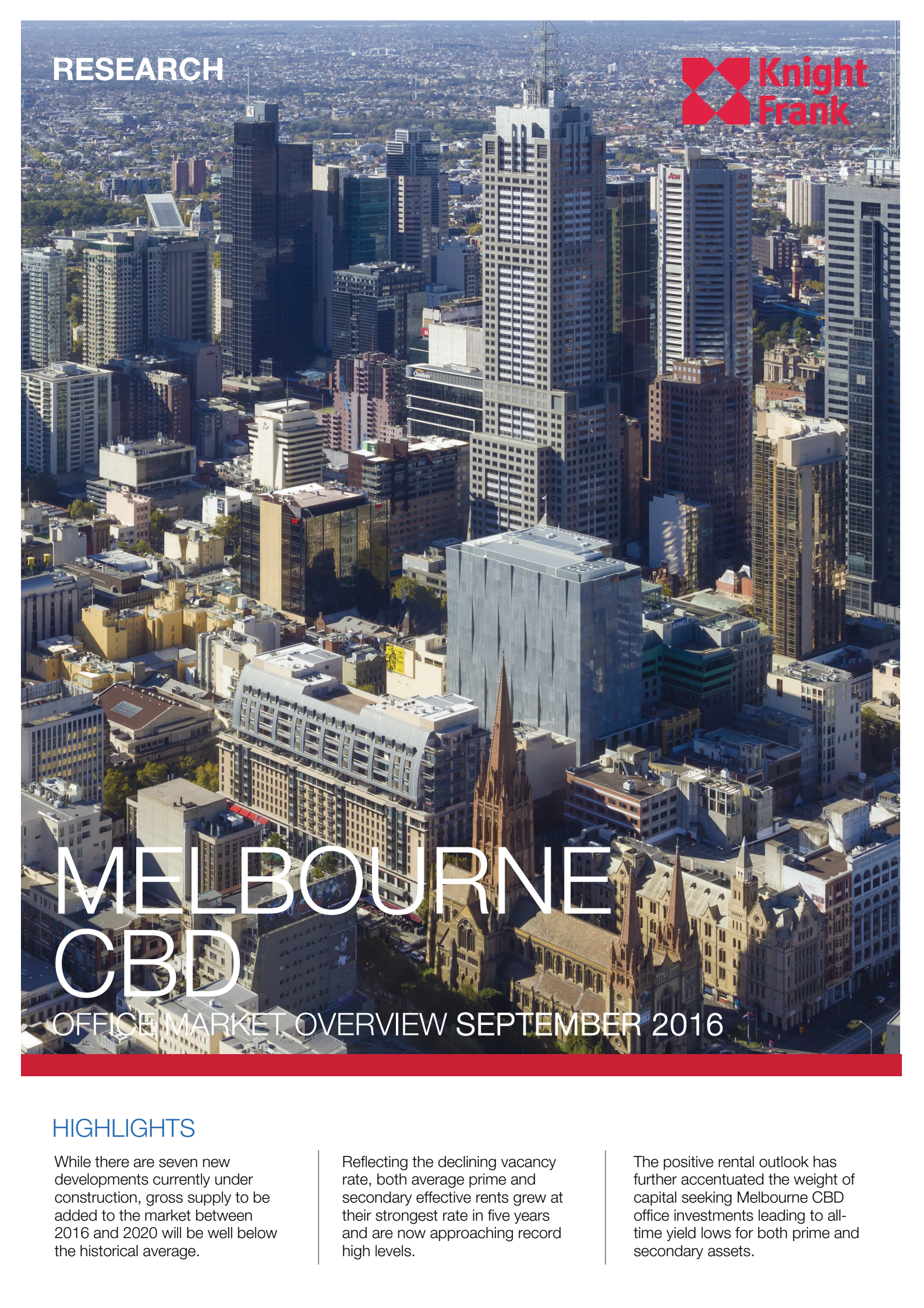


An aerial photograph of the Melbourne Central Business District (CBD) skyline. The image shows a dense cluster of skyscrapers and commercial buildings, with a mix of modern glass-fronted structures and older, more traditional architecture. The city extends into the background, showing a vast urban landscape under a clear sky. The text 'RESEARCH' is overlaid in the top left corner, and the Knight Frank logo is in the top right corner.

RESEARCH



MELBOURNE CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2016

HIGHLIGHTS

While there are seven new developments currently under construction, gross supply to be added to the market between 2016 and 2020 will be well below the historical average.

