

# Market Link Canberra

## Introduction

The ACT property market has been in a period of turmoil since the onset of the Global Financial Crisis (GFC). In addition to the re-rating of risk, which impacted property markets globally, the office and retail markets within the ACT, recorded a significant increase in supply during a period of reduced demand.

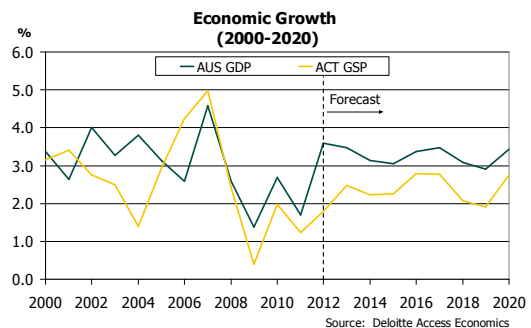
This edition of Market Link Canberra reviews the performance of the office, industrial and retail property markets within the ACT over the past 12 months to October 2011.

While the performance of higher value properties remains firm (albeit in a rarely traded market), conditions at the lower end of the market have weakened, with limited tenant demand leading to higher vacancy rates. Investor demand appears firmly aligned with the risk profile of the investment, with investors unwilling to commit to a purchase lacking a strong lease covenant.

## Economic Conditions

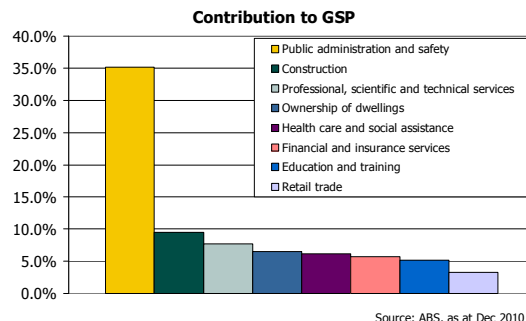
### Economic Growth

The Australian economy grew in the second quarter of 2011, with quarterly economic growth bouncing back after falls in the first quarter of 2011 due to the impact of the Queensland floods. GDP rose by 1.2% in the second quarter of 2011, after falling by 1.2% in the first three months of 2011.



In the 12 months to December 2010 the ACT economy grew at a rate of 2.0% compared to the Australian economy which grew by 2.7%, over the same period.

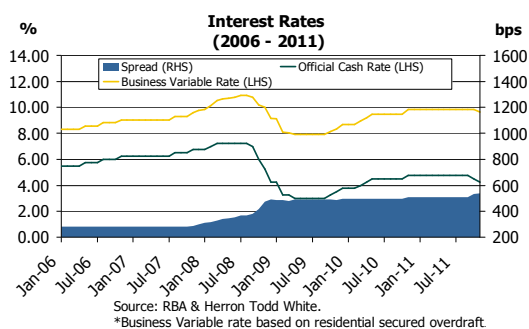
Looking forward it is forecast that Australian economic growth will outpace the ACT economy, with ACT growth forecast to fall to 1.2% in 2011 and 1.8% in 2012. In comparison the Australian economy is forecast to grow by 1.7% and 3.6% in 2011 and 2012 respectively.



Reflecting the high levels of public service employment within the ACT, the public sector is by far the single greatest driver of the ACT economy contributing over 35% to the Gross State Product (GSP). The construction industry is the next largest contributor, accounting however for only 9.5% of the GSP.

## Interest Rates

With the global economic outlook now less than certain and domestic demand seemingly reduced, the Reserve Bank of Australia (RBA) resolved to cut the cash rate by a further 25 basis points in December. This follows a 25 basis point reduction in the cash rate in November. The cash rate now stands at 4.25%.

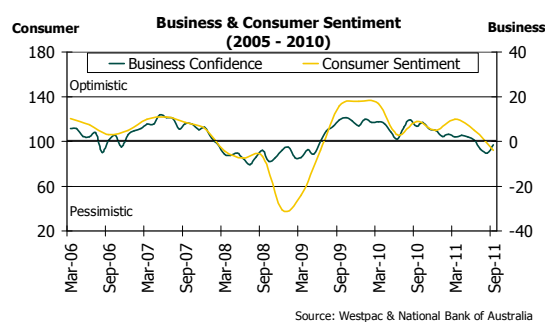


According to the RBA, CPI inflation is likely to abate over the coming year as the production of key crops recovers, following the impact of the summer floods. Looking forward, the RBA expects inflation will remain within the 2.3% range, if the impact of the carbon pricing scheme is ignored.

