease.

Wide Bay

In broad terms, rental levels have been stable in the Wide Bay office market at between $150 and $250 per square metre. Demand has been at a stable and moderate level for smaller sized offices while larger office space has experienced softer demand and is generally more susceptible to volatility in the rental level. Most office developments in the Wide Bay market over the past few years have been related to medical or government departments at higher rental levels of around $300 to $400 per square metre. Trends to keep an eye on in our office markets would be the continuation of hot desk offices and the impacts the new specialist medical office supply industry could have on the existing office market.

Gladstone

In line with most sectors of the property market in Gladstone, the office market has experienced a significant softening in recent years. Increasing vacancies over this time have resulted in downward pressure on rentals. In some cases there have been reductions in the order of 50%. Current rentals for office accommodation are generally being negotiated at between $225 and $300 per square metre gross for average sized tenancies within the CBD of 100 to 400 square metres. Tenancies in excess of this size are very difficult to let in the current market, with few tenants requiring accommodation of this size. We are aware of one large, modern office tenancy of 800 square metres in the CBD that was leased earlier in the year. The rental reflected $233 per square metre gross. Other accommodation proving difficult to let in the current market are offices in secondary locations, dated and poorly presented accommodation and first floor walk up tenancies. Due to current vacancies, tenants currently have bargaining power and new leases often include a rent free period or contribution to fit out works. While market conditions appear to have started to bottom out, we consider the market remains volatile. We do not forecast any upward movement in rental rates in the short or medium term until current vacancies are absorbed and new projects commence in Gladstone.

Rockhampton

The rental market for office accommodation in Rockhampton has remained relatively steady throughout 2017. There has been a slight softening of rentals due to current supply mainly for secondary office accommodation.

Rockhampton benefits from a fairly diversified economy and offers a good supply of office premises which would suit both national and local tenants. National tenants generally pay a premium for their accommodation but in return demand a better quality building. For example, we are aware of a national tenant paying $400 per square metre gross for a 250 square metre office for premium grade office space in the CBD (39 East Street, NAB Building).

Currently, office rentals for space below 300 square metres within the CBD or other well situated locations are typically achieving rents in the order of $250 to $350 per square metre gross.

Modern premises within the CBD that offer functional layout and good parking are certainly able to achieve the higher end of this range. Larger office accommodation has been difficult to let, with few local tenants requiring floor areas of this size. Tenancies of this size typically appeal to government and national tenants who require more space and are not as sensitive to rental affordability.

We are aware of one recently negotiated lease for a modern office tenancy in the CBD of approximately 800 square metres, which has leased for $250 per square metre gross. This lease does not incorporate car parking. Secondary office accommodation of sub 300 square metres is generally attracting a rate range of $150 to $200 per square metre gross. Given the higher supply relative to demand, negotiable conditions are available to tenants with their bargaining power. Incentives such as rent free periods or contributions to fit out are common in new lease negotiations.

Buildings which are showing signs of age or are in poor condition are sitting vacant for extended periods of time. It appears that demand is there for realistically priced and tidy office space that is well located and provides on site car parking.

We do not forecast any increase in rental rates in the immediate term until current supply is absorbed and local economic conditions improve.

Mackay

The office rental market in Mackay has experienced a significant downward correction in rental levels as a result of the coal mining downturn. The majority of recent office leases have been for properties less than 200 square metres in the Mackay CBD and are usually negotiated on a gross basis. In 2017 incentives have still been common place in the current market with the most recent incentives of up to three months rent free. The market has been most active at total annual rental ranges of $10,000 to $45,000 per annum gross. The highest recent rental was struck at approximately $212,800 per annum gross in April 2017 which was a new lease to the sitting tenant. The market is approaching its cyclical trough, although agents are reporting increasing interest from tenants and improved market sentiment.

Townsville

Our recent CBD office survey indicates that over the six month period from January to July 2017, a net absorption of 2,026 square metres of office space occurred in the CBD. This is the highest level of net absorption over a six month period since our January 2014 office survey when two new office buildings came online.

