Brisbane CBD Net Absorption Leads the Country as Demand Persists

▲ 2.9%
QLD State Final Demand Growth y-o-y

▼ 0 sqm
Net Supply Office in YTD 2023

▼ 29,114 sqm
Net Absorption in H1 2023

▲ 6.06%
Prime Yield

Note: Arrows indicate change from previous quarter / year.

Key Points

- Leasing activity has remained strong in the face of economic uncertainty with prime offerings being highly sought after.
- The Brisbane CBD will experience a gap in supply with no new developments delivered until early 2025.
- Vacancy has improved markedly since the beginning of 2022, with total Brisbane CBD vacancy dropping to 11.6% in July 2023, from a peak of 15.4% in January 2022.
- Face rents have continued to grow in the CBD in the current inflationary environment. Over Q2 2023, CBD prime gross rents increased by 1.8% to $897/sqm (+5.0% y-o-y).
- Sales activity was subdued in Q2 2023, totalling $81m.
- Office prime yields softened 18bps q-o-q to 6.06%

FIGURE 1: Total CBD Vacancy

Brisbane CBD	July 2022	January 2023	July 2023	H-o-H Change	Y-o-Y Change
Vacancy	13.9%	12.9%	11.6%	-130bps	-250bps

FIGURE 1: Summary of Prime CBD Market Indicators

Brisbane CBD	Q3 2021	Q3 2022	Q3 2023	Q-o-Q Change	Y-o-Y Change
GFR	$833/sqm	$878/sqm	$916/sqm	+2.1%	+4.2%
Incentives	42.2%	41.1%	40.7%	-40bps	-40bps
NER	$314/sqm	$340/sqm	$360/sqm	+4.3%	+6.1%
Yield	5.31%	5.38%	6.25%	+19bps	+87bps

Source: CBRE Research, PCA

Economic Overview

Queensland's population growth and strong labour market is supporting economy, despite global and national headwinds

The global economy is entering a period of uncertainty. The Australian economy is in the midst of feeling the impacts of these global forces and has seen weakening consumer spending and dwelling investment off the back of higher interest rates to combat inflation. However, the Australian economy has been buoyed by international demand for Australian exports and strong population growth. This is particularly true for Queensland where strong population growth, a robust mining and export sector, and the return of international tourists has advantaged Queensland to date. However, global economic slowdown, geopolitical tensions, high inflation, and interest rate hikes are dampening economic growth forecasts across the country.

State Final Demand in Queensland grew by 1.3% q-o-q in Q2 2023, with y-o-y growth at 2.9%. The slight increase in Q2 was driven by public spending related to infrastructure, up 16.6% since last year. Construction of major transport projects as well as a significant spend on health related projects is the likely cause of the increase. Dwelling construction is likely to be a drag on growth moving forward with developers struggling to proceed with new developments, given high construction costs and interest rates.

The rebound of net overseas migration into Queensland has caused the state to record the second largest population growth in the country after Western Australia at 2.2% in 2022. Net overseas migration was approximately 58,000, and interstate migration totalled almost 35,000.

The infrastructure allocation for Queensland and Brisbane remains high with over $20.3 billion worth of capital to be delivered in 2023-24 state-wide, directly supporting 58,000 jobs. The largest in the Brisbane area is the Cross River Rail worth $6.3 billion total due for completion in 2025. In addition, Brisbane City Council's Brisbane Metro ($944 million) is on track for completion in 2024. The private sector is also contributing to the pipeline with Queen's Wharf ($3.6 billion), due for completion in 2024.

Queensland's labour market has performed very well since 2020. The unemployment rate dropped to historically low levels in 2022. However, there has been some early evidence of softening in recent times with the unemployment rising to 4.1% in Queensland as of August 2023. The unemployment rate remains well below pre-covid levels, sectors such as construction and accommodation & food have seen a decline in payroll jobs over the past 6 months in Queensland.

The outlook for the Queensland economy has dampened with commodity prices and population growth coming off their recent peaks. Despite interest rate hikes, demand for housing persists with Brisbane residential vacancy at a low 0.9% in August 2023. In addition, the infrastructure pipeline remains elevated over the next few years. Evolving sectors such as renewables and hydrogen production may also provide a boost to economic growth, particularly to regional areas. Finally, the tourism sector in Queensland has rebounded stronger than the rest of Australia with visitor nights in July 2023 up 5.6% on 2019 levels, compared to -1.8% for Australia.

