



Aurizon 900 Ann Street Lease: CBD and Fringe Office Market Analysis

Aurizon Submission to the Queensland Competition Authority

—

22 February 2018

Private and confidential

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Mr Karl Boron
Manager, Capital Transactions
Enterprise Real Estate
Aurizon Operations Limited

By email: karl.boron@aurizon.com.au

Dear Karl

900 Ann Street Leasing Analysis and CBD and Fringe Office Market Overview

We have been engaged by Aurizon Operations Limited ('Aurizon') to provide commercial and governance advice in relation to Aurizon's corporate head office accommodation at 900 Ann Street.

As part of these ongoing services, KPMG has prepared a market overview analysis for Brisbane's office market to assess the relative commercial terms of the Aurizon lease to the wider market.

Scope of work

Our work has been performed in accordance with the scope of work outlined in our engagement variation contract dated 25 September 2017 in respect to the subleasing of the Aurizon offices at 900 Ann Street.

Procedures

Our work for the market overview report commenced on 19 February 2018 and was carried out up to 21 February 2018. We have not undertaken to update this report for events or circumstances arising after this date.

Information

In undertaking our work we had access to and relied upon information provided by Aurizon, publically available information and KPMG analysis.

We have indicated in this report the sources of the information presented.

Distribution

This report has been prepared exclusively for Aurizon.

We acknowledge that this report has been prepared to inform, and may be included with, Aurizon's response to the Queensland Competition Authority recent regulatory determination. As a result, we acknowledge that the report may be released publically. We note that our report must be read in conjunction with the limitations set out on page 3.

Should you have any queries or require any additional information, please do not hesitate to contact Paul Morris on 07 3233 9420.

Yours faithfully



Paul Morris
Partner
Real Estate Advisory Services

Important Notice

If you are a party other than Aurizon, KPMG:

- owes you no duty (whether in contract or in tort or under statute or otherwise) with respect to or in connection with the attached report or any part thereof; and
- will have no liability to you for any loss or damage suffered or costs incurred by you or any other person arising out of or in connection with the provision to you of the attached report or any part thereof, however the loss or damage is caused, including, but not limited to, as a result of negligence.

If you are a party other than Aurizon and you choose to rely upon the attached report or any part thereof, you do so entirely at your own risk.

Limitations

The responsibility for determining the adequacy or otherwise of our terms of reference is that of Aurizon.

The services provided under our engagement contract ('Services') have not been undertaken in accordance with any auditing, review or assurance standards. Any reference to 'audit' and 'review', throughout this report, is not intended to convey that the Services have been conducted in accordance with any auditing, review or assurance standards.

Further, as our scope of work does not constitute an audit or review in accordance with any auditing, review or assurance standards, our work will not necessarily disclose all matters that may be of interest to Aurizon or reveal errors and irregularities, if any, in the underlying information.

In preparing this report, we have had access to information provided by Aurizon, publicly available information and KPMG analysis. We have relied upon the truth, accuracy and completeness of any information provided or made available to us in connection with the Services without independently verifying it.

Any findings or recommendations contained within this report are based upon our reasonable professional judgement based on the information that is available from the sources indicated. Should the project elements, external factors and assumptions change then the findings and recommendations contained in this report may no longer be appropriate. Accordingly, we do not confirm, underwrite or guarantee that the outcomes referred to in this report will be achieved.

We do not make any statement as to whether any forecasts or projections will be achieved, or whether the assumptions and data underlying any such prospective financial information are accurate, complete or reasonable. We will not warrant or guarantee the achievement of any such forecasts or projections. There will usually be differences between forecast or projected and actual results, because events and circumstances frequently do not occur as expected or predicted, and those differences may be material.

Market Overview – Current Market Parameters 2018 and 2015

Market Summary – March 2018	Aurizon 900 Ann St	CBD 2018	CBD 2015	Fringe 2018	Fringe 2015
Vacancy rate	N/A	16.2%	15.6%	14.4%	12.8%
A-Grade – gross face rent	██████████ (Rent fixed for first 2yrs)	\$625 - \$750/sqm	\$675 – \$750/sqm	\$525 - \$625/sqm	\$525 – \$600/sqm
A-Grade – incentives	████	32.0% - 40.0%	30.0% – 35.0%+	30% - 42%	27.5% – 35.0%
A-Grade – equivalent yield	N/A	6.00% - 6.50 %	6.50% – 7.75%	6.00% - 8.00%	7.25% – 8.25%
Supply (under construction)	N/A	47,000 sqm	188,437 sqm	33,220 sqm	38,500 sqm
Supply (mooted)	N/A	487,806 sqm	114,081 sqm	c. 128,332 sqm	62,748 sqm

Leasing Market – Tenants benefiting from higher vacancy and higher asset values

CBD Fringe – Market Update 2015 to 2017

The penetration of offshore investors into the Brisbane Fringe market was prominent during 2017, as well as there being high demand from other investor groups. Leasing activity remains subdued in fringe areas, with both the prime and secondary markets recording negative absorption into the beginning of 2018.

