

SUMMER 2011

Impact of the Big Wet on the Brisbane Property Market



The rebuilding in the aftermath of the floods will give Brisbane property market a lift over the period 2011-2013. This could be similar to the impact that Infrastructure investment programs and population growth had on the Brisbane property market over much of the last decade. While the residential market

has been the most effected by the floods, little overall direct impact was felt by the CBD office market. The impact to the industrial market was also limited mainly to some areas in the south and outer south-west regions. For the great majority of properties its been a case of back to business as usual.





THE IMPACT OF THE 2011 FLOODS

The following presents an assessment of the impact of the 2011 Floods. The assessment presents the key impacts to the Queensland and National economy and the Brisbane property market.

ECONOMIC IMPACT

On 28 January 2011, the Queensland Government State Budget’s Mid Year Fiscal and Economic Review (MYFER) 2010-11 was released. It presented the key points in regards to the estimated potential impact of the flooding to the Queensland economy. The following table was taken from the budget papers and shows the impact in terms of economic growth, employment, wages and prices and the coal, rural and tourism sectors. Note that this was released pre-cyclone Yasi.

IMPACT OF FLOODS ON MYFER ECONOMIC FORECASTS ¹ (ANNUAL PERCENTAGE CHANGE)				
	2010-11		2011-12	
	MYFER Forecast	Excluding Floods	MYFER Forecast	Excluding Floods
Gross state product ²	1.25	3	5	4.25
Employment	2.75	2.75	3.25	3
Unemployment Rate	5.75	5.75	5.25	5.5
Inflation	3.25	3	3	3
Wage Price Index	3.5	3.5	4	3.75
Population	2	2	2	2

Notes:

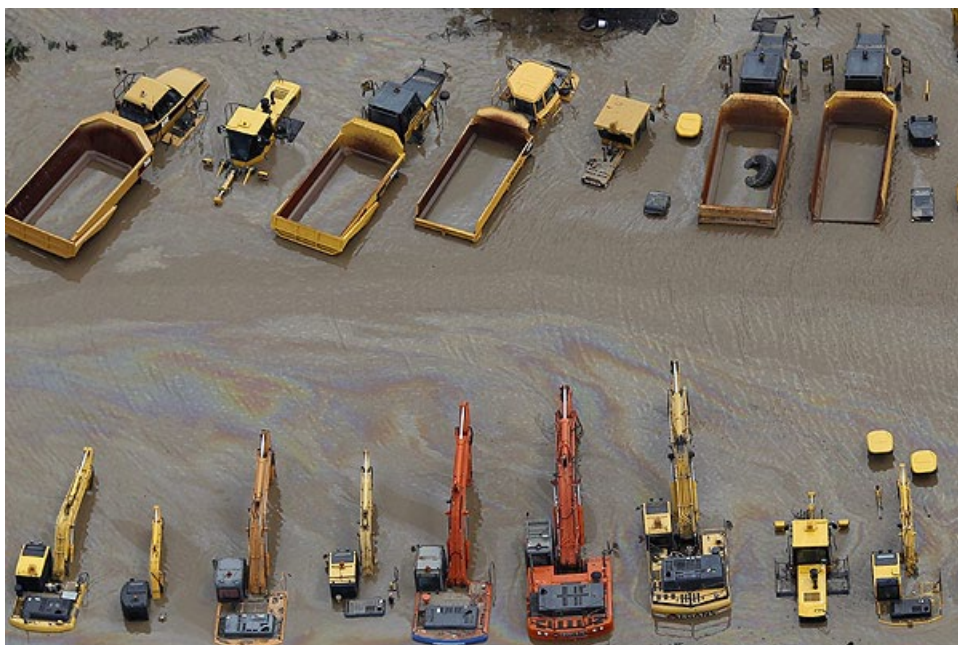
1. All numbers are in year-average terms unless stated otherwise.
2. CVM, 2007-08 reference year.