Office Demand

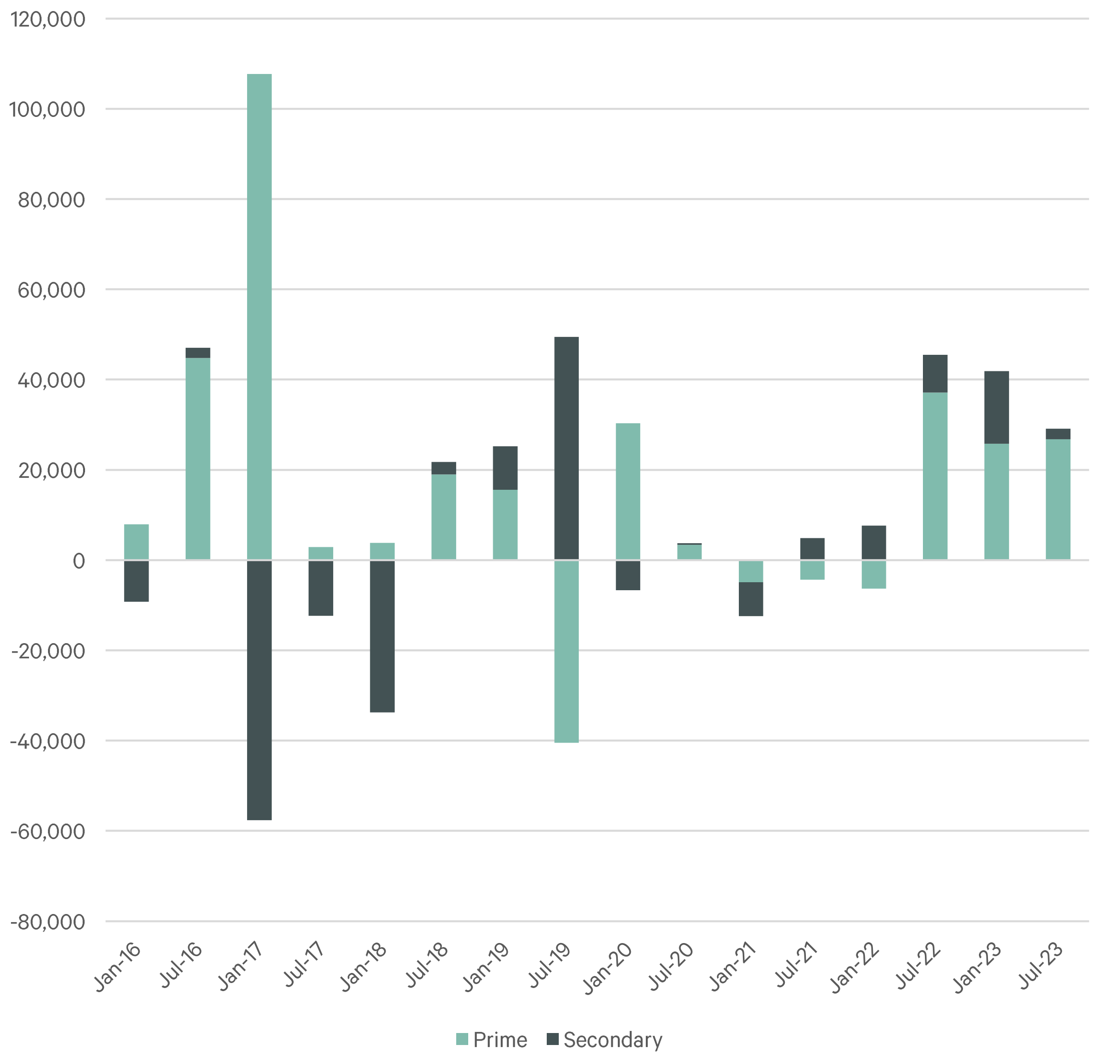
Strong leasing activity leading to strong net absorption

Leasing activity in Brisbane CBD has remained robust into 2023 after a strong year in 2022. This has been led by greater decisiveness in occupancy requirements due to a relatively quick return-to-office trend compared to Sydney and Melbourne. Additionally, prelease deals have accounted for a high volume of deals due to the lack of existing premium space.

Net absorption in the Brisbane CBD outperformed all markets across the country in H1 2023 at 29,114 sqm, slightly down on 2022 volumes. Full year net absorption reached 71,000sqm which was largely attributable to the incremental growth of small tenants. Absorption was also elevated in Brisbane CBD by expansionary activity from the mining and public sectors, as well as some centralisation into the CBD. Tenants upgrading into better buildings continues to be a trend, partly to encourage their staff back into the office.