## Business and Consumer Sentiment

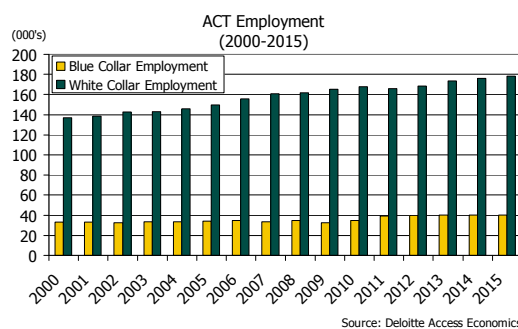
Business confidence levels are a key lead indicator of future spending and economic growth. After recording a rise in the March quarter, business confidence fell significantly. Confidence was most impacted in the finance and mining sectors with the high Australian dollar and concerns about the global outlook playing on the minds of businesses. The fall in consumer confidence also has had a direct impact on business confidence, with a rumoured scaling back of future employment plans occurring in many industries.

After four consecutive falls in consumer sentiment, following the announcement of the carbon tax and the deterioration of the global financial markets, consumer confidence improved in September and October, albeit from a low base. Commenting on this shift in consumer sentiment, Westpac noted that the outlook for reduced interest rates and the movement by the major Australian banks to reduce their fixed mortgage rates, has helped boost confidence.



## Employment

Reflecting the significant number of government employees within the ACT, it comes as no surprise that white collar jobs significantly outweigh blue collar jobs. White collar employment accounts for over 80% of all jobs within the ACT.



Over the forthcoming four years it is forecast that total employment within the ACT will grow by 6.5%, with white collar employment expected to grow by 7.6% in this same period.

## Office Market Conditions

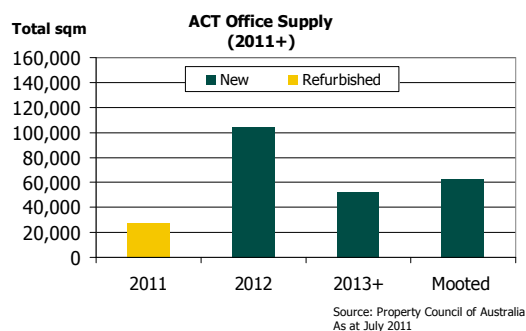
With just over 2.2 million sqm of office floorspace, Canberra is Australia's third largest office market. The Canberra tenant profile is dominated by the Commonwealth and ACT Government departments, setting it apart from other smaller provincial, non-State capital cities. Consequently, performance can be volatile given the impact of elections and decisions made by the Federal Government which directly impacts on the number of public servants employed in the capital. On the upside, the ACT economy is far less volatile than other Australian states.

While the leasing market remains depressed following a significant increase in total office supply, strong interest in the recently listed 50 Marcus Clarke Street has indicated that investor demand exists for quality buildings with strong lease covenants. At the bottom of the market weaker investor and occupier demand is limiting the performance of these properties.

### Supply

Over the three years to January 2011 the Canberra commercial office market has grown substantially with around 597,456 sqm of additional floor space added to the market. This represents a 36.1% increase of the total Canberra floorspace recorded in January 2008.

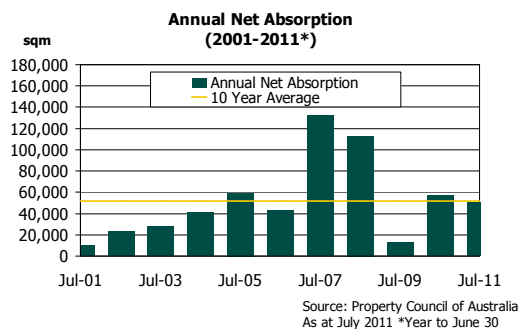
As of July 2011 the Canberra office market contained 2,233,749 sqm of net lettable office space. Over the 18 months to December 2012 the Canberra office market will see a substantial increase in supply as the current development cycle reaches completion. As illustrated in the chart below (ACT Office Supply), 1,050,080 sqm of new floorspace and an additional 29,508 sqm of refurbished floorspace will be added to the market between July 2011 and December 2012.