Only two projects are currently under construction scheduled to complete in 2018 resulting in a limited supply pipeline for the medium term. This could in turn provide an upward pressure on effective rents, however it should be noted that due to the competitive rents and incentives being offered by CBD landlords, the extent to which the Fringe markets can grow will be restricted.

Recent Lease Evidence – Comparative to 900 Ann Street

The derived lease parameters for Aurizon's 900 Ann St premises are the result of a competitive tender process and the lease terms (gross and effective rent basis) is consistent to other CBD fringe properties¹.

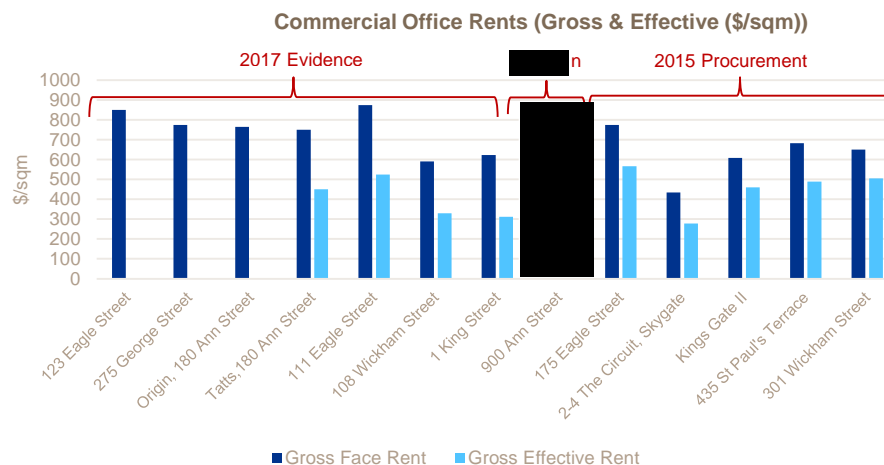
Direct comparison of 900 Ann St to other rents, must consider Aurizon's base building specification, which is above that of a standard A-Grade building, (e.g. power redundancy to support operational control rooms), which adds \$20 and \$35 per square metre to the rent relative to other A-Grade leases.

Recent evidence from large tenants is shown in the table and graph opposite. This highlights that Aurizon's lease is comparable to other large tenant leases in the fringe, particularly when the cost of the Aurizon building specification is considered. Comparable recent leases are receiving gross face rents in the CBD and Fringe of \$590/m² to \$875/m² with lease incentives in the range of 30 – 50%.

Despite movements in the market since the procurement date, the lease terms at 900 Ann Street is considered to be competitive and relative to the building specification. Comparable recent leases such as SMEC's lease at 1 King Street and Aurecon's lease at 5 King Street (both new A-grade buildings) demonstrate that the gross rent at 900 Ann Street is within the market for Brisbane Fringe A-grade office.

It is important to note, that leasing of sub-lease space and space in completed new stock, has been supported by high incentives. These lease are not directly comparable to Aurizon's lease, which is a purpose built asset for a large single tenant commitment (~18,000sqm).

Comparative Analysis – Aurizon RFP lease offers to recent market leases



Note:

- Incentives include lease tails on Skygate, Kings Gate II, 435 St Paul's Terrace.
- No market information available on incentives for 123 Eagle Street (Deloitte), 275 George Street (Telstra), and 180 Ann Street (Origin).
- Incentives calculated on a straight line basis.

Lease	Comments / Comparison to Aurizon		
	Gross Face Rental	Incentive	Gross Effective Rental
Aurizon 900 Ann St (Fringe, A-Grade)	██████████	████	██████████
Tatts Group, 180 Ann St (CBD, A-grade)	\$700 - \$750/sqm (effective late 2017)	35.0% - 40.0%	\$420 - \$487/sqm
QTC, 111 Eagle St (CBD, premium)	\$875/sqm (effective Apr-17)	35.0% - 40.0%	\$525 - \$569/sqm
SMEC, 1 King Street (Fringe, A-grade)	\$623/sqm (effective Apr-17)	50%	\$312/sqm
Aurecon, 5 King Street (Fringe, A-grade)	\$590/sqm	N/A	N/A
Qld Health, 108 Wickham St (Fringe, A-grade)	\$590/sqm (effective 2017)	44%	\$330/sqm