While this absorption is a positive for our CBD office market, overall there remains an oversupply of office space available relative to the current demand in both the CBD and the suburban office markets. This high level of vacancy is maintaining downward pressure on rental rates and we continue to see incentives by way of rent free periods and fit-out contributions in order to attract tenants.

Confidence is being generated by Adani's $22 billion Carmichael Coal Mine and the recent opening of their Townsville office in June 2017 (expected to house about 500 employees). This project in conjunction with the $250 million North Queensland Stadium development which has commenced site works, is tipped to have a positive impact on the local economy but the timing and extent of the tangible impact this will have on the property market remains to be seen.

Cairns

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

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

Most 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 $400 per square metre per annum. Demand for lesser quality space remains limited and there is a large oversupply of good quality non-inner CBD and well exposed secondary space in the $200 to $275 per square metre per annum rental range. These conditions have placed downward pressure on secondary rents and have seen the emergence of incentives.

Overall the Cairns office market is expected to show little change during the remainder of 2017.

Northern Territory

Darwin

The rental market for office space across Darwin remains moribund and it is difficult to see how this will change in the short or medium term.

> Some sub-markets do remain brighter than others, so a prudent investor might still see some opportunities.

Certainly the more limited supply of A grade space is more sought after than lower grade space which is proving almost impossible to let. Vacancy rates in the CBD's top four or five buildings are significantly lower than the rest of the CBD market and this situation is expected to continue as tenants seek out the limited supply of better quality accommodation.

Some areas outside the CBD are also punching above their weights when it comes to maintaining office rental levels. In this regard, we especially note Berrimah Business Park which many tenants prefer due to its modern accommodation, availability of parking and location closer to the demographic centre of Darwin than the CBD.

Growth of the office market in the Palmerston CBD is expected to be stifled for some time due to the introduction of parking meters, the Council's well documented difficulties with the proposed new multi-level carpark and the loss of the Health Department's office requirements to the Darwin CBD.

The market is also weak in Alice Springs. Similar to Darwin, the dominant tenant is the NT Government and the fact that they have adequate space means little movement in the market. Consequently rents are under downward pressure and incentives are increasing. While this is not good news for landlords, the situation is not as difficult as it is in Darwin at present.

Western Australia

Perth

There is a general feeling in the Perth commercial office market that we have hit the bottom. Mining companies are beginning to look at projects and are beginning to pull sub-lease space off the market. Further office market flight to quality and centralisation trends have resulted in the highest six month net absorption rate of the national CBD markets. Underpinned by the flight to quality trend, the Prime grade office vacancy rate has declined for the first time since 2012.

In the 12 months to June 2017, approximately 120,000 square metres of office space was leased, 85% of this in the Perth CBD.

Of the space leased over the past 12 months, 80% was in Prime or A grade space, further imprinting the flight to quality mantra running in the market.

Two of the largest deals in the past 12 months include new leases to sitting tenants, Inpex, a Japanese oil and gas company, and Quadrant Energy, an Australian oil and gas company, in 100 St Georges Terrace. Inpex has committed to 13,000 square metres and Quadrant 7,000 square metres. As part of the renewals, a significant refit will be undertaken to their floors. While there continues to be examples of firms seeking to rationalise space requirements through relocation strategies including consolidation of separate tenancies, an increasing number of tenants have upgraded and taken on or taken back expansion space.

Net face rents in Perth typically range from $600 to $725 per square metre per annum for Premium grade, $475 to $650 per square metre per annum for A grade and $250 to $475 per square metre per annum for B grade.

Incentives began to rise in 2013, resulting in a decline in net effective rents of between 40% and 50% over the three years to 2016. Notwithstanding that, incentive levels still vary greatly by building. Incentives in Prime grade in the CBD are close to 50% on average. Secondary grade incentives are slightly higher, averaging 50% or above in some cases. Net effective rents typically range from $315 to $380 per square metre per annum for Premium and between $250 and $340 per square metre per annum for A grade, representing no change over the year. While the CBD market has re-based its rental indicators, a differential between the precincts and prime and secondary stock still exists. This dynamic is creating pockets of opportunity for tenants looking to tap into the increasingly competitive gap in the market to upgrade to higher quality prime space at similar or in some cases a lower cost than their existing tenancy.