As highlighted in the table on the following page (Office Building Completions), refurbished buildings comprise the majority of new supply during 2011. From 2012, following the completion of ASIO Headquarters, The Nishi Towers, 4 National Circuit, Barton and several smaller developments around 104,580 sqm of new space will be added to the Canberra market.

### Occupier Demand

After a slump in demand during the financial crisis, net absorption rebounded in the 12 months to July 2011, with over 50,039 sqm absorbed in this time. During this period demand was greatest for upper end properties with A-grade space accounting for 75.9% of total net absorption.



Despite strong net absorption results and a fall in vacancy from July 2010 to January 2011, total market vacancy remained relatively unchanged in the six months to July 2011, falling slightly from 13.4% to 13.3%.

### Office Building Completions July 2011 – Jan 2013

Building Address	Suburb	New/Refurb	Total Size (sqm)	Completion Quarter
10 Mort St	Civic	Refurbishment	7,880	4 (2011)
12 Mort Street	Civic	Refurbishment	7,558	4 (2011)
Homeworld	Tuggeranong	Refurbishment	3,800	4 (2011)
Centrepoint	Tuggeranong	Refurbishment	2,970	4 (2011)
2 National Circuit	Civic	Refurbishment	5,190	3 (2011)
3 Sydney Avenue	Barton	New	500	3 (2011)
4 Edinburgh Avenue	Civic	New	21,000	4 (2012)
4 National Circuit	Barton	New	28,000	2 (2012)
2 King Street	Deakin	New	2,200	1 (2012)
20-22 Lonsdale	Braddon	New	3,000	1 (2012)
18 Canberra Ave	Forrest	New	9,630	4 (2012)
ASIO HQ	Parkes	New	40,000	4 (2012)

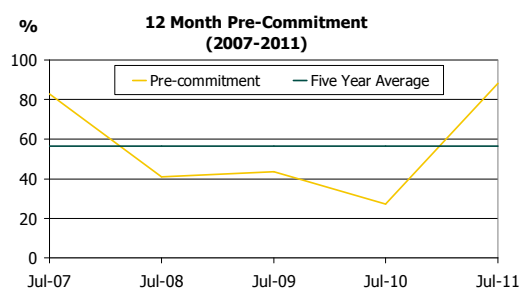
Source: Property Council of Australia

The disparity between the net absorption results and the vacancy results has come in part from an increase in A-grade supply over the last 12 months and a lag in the take up of new buildings delivered to the market in the 18 months to July 2011. The following table illustrates the graded individual market vacancy rates over the six months to July 2011.

### Canberra Office Vacancy July 2011

Grade	Vacant Space (Sqm)	Vacancy Rate %	Movement
A	111,838	12.7	↑
B	47,965	8.4	↑
C	97,730	14.5	↓
D	39,016	34.9	↑

Source: Property Council of Australia



Source: Property Council of Australia  
As at July 2011

As shown in the table above, pre-commitment levels are now at their highest within the last five years, suggesting an increased level of demand for new floorspace. It is important to note however that the Canberra office market historically has a higher pre-commitment rate than other capital city markets, with government departments commonly seeking a new building upon lease expiry.

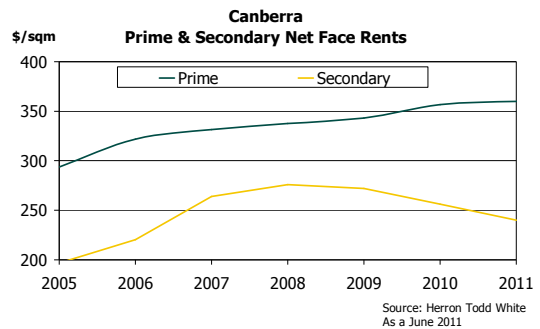
## LEASING ANALYSIS



<b>Address:</b>	40 Allara Street, City
<b>Property:</b>	A six storey 1970's office/retail building refurbished in 2009
<b>Details:</b>	The tenant has leased levels 2,3,4 and part of level 6.
<b>Rental:</b>	\$1,163,560 (gross)
<b>Start Date:</b>	1/08/2011
<b>Floor Area:</b>	3,062 sqm
<b>Lease Term:</b>	3 Years and 8 Months
<b>\$/sqm:</b>	\$380 (gross)