Demand for space in Brisbane's CBD is likely to continue with state and federal occupiers actively searching for space. This demand is to be met with a lack of available prime space, which will likely accelerate rents further.

FIGURE 2: 6-Month Office Net Absorption – Brisbane CBD



Source: CBRE Research

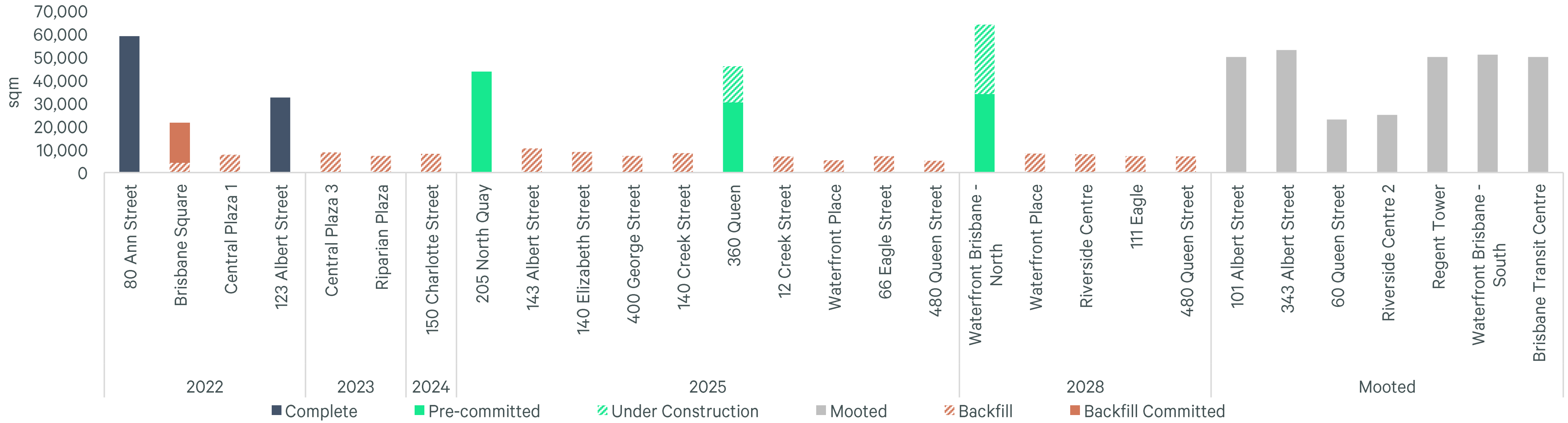
Supply

Supply gap until early 2025

Unlike previous cycles, the supply outlook for the Brisbane CBD is quite manageable, given the strong underlying tenant demand. The Brisbane CBD is currently experiencing a gap in supply with no new developments delivered until early 2025. Two buildings are expected to complete in that year. Services Australia has pre-committed the entire building at 205 North Quay, with the amalgamation of the government entity resulting in backfill from four separate CBD properties (143 Turbot St, 140 Elizabeth St, 400 George St and 140 Creek St). Charter Hall and Investa will also deliver 360 Queen Street in early 2025, with pre-commitment of approximately 66%. The only other committed project in the pipeline is Dexus' Waterfront Brisbane being delivered in early 2028 with pre-commitments for about 53% of the building.

There are a range of mooted projects in the pipeline such as QIC's 101 Albert Street, ISPT's Regent Tower and Charter Hall's 343 Albert Street. However, all of these projects are subject to pre-commitment and are not likely to be delivered to the market until at least 2027.

FIGURE 3: Brisbane CBD Development Supply Pipeline



Source: CBRE Research

Vacancy

Vacancy drops due to strong net absorption lack of supply additions

Vacancy has continued to improve in 2023, with total vacancy dropping from 12.9% to 11.6% y-o-y in July 2023. This comes as demand surges and new supply struggles to keep pace.

Demand for premium space in a flight-to-quality trend has tightened vacancy in premium grade assets to just 4.4% (17,194 sqm), down 280bps from July 2022. There are a number of A Grade buildings that have significant vacancy, which is gradually getting leased. CBRE Research expects the prime vacancy rate to decline at a faster rate than the overall market, given the recent trend of tenants upgrading their space that has been observed nationally. The expectation is that prime vacancy could get to 9% by the end of 2024 before rising as the supply in 2025 is delivered.