Reflecting the declining vacancy rate, both average prime and secondary effective rents grew at their strongest rate in five years and are now approaching record high levels.

The positive rental outlook has further accentuated the weight of capital seeking Melbourne CBD office investments leading to all-time yield lows for both prime and secondary assets.

KEY FINDINGS

CBD total vacancy fell to its lowest level in three years down from 8.1% to 7.0% over the 12 months to July 2016

For the first time on record, **no new gross supply was delivered to the Melbourne CBD** office market in H1 2016

Average **prime net effective rents are now approaching record high levels** having grown by 7.3% over the year

Local private investors continue their resurgence, spending \$228 million in 2016 to date.



RICHARD JENKINS
Director — VIC Research

Follow Richard at @RJenkinsR

SUPPLY & DEVELOPMENT

The supply cycle is set to increase materially from late-2019 with a number of developments close to securing pre-commitments to launch construction.

For the first time on record, there was no new gross supply delivered to the Melbourne CBD office market in a six monthly period. In fact over the 12 months to July 2016, only one building, being 567 Collins Street was added to the CBD office market. The Melbourne CBD office market was the only CBD market not to record any gross supply in the first half of 2016 across Australia's CBD office markets.

Coupled with the lack of new supply, 26,343m² was withdrawn from the CBD office market, resulting in a net loss in the total CBD stock level. Moreover, the level of net new supply added to the Melbourne CBD over the 12 months to July 2016, was the third lowest annual quantity in 13 years (22,512m²).

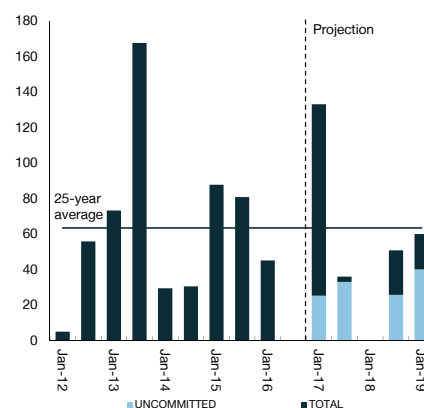
Looking forward, there are seven new developments which are under construction or have begun siteworks. Office buildings set for imminent completion are within Walker Corporation's Collins Square development in the Docklands precinct; Tower 4 (40,000m²) and Tower 2 (70,000m²). However, the supply cycle is set to increase materially from late-2019 with 447 Collins Street (49,000m²) and 477 Collins Street (51,000m²) having recently secured commitments to commence development.

Of the space that is under construction or being refurbished, 56% is pre-committed, leaving 127,700m² uncommitted. A

further 142,800m² of backfill is also forecast to be delivered to the market over the same time frame. While there are emerging signs that new supply levels will increase from 2020, gross supply added to the market between 2016 and 2020 will average 2.3% of total stock per annum, well below the historical annual gross supply average of 3.5% of stock.

With the City of Melbourne's population expected to increase by over 77,600 people to 181,325 by 2031, well located office buildings offering potential for residential development remain of interest to developers. Within the CBD, permanent withdrawals in the next three years is forecast to total 53,948m² or 1.2% of current stock levels.

FIGURE 1
Gross Supply & Commitment
CBD Office (000's m²)



