Canberra Commercial Property Prospects
2011 – 2021

EXTRACT TO INDICATE THE GENERAL NATURE OF THE REPORT

COMMERCIAL PROPERTY

BIS Shrapnel
BUSINESS RESEARCH AND FORECASTING

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1. INTRODUCTION

Canberra Commercial Property Prospects 2011 to 2021 is the latest edition of BIS Shrapnel's regular demand and supply analysis of the Canberra office market.

After experiencing a boom of unprecedented magnitude in both demand and supply in the second half of the 2000s, the Canberra office market was forced into a downturn by the combination of oversupply, weakening demand and the effects of the GFC.

The cause of the oversupply was a construction boom, resulting from one of the Commonwealth's regular building upgrading phases and exacerbated by speculative construction. Most of the new stock was readily absorbed due to surging Commonwealth employment growth, but a post 2007 weakening in demand saw vacancy rates rise sharply. Backfill space was no longer able to attract follow-up tenants and speculatively built projects struggled to find tenants willing to upgrade and/or move to a less attractive location (particularly the airport).

The blow-out in the metropolitan vacancy rate from around 1% in 2007 to 14% in mid 2010 caused a significant weakening in the leasing market. Competition for tenants led to an increase in incentives and falls in effective rents. However, the Canberra market was split into two tiers in the process, with the secondary market being much worse affected

While the leasing market was affected by deteriorating property fundamentals, the GFC led to a haemorrhaging of the investment market. Yields blew out and capital values declined in an environment of uncertainty as to how severely property markets would be affected.

Now, three years later, both the leasing and investment markets are at the trough of their respective cycles. The fall in effective rents has been arrested and yields have stabilised—but only at the prime end of the market. Despite weakening leasing demand overall, vacancy rates amongst A grade stock have started to decline, particularly in Civic. Triggered by lease expiries, attractive deals have lured tenants to new and greener, speculative built projects.

The investment market remains patchy, with thin, narrowly based demand. There is strong interest for large new buildings with very long leases to the Commonwealth: overseas interests have thus far outbid local players, while A-REITs remain net vendors of property in Canberra. Amongst secondary stock, yields are still softening, with virtually no interest being shown by investors.

While new construction has dropped sharply since mid 2010, activity has not stopped altogether. Three new projects with a combined 94,000 square metres are under way, mostly pre-committed to Commonwealth agencies. Moreover, the Department of Human Services has just signed pre-leases for two new buildings totalling over 35,000 square metres of space—against the backdrop of a Commonwealth government efficiency drive.

In this climate of seemingly contradictory trends and a market that is split into two tiers with clearly different prospects, our report addresses the critical issues essential for all players in the office market—be they investors, developers, builders, lenders or tenants. We carefully analyse the market and set out our forecasts for office demand and supply over the next 10 years, as well as rents, yields and capital values. In particular, we address the following issues:

- What will be the strength of demand for office space in the short to medium term? What will be the impact of the government's attempt to return the budget to the black by FY2013? Will there be any job losses?

- What impact will the mandated workspace ratio for new tenancies of 16 square metres per person mean for demand?
- What does the Commonwealth's minimum accommodation standard of 4.5 star NABERS mean for future construction. What does it mean for secondary buildings that cannot be upgraded? How much more space will be built? Will speculative construction return and, if yes, when?
- What will happen to vacancy rates and what do they mean for rental growth?
- When will broader demand return to the investment market and what will be the trigger?
- Is the Canberra office a good investment proposition? What are the prospects for investment returns and should investors buy or sell Canberra commercial property in the near term?

1.1 How to use this report

Our report is not intended for one-off reading; it is meant to be a constant reference for practitioners. The following is a guide to assist your reading.

The Executive Summary provides a snapshot of the Canberra commercial property market, our key forecasts and our views on timing for investment in the market. The supply and demand tables and the forecasts of rents and property values are the key elements for providing realistic escalation assumptions in financial analyses.

Chapter 2 provides the economic backdrop to our forecasts. We discuss the current state of play and outlook for the Australian economy and identify key features of the ACT economy.

In **Chapter 3** we examine the two major determinants of office demand—growth of the office related workforce and the average workspace ratio. We put these together to forecast net absorption over the next 10 years.

Chapter 4 considers the supply of Canberra office space and discusses the impact of the credit squeeze on office development.

The vacancy rate, discussed in **Chapter 5**, is the outcome of the demand and supply process. It is the major indicator of market conditions and the driver of rents and values. In this year's report, we also include forecasts of average A grade vacancies within Civic.

In **Chapter 6** we provide forecasts of A grade Civic rents, yields and capital values in current and constant price (inflation adjusted) terms to 2021.

In the final chapter, **Chapter 7**, we discuss investment and development issues from the perspective of different market players. The chapter also provides indicative IRRs and a comparison with other property markets and sectors.

Finally, a detailed account of definitions, our methodology and sources of data are given in the **Appendix**.

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