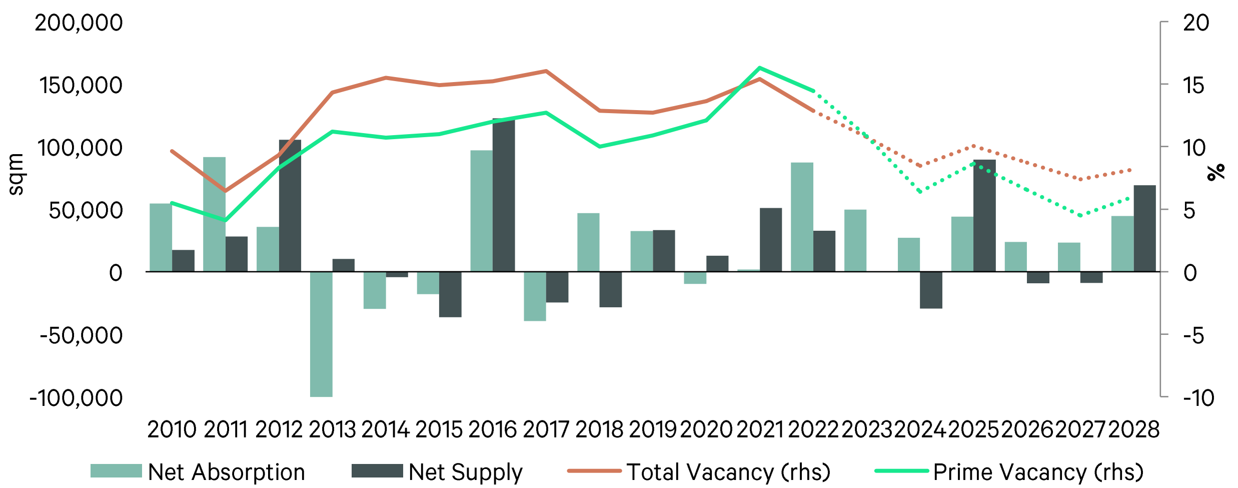
The secondary market has performed well with vacancy at 10.4%, well below the 15.1% observed pre-pandemic. The main reason for this has been the elevated leasing activity amongst smaller tenants. In addition, a number of landlords of secondary stock have refurbished their buildings over the past few years which has attracted new tenants. Finally, the majority of the speculatively fitted suites in the Brisbane market have been in the secondary market, which have been popular amongst tenants.

The outlook for vacancy is solid in the Brisbane CBD with no new supply due until 2025. Therefore, CBRE research expects vacancy to tighten to 8.5% by the end of 2024, with prime vacancy likely to be sub-7%. Vacancy is then likely to rise due to backfill opportunities in 2025 before declining over the following 2 years.

FIGURE 4: Summary of Brisbane CBD Office Market

Market/ Grade	Stock (sqm) – Jul 23	Net Stock Change (sqm) – 12 months	Vacant (sqm) – Jul 23	Vacancy (%) – Jul 23	Vacancy (%) - Jul 22	Net Absorption (sqm) – 6 months	Net Absorption (sqm) – 12 months
Prime	1,385,391	32,478	173,404	12.5%	14.3%	26,782	52,543
Secondary	971,217	-13,613	100,583	10.4%	13.5%	2,332	18,457
Total	2,356,662	18,865	273,987	11.6%	13.9%	29,114	71,000