Source: Queensland Treasury



Flooding over December and January, combined with much wetter than usual weather conditions since September 2010, is estimated to have detracted 1¾ percentage points, or \$4 billion in real terms, from gross state product (GSP) in Queensland in 2010-11. The table above compares forecasts in the MYFER with what forecasts would have been under normal weather conditions. In the absence of floods, economic growth in Queensland would have been predicted to improve to 3% in 2010-11, rather than ease to 1¼% as currently forecast.

The loss in economic growth of 1¾ percentage points in Queensland includes estimates of the direct impact of flooding on coal, rural and tourism sectors, some delays to construction activity, as well as flow-on effects to employment, private spending, wages and prices.

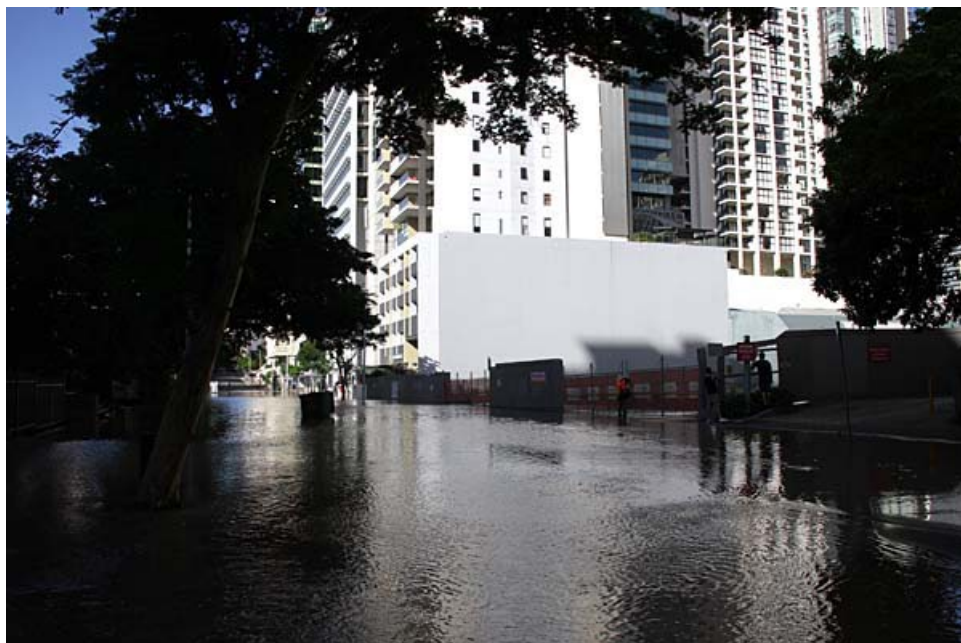


The need to rebuild this infrastructure, residential and commercial structures means that economic growth in Queensland is expected to be higher in 2011-12 than would have otherwise been the case. In particular, around 30,000 properties have been flood affected, requiring significant increases in dwelling construction activity. Some catch up in coal exports is also expected to occur from June quarter 2011, and continue through 2011-12, given expansions to system capacity made in recent years. As a result, economic growth is now forecast to be 5%, compared with 4¼% in the absence of floods.

NATIONAL ECONOMIC IMPACT

In regards to the national economy the key impacts include:

- › In the order of 1 per cent (\$3 billion on an annualised basis) is expected to be taken off the Australian economy in the December and March quarters.
- › Rebuilding should see 0.5% of this recouped by year end and a further modest boost to growth through 2012.



- › The Reserve Bank of Australia (RBA) is likely to look through the short-term boost to inflation that may result from flooding and focus more on the short-term hit to growth, leaving rates on hold until around mid-year.
- › Once rebuilding kicks in and production rebounds the RBA is likely to return to raising rates from around mid-year to head off an overheating in the economy.
- › In regards to Agriculture and Food Prices, higher food prices will add around 0.5% to 0.75% to inflation in the March quarter. Agricultural production in Queensland and other parts of eastern Australia is estimated to be reduced by at least \$500 million to \$600 million 2010/11.
- › In addition, coal export earnings could diminish by between \$2 billion and \$2.5 billion.