Source: Knight Frank Research/PCA

TABLE 1
Melbourne CBD Office Market Indicators as at July 2016

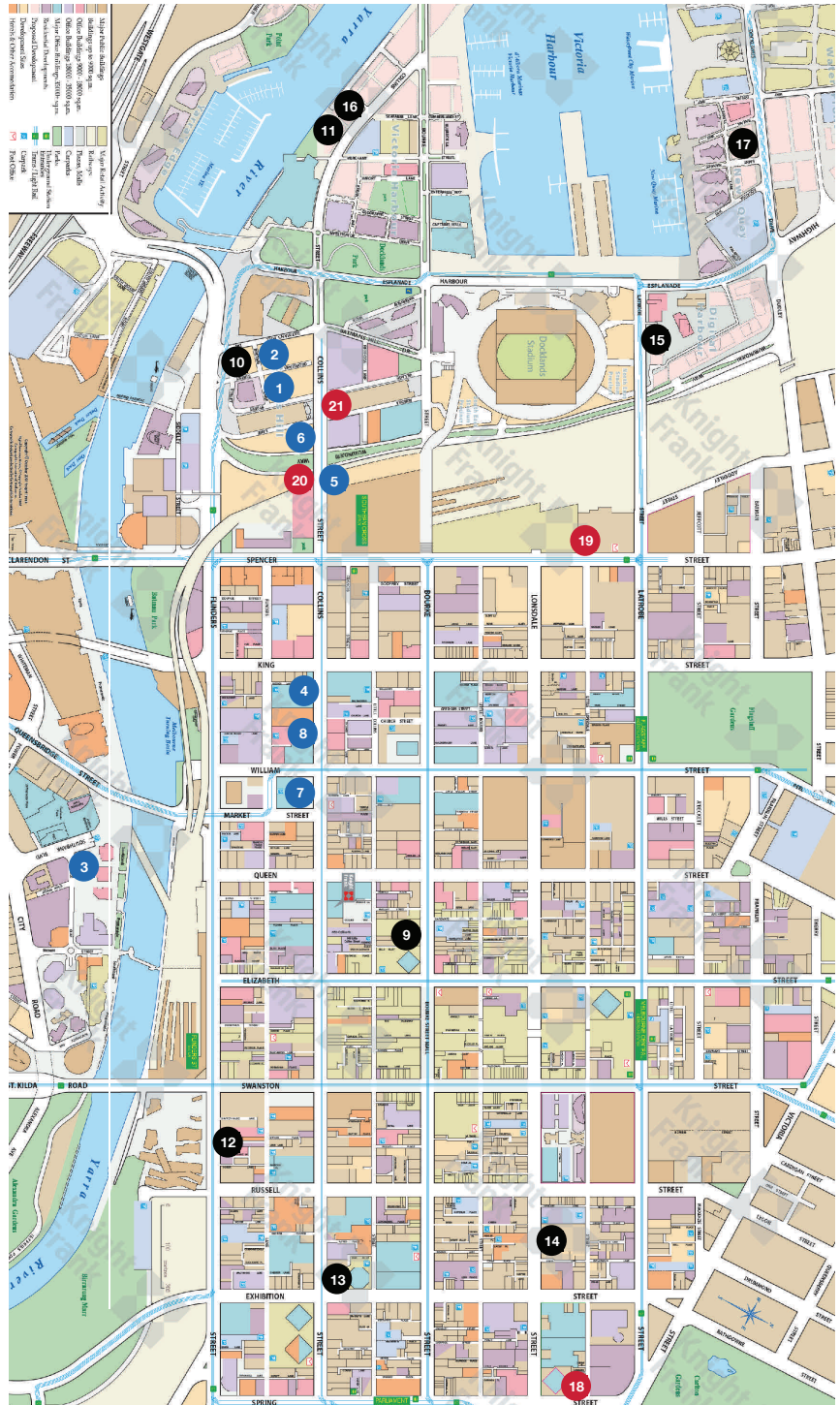
Grade	Total Stock (m ²)	Vacancy Rate (%)	Annual Net Absorption (m ²)	Annual Net Additions (m ²)	Average Net Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	2,898,081	6.7	58,319	37,784	490—560	25.0—30.0	5.00—6.00
Secondary	1,539,743	7.5	8,707	-15,272	310—420	25.0—30.0	5.75—6.75
Total	4,437,824	7.0	67,026	22,512			

Source: Knight Frank Research/PCA

NB. Average data is on a weighted basis

MAJOR OFFICE SUPPLY

- 1 2 Collins Sq - 70,000m² [KPMG/Maddocks/AECOM]
Walker - Q3 2016 - 91% committed.
- 2 4 Collins Sq - 40,000m² [Link Group/Deakin Prime]
Walker - Q4 2016 - 100% committed.
- 3 2-4 Riverside Quay ^ - 20,100m² [PwC]
Mirvac/ISPT - Q4 2016 - 100% committed.
- 4 525 Collins St - 6,000m² [Bank of Melbourne]
St Martins/Equiset - Q2 2017 - 50% committed.
- 5 664 Collins St - 25,800m² [Pitcher Partners]
Mirvac - Q2 2018 - 39% committed.
- 6 One Melbourne Quarter - 25,000m² [Arup/Lend Lease]
Lend Lease - Q2 2018 - 40% committed.
- 7 447 Collins St - 49,000m² [King & Wood Mallesons]
Cbus Property - Q4 2019 - 17% committed.
- 8 477 Collins St - 51,000m² [Deloitte]
Mirvac - Q2 2020 - 35% committed.
- 9 405 Bourke St - 61,000m²
Brookfield - 2020+
- 10 5 Collins Sq - 40,000m²
Walker - 2019+
- 11 Y3, 839 Collins St - 39,200m²
Lend Lease - 2020+
- 12 180 Flinders St - 20,000m²
DEXUS - 2019+
- 13 80 Collins St - 43,000m²
Queensland Investment Corporation (QIC) - 2019+
- 14 124-148 Lonsdale St - 55,000m²
Uniting Church/Charter Hall - 2020+
- 15 1000 Latrobe St - 32,500m²
Digital Harbour - 2019+
- 16 Y4, 855 Collins St - 34,000m²
Lend Lease - 2020+
- 17 395 Docklands Dve - 22,000m²
MAB - 2019+
- 18 271 Spring St - 20,000m²
ISPT - 2019+
- 19 311 Spencer St - 55,000m²
Australia Post/Cbus Property - 2020+
- 20 Melbourne Quarter - 85,000m²
Lend Lease - 2020+
- 21 710 Collins St - 47,500m²
Abacus Property Group - 2020+