### Leasing Market Conditions

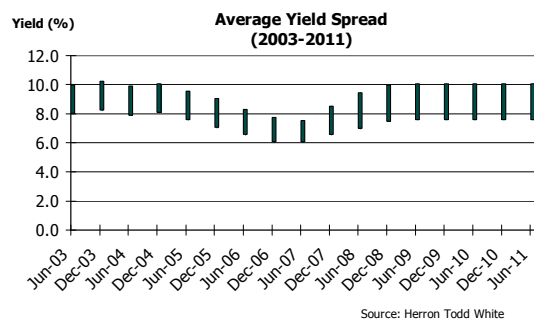
Despite the significant increase in supply recorded over the last 18 months, prime rental rates within Canberra have only slid marginally, with the majority of new projects featuring pre-commitments to government departments. Rental rates within the secondary market however have been impacted considerably, with a large amount of backfill space released onto the market. Given the preference of government tenants for newer buildings, which feature minimum sustainability rating 4.5 AGRB (now NABERS Office Energy), many secondary buildings have been unable to attract government tenants.



### Investment Market Conditions

Investment activity has been limited in 2011, as buyers remain unsure about future income prospects of properties which lack strong lease covenants. Since the beginning of 2011 there has been only one significant sale of a completed office building; a 2,226 sqm office anchored by Westpac for \$10 million. The largest sale in the past 12 months was 255 London Circuit, City at \$55.2 million at an initial yield of 7.25%.

Prime yields within Canberra office properties typically range from 7.55% to 10.05% for A-Grade buildings. New and refurbished stock featuring sustainable credentials and with strong lease covenants have outperformed secondary stock with short lease tails or higher vacancies, which have recorded a softening in yields.



Reflective of the income security offered by federal government tenants, the premium paid for prime properties within Canberra is greater than the price premium recorded in other capital city markets. As of June 2011 average capital values for prime office properties were up to 50% higher than average secondary office values.

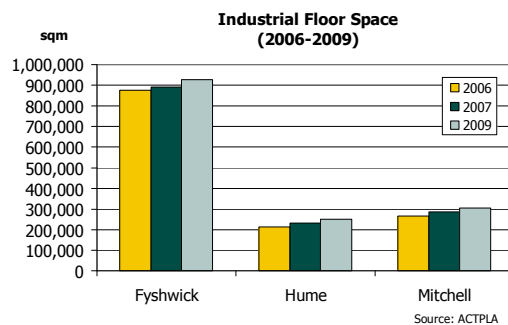
## SALES ANALYSIS



<b>Address:</b>	37 Geils Court, Deakin
<b>Details:</b>	Semi modern (circa 1987) two storey office building.
<b>Sale Price:</b>	\$2,000,000
<b>Sale Date:</b>	26/11/2010
<b>Building Size:</b>	643 sqm
<b>Land Size:</b>	564 sqm
<b>\$/sqm:</b>	\$3,456/sqm (building)
<b>Yield:</b>	8.5%

## Industrial Market Conditions

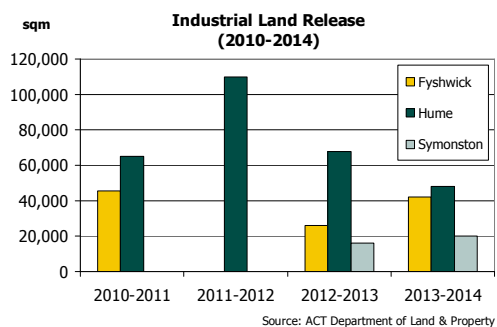
Due to the location of Canberra, in relation to other capital cities, the industrial market fails to benefit from any demand originating from companies servicing both local and interstate clients. As a result the Canberra industrial market operates in a similar manner to a regional market, with demand constrained to those firms which serve the local population.



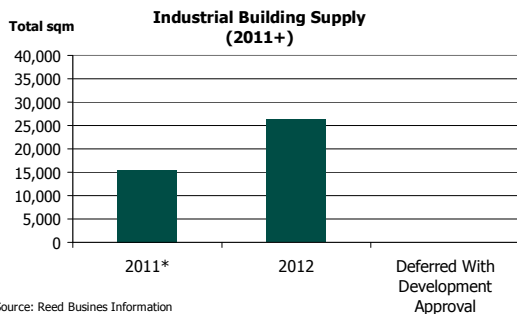
As shown in the table above Canberra's industrial market is concentrated in three main localities.