IMPACT ON BRISBANE PROPERTY MARKETS

The following presents an assessment in terms of the impact on the Brisbane residential, commercial and industrial markets.

RESIDENTIAL MARKET

A total of 77 Brisbane suburbs were flooded across all range of values. Approximately 5,400 houses flooded over floorboards, 21,000 flooded other than over floorboards, 15,000 houses with flooded yards, 5,900 houses evacuated. A very small percentage of the property inundated was apartments and most of them were only partially damaged.

In the majority of cases, apartment flooding was limited to the basement only. Many owners ensured that their lifts were locked at higher levels as the waters came. Some ground floors of high profile apartments were flooded however in the main damage has been quarantined to the grounds, lifts and basements. It is notable that many new apartment projects along the river weren't affected at all.

There is a strong likelihood that the market will exhibit some price differential reflecting properties affected by water, and those that were not.

Properties located in the flooded areas might now experience some longer term downward adjustment reflecting future flooding risk and stigma. However, market evidence remains critical to this assessment.

Some areas will see an eventual return to similar values and in some cases this will reflect the strength of the recovery of the local economy of those areas. For prestige properties where "money is no object", perceived values may dip temporarily but purchase prices paid will remain high. In any sense, people are unlikely to sell unless they are absolutely compelled to do so. As a result, some analysts estimates of 30-50% decreases in values are unfounded, particularly those that rely on the 1974 floods and the property market at that time (37 years ago!) as a basis for analysis. We are also aware of some banks that are undertaking valuations of some flooded properties. It will be interesting to see the basis of their new valuations given that at this point no market evidence is available. While longer selling periods are expected, Colliers International is of the view that it is too early to determine the level of softening in values.

It is likely that for the next few years, a flood report is going to be THE REPORT for potential purchasers.

Buyers, in the short and medium term, are likely to be more selective about where they buy properties, avoiding low-lying areas that are in the flood zone.

The Brisbane residential market is likely to remain flat for most of this year with some improvement in prices likely around Q4 this year. This is probably a bit more subdued than would have otherwise been the case if not for the floods. This outlook assumes no lasting downturn in the economy (and in fact a rebound in H2) and no additional severe natural disasters.



COMMERCIAL OFFICE MARKET

Flooding issues are unlikely to have an impact to CBD office beyond the Q2. That is, in an overall sense no material impact for rents, yields and prices is expected.

Some impacted sites may see yields increase if insurance is not available and/or the banks revisit values of highly geared properties and these new valuations fall well below pre-flood values.

CBD areas disrupted the most included those in Eagle and Margaret Streets. Post Office Square in Queen and Adelaide Streets was also effected. However, CBD office "flood" issues mainly related to access to buildings. These building may not have been inundated but access was not possible either by impact of flood waters or disconnection of utilities. While Insurance claims will be lodged over damage to property and business interruption, rental abatement issues will be negotiated between landlords and tenants.



For the commercial office sector, it is expected that there will be a heightened emphasis on:

- › flood reports in due diligence in leasing and purchase decisions,
- › reference to abatement clauses in leases,
- › the definition of flooding and legal interpretation in leases to be under more scrutiny.

The flood gives added impetus to design and engineering innovations that mitigate flood/flood related damage to suite the CBD location. Any new or mooted developments should be considering the design element of their project in respect to location of building services/plant rooms/generators etc. The design and implementation of flood gates is also something to be considered.

Some major corporates currently located in the affected zones of the CBD being are re-assessing their desire to continue to be located in these zones. For example, call centre type operations in the future might review other sectors of the CBD that were not impacted by the recent floods.