Source of Map: Knight Frank Research

- Under Construction / Complete
- DA Approved / Confirmed / Site Works
- Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates
Major tenant precommitment in [brackets] next to NLA
^ Southbank precinct
Office NLA quoted

TENANT DEMAND & RENTS

The Victorian economy is growing faster and stronger than any other in the country. Total employment in Victoria has grown by 93,000 or 3.2% over the year to July 2016 compared to growth of 2.4% recorded in NSW. Importantly full-time employment has underpinned the growth of total employment in Victoria, which should lead to increased demand for office accommodation.

Victoria continues to benefit from the lower interest rates and a lower dollar. According to the Australian Bureau of Statistics, Victorian employment growth was largely driven by the health care, construction and retail trade sectors. In terms of traditional white collar employment sectors, employment levels continue to be mixed with the finance sector growing, while employment in the professional services and public services sectors contracted over the year.

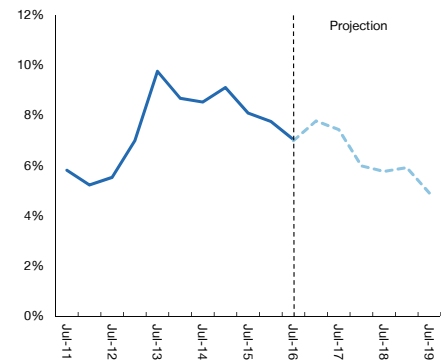
Reflecting Australia's economic rebalancing, net absorption recorded in the 12 months to July 2016 within the Melbourne and Sydney CBD office markets accounted for 80% of all space absorbed across the Australian CBD office markets. In the first half of 2016 however, net absorption in the Melbourne CBD office market totalled 7,641m², having been adversely impacted by the stock withdrawals. As a result of the withdrawals, occupied CBD space fell by 26,343m². With the unemployment rate appearing to

have peaked for the short term, tenants are increasingly focused on the attraction and retention of staff; occupiers continue to upgrade their office space. Premium and A-grade net absorption totalled 58,319m², accounting for 87% of the office space absorbed in the 12 months to July 2016.

Mirroring the trend witnessed in the Sydney CBD a year ago, the technology sector has been one industry driving demand for prime CBD office space. Recent commitments made by tech companies include: Facebook (974m²), Electronic Arts (4,205m²) both at 720 Bourke Street; Amazon (1,619m²) at 8 Exhibition Street and Bloomberg (596m²) at 120 Collins Street.

Complementing the growth of the technology sector, with small business on the rise underpinned with businesses employing 1-4 employees growing at 14,800 per year, demand for flexible office accommodation is also increasing. Knight Frank Research reveals that within the CBD, coworking space totals 16,935m² with 32 operators. Coworking spaces account for 0.4% of total CBD office stock of which 62% of spaces are located in B-grade and C-grade stock, with 12.5% occupying space in prime grade assets. Coworking operator, Hub Melbourne recently leased 3,900m² at 696 Bourke Street while US-based

FIGURE 3
Melbourne CBD Vacancy Rate
Total Vacancy (%)



Source: Knight Frank Research/PCA

WeWork and Singaporean coworking provider, The Working Capitol, are both seeking space in the Melbourne CBD.

Sub-lease vacancy in the Melbourne CBD office market continued to fall, decreasing from 0.9% in January to 0.7% as at July 2016, its lowest level in four years. Whilst the headline sublease vacancy rate is almost half the long term average for the Melbourne CBD office market, there remains a component of hidden sublease vacancy with additional space being actively marketed for sub-lease but not physically vacant.