FIGURE 5: Brisbane CBD Office Market Balance



Source: PCA, CBRE Research

Rental Performance

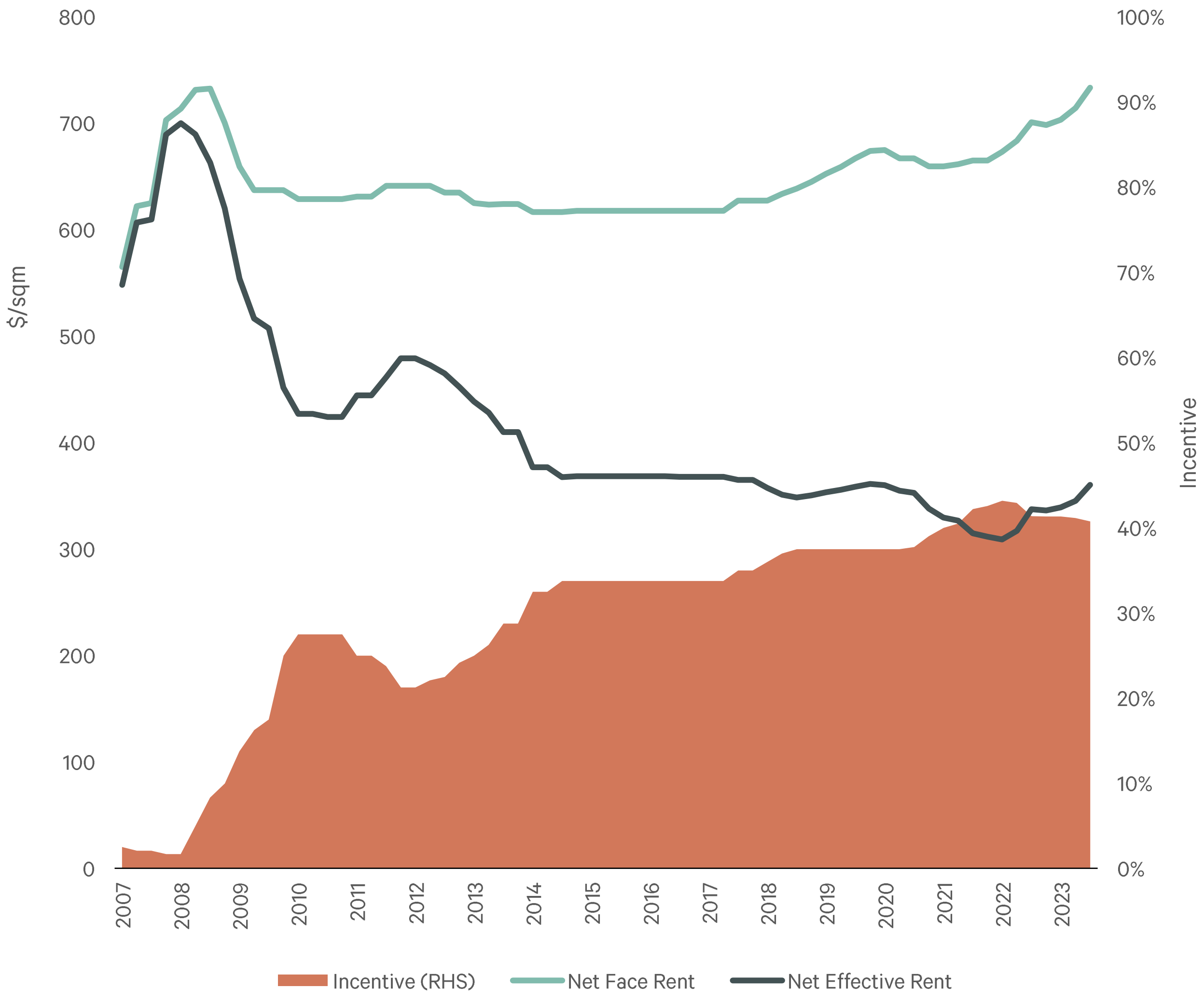
Tight vacancy and inflationary pressures push rents higher

The tightening vacancy across the Brisbane CBD market continues to put upward pressure on rents. Prime gross face rents rose by 1.8% q-o-q in Q3 2023, and 4.1% y-o-y. High construction costs as well as cap rate impacts are pushing up new development rents which is flowing through to the existing market. Also, downward pressure on incentives has been observed, given the tightening opportunities for tenants to move and improved leverage for landlords. Average prime incentives were 40.7% in Q3, down from a peak 18 months ago of 43.2%. As such, prime net effective rents have accelerated by 4.3% q-o-q and 6.1%. Net effective rents are now back to pre-covid levels.

The secondary market has also observed decent rental growth with Gross Face Rents up 3.9% y-o-y and net effective rents up 7.2%. Effective rents in the secondary market are coming off a very low base as a result of higher incentives since the start of the pandemic.

The expectation is that stronger rental growth will continue as vacancy tightens further over the medium term due to no supply additions until 2025. Incentives in the prime market should see a further decline due to the stronger negotiating power that landlords currently have. This will significantly enhance effective rental growth which has been absent in Brisbane for a number of years.