Appendices

Appendix A: Rental Evidence - CBD 2018

Address	Suburb	Building Grade	Tenant	Start Date	Area	Gross Face Rent	Incentive	Term	Source
180 Ann Street	Brisbane	A Grade	Tatts Group	-	18,000 sqm	\$700 - \$750 g	35- 40 %	15.0 yrs	AFR
			Stanwell	Jun-18	2,991 sqm	\$665 g	35-40 %	10.0 yrs	KPMG Data
			Origin	Mar-18	16,250 sqm	\$765 g	Undisclosed	17.0 yrs	KPMG Data
			The State of Queensland (DHPW)	Jan-17	2,015 sqm	\$775 g	c. 40%	3.00 yrs	KPMG Data
345 Queen Street	Brisbane	A Grade	Avant	Nov-17	1,600 sqm	\$710 g	35-40 %	10.0 yrs	KPMG Date
259 Queen Street	Brisbane	A Grade	NAB	Oct-17	8,064 sqm	Undisclosed	Undisclosed	10.0 yrs	Knight Frank Research
175 Eagle Street	Brisbane	A-Grade	Victory Serviced Offices	Jul-17	1,000 sqm	\$730 g	30 – 35 %	10.0 yrs	KPMG Data
240 Queen Street	Brisbane	A-Grade	Conrad & Gargett	Jul-17	1,000 sqm	\$685 g	35 – 40 %	10.0 yrs	Knight Frank Research
			Christie Offices	Aug-17	3,501 sqm	\$685 g	Undisclosed	10.0 yrs	KPMG Data
111 Eagle Street	Brisbane	Premium	QLD Treasury Group	Jun-17	2,830 sqm	\$875 g	35 – 40 %	8.00 yrs	KPMG Data
275 George Street	Brisbane	A-Grade	Telstra	Jan-17	19,577 sqm	\$775 g	Undisclosed.	8.00 yrs	KPMG Data
369 Ann Street	Brisbane	B-Grade	Kaplan	Apr-18	2,227 sqm	\$510 g	25 – 30%	7.00 yrs	Knight Frank Research
123 Eagle Street	Brisbane	A-Grade	Deloitte	Aug-18	8,000 sqm	\$800-850 g	Undisclosed	10.00 yrs	Courier Mail

Note:

1. All incentives calculated on a straight-line basis.

Appendix A: Rental Evidence - CBD 2015

Address	Suburb	Building Grade	Tenant	Start Date	Area	Gross Face Rent	Incentive	Term
480 Queen St	Brisbane	A Grade	Allens Linklaters	P/L (effective early 2016)	4,000 sqm	\$850/sqm ¹	35.0% ¹	8.0 yrs
			BHP Billiton	P/L (effective early 2016)	14,000 sqm	\$800/sqm ¹	25.0% ¹	10.0 yrs
			PwC Australia	P/L (effective early 2016)	6,900 sqm	\$910/sqm ¹	Market Incentive + Lease Tail	10.0 yrs
			HWL Ebsworth	P/L (effective early 2016)	5,091 sqm	\$900/sqm ¹	Market Incentive + Lease Tail	10.0 yrs
180 Ann St	Brisbane	A Grade	Commonwealth Bank of Australia	P/L (effective late 2015)	10,500 sqm ¹	\$700 – \$740/sqm ¹	38.0% – 42.0% ^{1 2}	11.0 yrs
1 William St	Brisbane	A Grade	Queensland State Government	P/L (effective late 2016)	74,854 sqm	\$768/sqm ¹	25.0% ¹	15.0 yrs
111 Eagle St	Brisbane	Premium	Corrs Chambers Westgarth	Nov-14	5,904sqm	\$865/sqm	20.0% + Lease Tail	15.0 yrs
			Arrow Energy	Mar-13	14,800 sqm	\$835/sqm	20.0% – 25.0%	8.0 yrs
192 Ann St	Brisbane	A Grade	Uniting Care	TBA	6,300 sqm	\$585/sqm	36.0%	10.0 yrs
55 Elizabeth St	Brisbane	A Grade	Australian Taxation Office	May-13	18,517 sqm	\$695/sqm	-	15.0 yrs

Note:

1. Reported information.
2. Additional incentives, include: lease-tail and exclusive end-of-trip facilities.
3. Incentive – calculated on a straight-line basis.
4. 480 Queen Street and 111 Eagle Street - Premium-Grade office building.