### Supply

In response to industry concerns relating to an oversupply of industrial land, the ACT Government, through its indicative land release program, has curtailed the amount of new industrial land released over the four years to 2014. Despite this reduction it is still expected that around 440,616 sqm of industrial land will be released to the market during this time.



In the coming three years the Hume industrial area is expected to record the greatest increase in industrial land with approximately 291,000 sqm of land due to be released. No industrial land is scheduled to be released in Mitchell between 2010 and 2014.



Source: Reed Business Information  
\*Six months to December

While the ACT Government has committed to reducing the level of new industrial land released, it is expected that the market will remain oversupplied, with only 41,868 sqm of new industrial floorspace expected to be released to the market in the 18 months to December 2012. As illustrated in the chart above there are no projects with development approval that have been deferred.

### Demand

Demand for industrial floorspace within the ACT is highly correlated with construction in both the residential and commercial office sector.. As a result demand for industrial floorspace has fallen in the past 24 months as the commercial office sector nears the end of its development cycle.

As previously mentioned, demand for industrial land within the ACT is limited, with developers struggling to secure the pre-commitments necessary to justify a development.

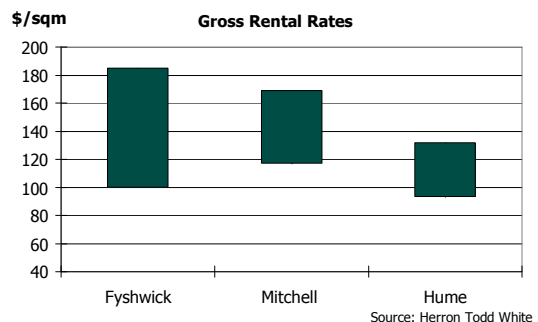
## LEASING ANALYSIS



**Address:** 3/5-7 Felton St Mitchell  
**Property:** Older strata warehouse property.  
**Rental:** \$20,240 (gross)  
**Start Date:** 01/04/2011  
**Floor Area:** 172 sqm  
**Lease Term:** 3+3 Years  
**\$/sqm:** \$120 (gross)

### Leasing Market Conditions

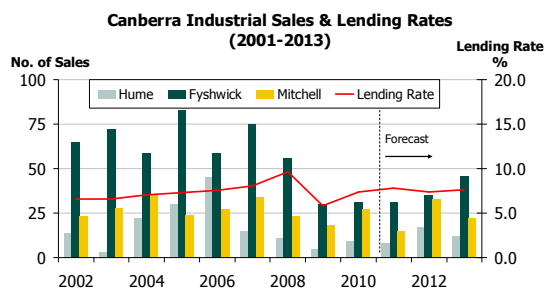
With demand remaining low, rental rates have shown little growth over the 12 months to October 2011. Consequently landlords are more concerned with minimising vacancy, rather than securing rental growth. Reflecting the uncertain economic conditions there have been limited leasing transactions in the 12 months to October 2011.



On average, industrial properties in Fyshwick command the highest rental rates, with the region benefiting from a higher presence of bulky goods retailers willing to pay higher rents than traditional industrial occupiers. Reflecting the limited demand for industrial premises within Canberra, incentives have risen for larger properties and for smaller properties in substandard locations. Across the market incentives generally range between one to three months free rent for every year committed.

### Investment Market Conditions

Reflecting the relative stability of the ACT industrial market, capital values exhibit far less volatility than comparable capital city locations. Similarly to other Australian regional locations, the market is dominated by owner occupiers who are predominantly driven by interest rate movements as opposed to the investment characteristics of the property. Notwithstanding this relative stability, a decrease in the number of buyers actively seeking industrial property in the years following the GFC has seen capital values fall across all ACT industrial markets.



Source: RBA & Herron Todd White

Activity in the ACT industrial market has been limited since the onset of the GFC with investors and owner occupiers unsure about the future performance of the economy. As highlighted in the chart above, sales volumes are yet to return to their pre-GFC levels, following a 41% fall in the number of transactions recorded in 2009, when compared to 2008.