FIGURE 6: Brisbane CBD Office – Prime Rents



Source: CBRE Research

Investment Market

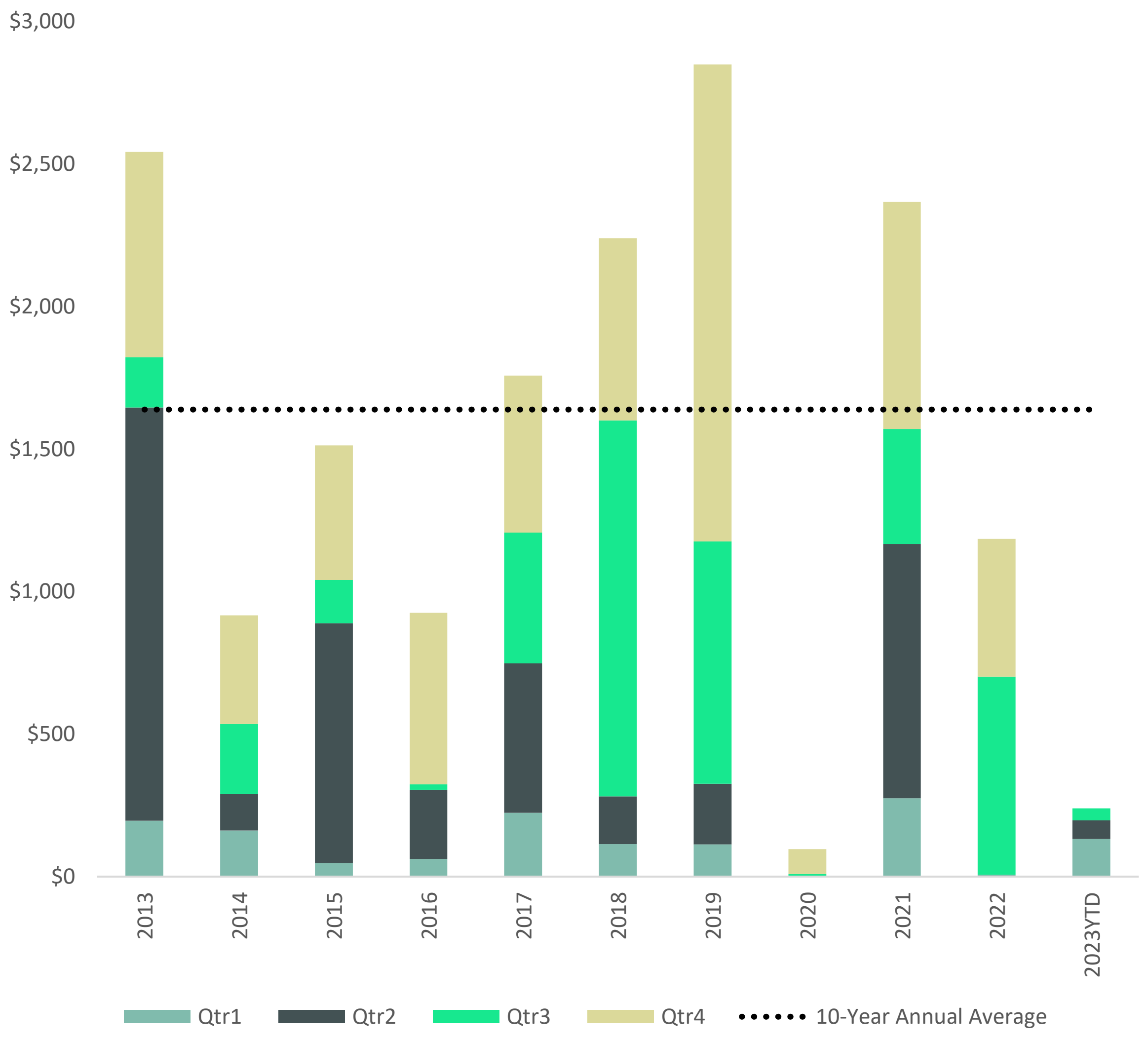
Sales volumes continuing to quieten in 2023

Capital markets across the region have been subdued as a result of the higher interest rate environment. This is also the case in Australia and Brisbane. Volumes are down significantly with a lack of conviction from both vendors and buyers a key thematic. The only major deal in Q3 was 333 Adelaide Street for $41.75 million, bought by Stadia Capital. Remarkably, this is the largest transaction in the Brisbane CBD so far this year.

Brisbane CBD yields experienced further softening in 3Q23 with prime grade softening 19bps to 6.25% and secondary grade softening to 7.65%. The recent rise in bond rates is likely to impact on pricing further.