Appendix B: Rental Evidence - Brisbane CBD Fringe 2018

Address	Suburb	Building Grade	Tenant	Start Date	Area	Gross Face Rent	Incentive	Term	Source
433 Boundary Street	Spring Hill	B Grade	International Education Services	Dec-17	6,000 sqm	\$485 - \$515 g	Undisclosed	12.00 yrs	Savills Research
520 Wickham Street	Fortitude Valley	A Grade	RPS	Nov-17	2,226 sqm	\$600 g	Undisclosed	6.00 yrs	Savills Research
5 King Street	Bowen Hills	A-Grade	Aurecon	Oct-17 P/L	6,489 sqm	\$590 n	Undisclosed	10.00 yrs	Savills Research
1 King Street	Fortitude Valley	A Grade	SMEC	Apr-17	3,600 sqm	\$630 g	40% +	7.00 yrs	KPMG Data
100 Wickham Street	Fortitude Valley	B Grade	State of Queensland (eHealth)	Jan-17	8,695 sqm	525 g	Undisclosed	7.00 yrs	KPMG Data
153 Campbell Street	Bowen Hills	B Grade	Siemens	Aug-17	2,873 sqm	440g	Undisclosed	5.00 yrs	Savills Research
			State of Queensland	Aug-17	2,873 sqm	440 g	Undisclosed	5.00 yrs	KPMG Data
108 Wickham Street	Fortitude Valley	A Grade	State of Queensland	Apr-17	4,570 sqm	590 g	44%	7.00 yrs	KPMG Data
400 Wickham Street	Fortitude Valley	A Grade	CoCo Republic	Aug-17	2,652 sqm	377 n	Undisclosed	10.00 yrs	Savills Research
34 Corporate Drive	Cannon Hill		Optus	Aug-17	2,574 sqm	\$415 g	Undisclosed	5.00 yrs	KPMG Data
19 Corporate Drive	Cannon Hill	A Grade	NBN Co	Aug-17	2,548 sqm	\$450 g	Undisclosed	4.00 yrs	Savills Research
515 St Paul's Terrace	Spring Hill	A Grade	Urban Utilities	Aug-17	1,200 sqm	\$560 g	<20 %	2.00 yrs	KPMG Data
10 Browning Street	South Brisbane	A Grade	Shortcut Software	Jul-17	1,014 sqm	\$535 g	35%	7.00 yrs	KPMG Data
25 Montpelier Road	Bowen Hills	A Grade	Neds International	Apr-17	1,245 sqm	\$520 g	30 – 35 %	3.00 yrs	KPMG Data

Note:

1. All incentives calculated on a straight-line basis.

Appendix B: Rental Evidence – Brisbane CBD Fringe 2015

Address	Suburb	Building Grade	Tenant	Start Date	Area	Gross Face Rent	Incentive	Term
1 King St	Fortitude Valley	A Grade	Robert Bird Group	P/L	1,820 sqm	\$600/sqm ¹	20.0% ¹	7.0 yrs
757 Ann St	Fortitude Valley	A Grade	Ventyx	Jul-14	6,305 sqm	\$610/sqm ¹	25.0% ¹	10.0 yrs
15 Green Square CI	Fortitude Valley	A Grade	Queensland Urban Utilities	Jun-13	8,736 sqm	\$540/sqm ¹	20.0% ¹	10.0 yrs
			Optus	Jun-13	5,884 sqm	\$550/sqm ¹	23.0% ¹	7.0 yrs
			Oil Search	May-13	2,184 sqm	\$580/sqm ¹	20.0% – 25.0% ¹	10.0 yrs
100 Skyring Terrace	Newstead	A Grade	Bank of Queensland	Dec-14	13,174 sqm	\$595/sqm ¹	20.0% ¹	12.0 yrs
			Collection House	Nov-14	7,500 sqm	\$550/sqm ¹	Undisclosed	Undisclosed
			Red Chip Lawyers	Aug-14	1,000 sqm	\$585/sqm ¹	35.0%+	Undisclosed
275 Grey St	South Brisbane	A Grade	Flight Centre	P/L (effective mid 2016)	22,000 sqm ¹	\$525 – \$550/sqm ¹	27.0% – 32.0%	10.0 yrs
76 Skyring Tce	Newstead	A Grade	AEGIS Media	Aug-13	1,382 sqm	\$570/sqm	22.0%	10.0 yrs
104 Melbourne St	South Brisbane	Unknown	Downer Resources	Jul-14	5,229 sqm	\$540/sqm	28.0%	8.0 yrs
100 Melbourne St	South Brisbane	Unknown	Peabody Energy	Jun-14	5,762 sqm	\$545/sqm	25.0% – 30.0%	10.0 yrs

Note:

1. Reported information.

2. Incentive – calculated on a straight-line basis.



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