### SALES ANALYSIS



**Address:** 1/4 Geelong St, Fyshwick

**Property:** Two Storey strata industrial building with upper level office and ground floor showroom/warehouse.

**Sale Price:** \$560,000

**Sale Date:** 01/04/2011

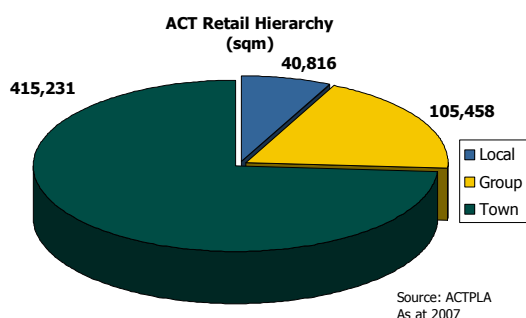
**Building Area:** 293 sqm

**\$/sqm:** 1,911

**Yield:** 6.75%

## Retail Market Conditions

The ACT retail market is characterised by a strict hierarchy of commercial centres determined by the ACT Planning and Land Authority. The aim of this rigid structure is to provide a level of consistency and equity across the greater geographic region.

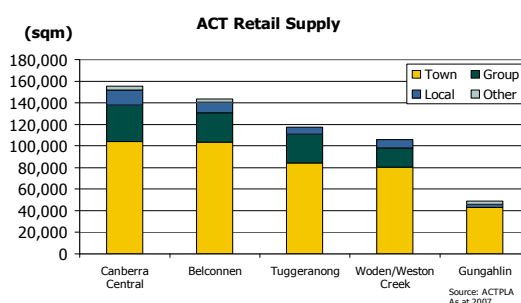


While the structure of this hierarchy is firmly based on serving the retail needs of the ACT population, these commercial centres also provide zoned land for mixed use, leisure and tourist accommodation. Outside of this hierarchy, further non food retailing is located in the industrial areas of Fyshwick, Hume and Mitchell.

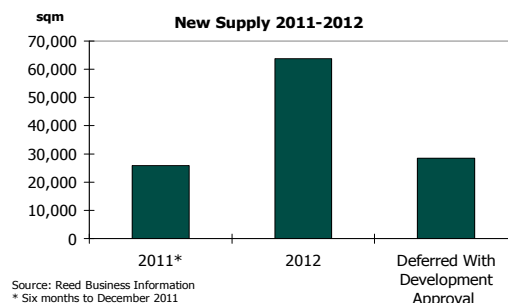
In recent years however, it has been claimed that the restrictive nature of the retail hierarchy has limited competition within the ACT, subsequently driving up retail prices.

## Supply

According to the ACT Planning and Land Authority there is an estimated 568,000 sqm of retail space within the ACT (as of 2007). As shown in the chart below Canberra Central ('Civic') accounts for the greatest portion of this space with around 155,000 sqm of retail floorspace.



Over the 18 months to December 2012 it is expected that approximately 89,682 sqm of additional retail floorspace will be added to the ACT market.



### Retail Building Completions 2011-2012

Building Address	Suburb	Retail Size	Comments
Blk 4 Secn 133 Lance Hill Ave	Dunlop	769	Single storey commercial / retail building
12 Dalby St	Fyshwick	974	Two storey commercial building with ground floor retail.
Blk4 Secn 86 Geraldton Cr	Fyshwick	2,465	Showroom / bulky goods development.
Blk 14 Secn 14 Nettleford	Belconnen	2,285	Bulky goods development.
40 Hibberson St	Gungahlin	5,734	Expansion of existing Coles supermarket
Majura Park Shopping Centre	Majura	20,050	A new centre to include a 4,800sqm Woolworths, 8,000 sqm Big W and associated specialties

Source: Reed Business Information & Herron Todd White

## LEASING ANALYSIS



<b>Address:</b>	Shop 2, 13-15 Garra Place, City
<b>Property:</b>	Prime retail space with frontage to Garra Place, within the CBD retail precinct.
<b>Rental:</b>	\$30,000 (gross)
<b>Start Date:</b>	1/06/2011
<b>Floor Area:</b>	30 sqm
<b>Lease Term:</b>	5+5 Years
<b>\$/sqm:</b>	\$1000 (gross)

### Demand

While retail expenditure within the ACT remains higher than other capital cities, an increase in supply over the past five years has effectively matched this heightened demand.