There remains a number assets on the market in the Brisbane CBD that may conclude by the end of the year. However, capital allocation towards office has declined globally, buyer depth is relatively thin at present. This may change given the yield softening that has occurred, which might look attractive to investors.

FIGURE 7: Brisbane CBD Office Sales (greater than AUD 5 million)



Source: CBRE Research

Outlook

Supply gap will drive rental growth over the next two years

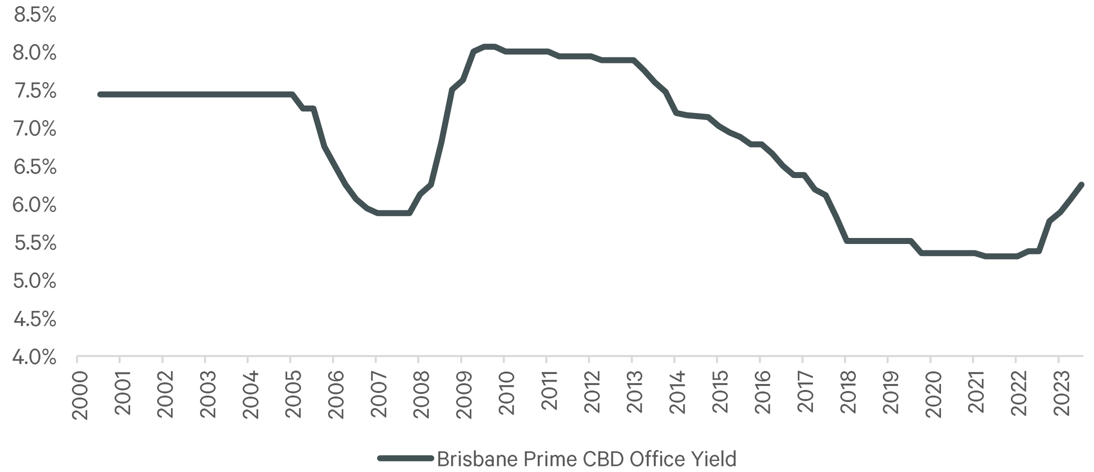
The Queensland economy is likely to remain in a relatively strong state despite the global headwinds. Population growth is the key component that is likely to insulate Queensland from any weakness. However, there do remain challenges, particularly around construction prices, which have risen the most in Queensland.

Net absorption has been very strong over the past 18 months in Brisbane. This is likely to moderate to more normalised levels, although prime absorption will be elevated given recent upgrade moves from the State Government.

The lack of supply until early 2025 will allow the vacancy rate to drop over the next few years. This will promote solid rental growth, while high construction costs will push up economic rents for new projects. CBRE Research expects total vacancy to drop to about 8.5% by the end of 2024, before rising to around 10.0% once supply comes through in 2025.

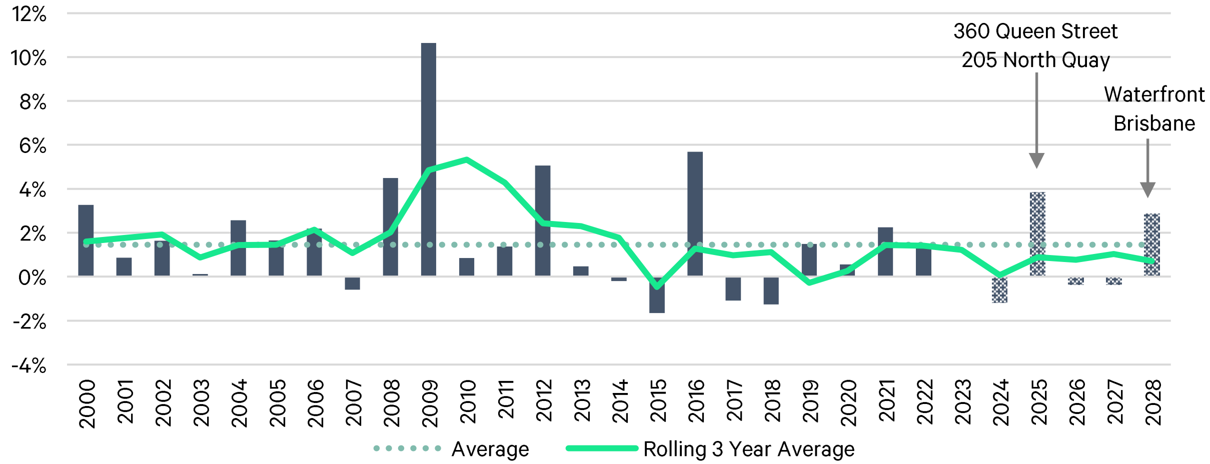
Transaction volumes are likely to improve over the coming 12 months, although this may not occur until early next year now. More pricing evidence is likely to come through in Brisbane as well as other markets around the country, which might entice buyers back into the market.