If they are not already doing so, major corporates impacted by the event should review their disaster contingency plans. This could mean the establishment of a secondary smaller office in the CBD or fringe to act as a disaster recovery type facility. The review may also incorporate an assessment of firms' internal technology capabilities in a crisis. This could assess the potential for staff to work from home, in remote locations and integration with interstate offices.

In regards to the fringe office markets, South Brisbane and Milton represented the most impacted areas. Some tenants relocated from flood-affected premises to restore their premises. However, this is expected to trigger only a minor and temporary fluctuation in the sector.

Naturally, some important questions have emerged regarding office accommodation strategies. Looking forward, because of technology advancements, will this event change the way business accommodates its office workforce? Could major corporates have a requirement for less office space in Brisbane as more staff work from home or as work functions are distributed to counterpart offices in other states?

INDUSTRIAL MARKET

The overall impact on the Brisbane industrial market is quite limited.

While industrial regions in the south west were inundated the impact on the total Brisbane industrial market has been minimal. For many users of industrial space, the effects have been temporary only. Like the other markets, the flood has led to many questions. Historically, the question of where is the Q100 (which means each year there is a 1% chance of flooding to that line) was an important part of due diligence. That question will again be a standard over the next few years. Should the Brisbane Markets at Rocklea be more strategically located to protect the general population's food supply and where should Brisbane's medical supplies be located are other big questions being asked in the industrial sector.

Overall, the outlook for Brisbane Industrial market remains as it was – a year of further consolidation. This is expected to be characterised by corporate activity similar to the likes of Kmart in 2010, and to include significant property moves by the likes of Bunning's and Main Freight in 2011. Again this outlook is largely based on the expected improvement in the Queensland economy into 2011-12. Our view is that average yields for prime assets are to move slightly lower to 8.00%-8.75% and rents to range \$90-\$120.



SUMMARY

The Key matters in regards to the impact of the 2011 Floods include:

- › Expect a greater emphasis on flooding reports as part of due diligence for all property sectors in low lying areas over the next few years.
- › Overall, little direct impact to CBD office markets rents, yields and values – more scrutiny regarding lease terms mentioning flood and rental abatement.
- › Impact to industrial market to be mainly limited to some estates in the south/outer southwest regions.
- › Residential market is the most impacted with some areas to have longer term impacts. The potential for some divergence in values reflecting flood effected and not affected properties and the impact of stigma to values will be monitored as evidence emerges.
- › There will not be a simple “one rule fits all” for values and presently the extent of the softening in prices is too early to call.
- › Increased constructions costs will come into play in the coming quarters.
- › Expect higher insurance premiums.
- › Town planning height limits may be extended from 8.5m in flood plain suburbs
- › More residential buy-outs by Brisbane City Council and possibly the State Government.
- › Potential for conversion of land uses into non-resi and non industrial uses such as parks and recreation fields.



- › Serious consideration of podium car parking as opposed to basement will become a feature in the design process of new buildings
- › The banks assessment of value for flood impacted properties could have a slightly bearish impact on the property market in coming quarters.
- › And last but certainly not least, the findings of the Flood Commission will be critical in informing legal actions and future property development.

Overall, 2011 is expected to be a year consolidation for the Brisbane property market. The boost to the economy from rebuilding business, houses, and infrastructure will however be important. IBISWorld forecast that while the floods are expected to have a negative short-term effect on economic growth as a result of temporary suspension and interruption to business, the floods will provide a boost to economic growth through rebuilding and is expected to last until 2012-13 and total \$11.75 billion.

Significantly, Moody's Investors Service stated that Queensland's credit rating would remain unchanged. They assert that the effect of the floods on Queensland's credit rating was ameliorated by anticipated Commonwealth disaster relief and the states' strong budget flexibility.

While there will be a short-term economic impact across the state, the Queensland capital is likely to receive an economic lift through the rebuild and flow-ons. In the past strong population growth combined with infrastructure investment have been the key drivers of growth that attracted investment in the Brisbane property market. This rebuilding should have a similar impact over 2011-12.

All images courtesy Brisbane Times

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