While current vacancy statistics are unavailable, anecdotally it appears that demand has failed to match supply. Since 2007, it is estimated that an additional 75,000 sqm or 13% of total retail supply has been added to the market, including the 45,000 sqm Homemaker/DFO centre and the 22,000 sqm expansion of Westfield Belconnen. A review of vacancy in several retail centres within the ACT reveals that vacancy has likely risen as a

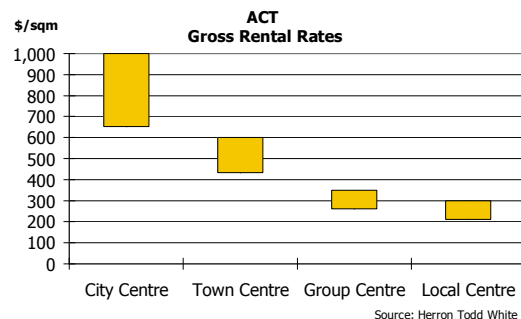
result of this increase in supply. This has particularly been the case in lower order retail and factory outlet centres.

Most recently demand for retail space has fallen, as retailers continue to feel the impact from the downturn in retail sales. Most notably the closure of the Brand Depot outlet store at the beginning of 2011, highlights the limited demand for discretionary retailing within the ACT.

Demand for food and beverage retailing however remains high, with larger retailers seeking to increase their market share in the restricted ACT supermarket sector. Over the coming 12 months it is expected that around 24,034 sqm of additional supermarket floorspace will be added to the ACT retail market. This will include the recently opened 13,500 sqm Costco reconfiguration of the former Brand Depot outlet centre and the Majura Park Shopping Centre, which includes a pre-commitment from Woolworths. In addition to these pre-commitments, Woolworths is currently undertaking refurbishment works on several of its existing stores throughout the ACT.

### Leasing Market Conditions

Recently a fall in retail sales has placed downward pressure on rental rates across all retail property types, as tenants continue to record a reduction in turnover.



The City Centre ('Civic') is achieving the highest rental rates of all retail property types throughout the CBD, with rental rates for properties in Civic ranging between \$650-\$100/sqm. In the first six months of 2011, rental rates for these prime properties have fallen, with demand from premium tenants declining. Outside of the CBD, rental rates in local centres remain under pressure, with a lack of major anchor tenants limiting the appeal to occupiers.

## SALES ANALYSIS



<b>Address:</b>	Farrer Place, Farrer
<b>Property:</b>	Mid 1970's retail shop in local centre. To trade as IGA supermarket.
<b>Sale Price:</b>	\$1,000,000
<b>Sale Date:</b>	05/2011
<b>Floor Area:</b>	343 sqm
<b>Yield:</b>	8.52%
<b>\$/sqm:</b>	\$2,915

## Investment Market Conditions

Investor demand for retail properties within the ACT has been limited for some time. Demand for properties within local centres is minimal as higher levels of vacancy coupled with ageing stock is failing to appeal to investors.

It would appear that the investment appetite for larger group and town centres remains strong. These properties however are rarely listed for sale and as a result the investor demand for these assets is untested.


## Market Outlook

With growing concern about the state of the global economy and more locally the stability of the incumbent federal labour government, the outlook for the ACT property market is increasingly uncertain.

Office vacancy is expected to remain high as the market struggles to fully absorb the increase in supply recorded over 2008 to 2011. Consequently rental rates will come under heightened pressure, with landlords predicted to cut asking rents in order to minimise vacancy. Older properties in particular, will face long term pressure as the pool of potential tenants is limited.

On a positive note, prime properties with long term leases to government tenants will continue to remain in demand from investors seeking a long term stable investment. The availability of these investments however will be limited.

In the industrial markets tenant demand will remain low in the short to medium term, as a fall in ACT construction will limit the demand for industrial properties. Bulky goods space and properties with strong lease covenants will feature the highest demand, with these assets appealing to local private investors.



The poor conditions experienced within the retail markets will likely continue into 2012, as the market continues to adjust to an increase in supply. Properties in older group centres will likely face the most pressure as increased vacancy limits the rental returns of these investments.

## Further Information

For a more in-depth understanding of the current market conditions within the ACT and how they relate to your property, or for further information regarding Herron Todd White's services please contact:

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