FIGURE 8: Brisbane CBD Office Yield



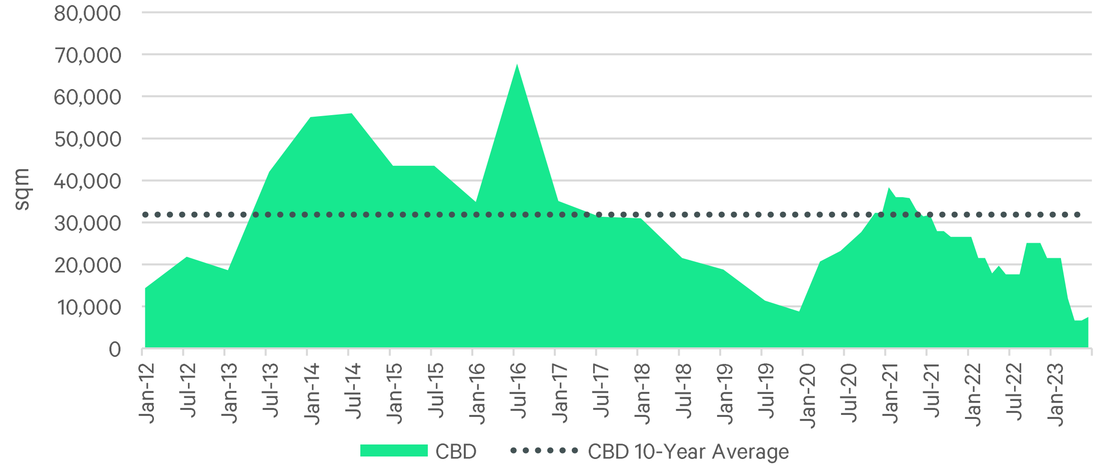
Source: CBRE Research

FIGURE 10: Brisbane CBD Future Growth in Stock



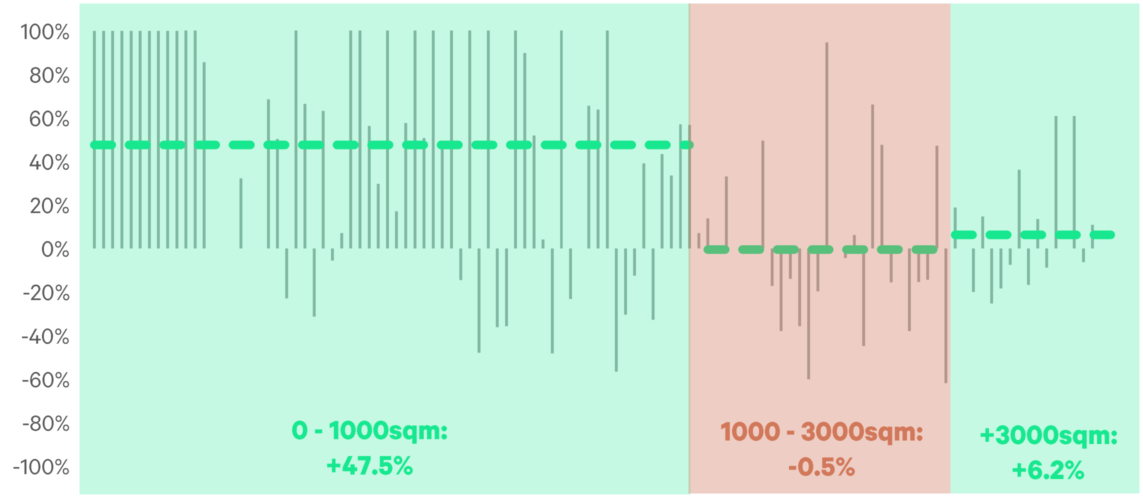
Source: CBRE Research

FIGURE 9: Brisbane CBD Sublease Availability



Source: CBRE Research

FIGURE 11: Brisbane CBD – Tenant Moves by Footprint (2021 – Q1 2023)



Source: CBRE Research

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