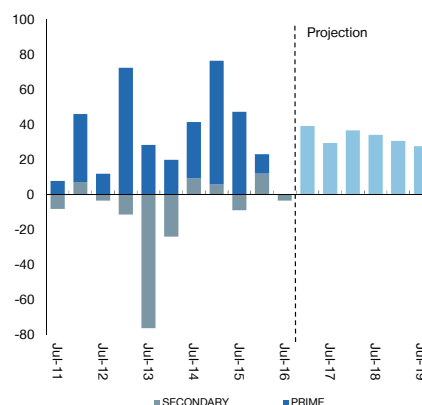
Vacancy fell in the majority of precincts in the six months to July 2016 with the Eastern, North Eastern and Flagstaff precincts increasing. Most CBD precincts also recorded vacancy rates below their respective 10-year average levels. The Spencer precinct continues to hold the highest vacancy of 11.9%. Elsewhere, the vacancy rate of the Docklands has the lowest rate at 3.4% having fallen in the six months to July 2016. In contrast, the North Eastern precinct has increased to 8.3%, its highest rate in 16 years. However further rises are expected for the North Eastern precinct as a result of Link's relocation from 2 Lonsdale Street to their new office in Walker Corporation's Collins Square development in the Docklands later this year.

TABLE 2
Melbourne CBD Vacancy Rates

Grade	Jul-15 (%)	Jan-16 (%)	Jul-16 (%)
Premium	7.2	10.2	8.4
A Grade	7.6	6.6	6.1
Prime	7.5	7.5	6.7
B Grade	9.4	8.3	7.5
C Grade	10.0	9.4	9.1
D Grade	3.0	2.4	2.2
Secondary	8.4	8.3	7.5
Total	8.1	7.8	7.0

Source: Knight Frank Research/PCA

FIGURE 2
Melbourne CBD Net Absorption
per six month period (000's m²)



Source: Knight Frank Research/PCA

Anticipated Vacancy Levels

Looking ahead, job advertisements in Australia were 8.0% higher as at August 2016 compared to 12 months prior. With business and consumer confidence levels both optimistic, the rise in job ads is consistent with the ongoing strengthening in the labour market. White collar employment growth in the Melbourne CBD office market is expected to continue to expand. Having grown by just 0.2% in the 12 months to July 2016, white collar employment is forecast to increase by 3.5% or 9,736 employees over the coming year. Over the next three years white collar employment growth in the Melbourne CBD office market is forecast to be driven by growth in the Accommodation & Food Services, Finance and Government sectors.

While the CBD vacancy rate is predicted to increase for the first time in two years, the rise is forecast to be short-lived. Vacancy is expected to rise to 7.8% as at January 2017 impacted by the new supply delivered at Collins Square and

associated backfill. From the start of 2017 vacancy is anticipated to trend down until the new construction cycle of 2020.

Rental Levels

With CBD total vacancy falling from 8.1% to 7.0% over the 12 months to July 2016 and to its lowest level in three years, both prime and secondary office net effective rents increased solidly. In the 12 months to July 2016, average prime effective rents increased by 7.3% to \$372/m² net. Melbourne prime CBD office net effective rents are now approaching previous record highs with forecasts indicating all-time highs will be reached by the end of 2016. While average prime incentives range between 25% and 30%, there is increasing evidence of incentives declining, albeit gradually.

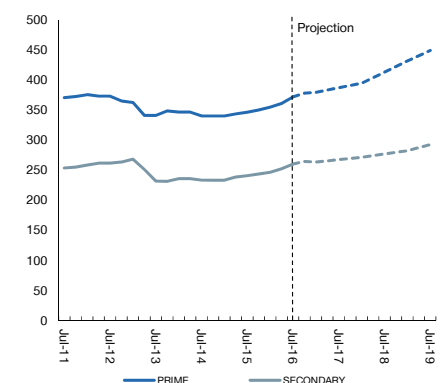
Along with prime CBD office rental growth, secondary effective rents also continue to gather momentum. With the CBD secondary office vacancy rate down to its lowest level since January 2013, average secondary rents grew at their strongest rate in six years. In the 12

months to July 2016, average secondary effective rents increased by 8.1% to \$260/m² net.

With new supply levels relatively constrained until 2020 and vacancy continuing to decline, prime net effective rental levels are forecast to record average annual growth of 7.2% over the next three years.

FIGURE 4

Average Net Effective Rents Melbourne CBD (\$/m²)



Source: Knight Frank Research

TABLE 3

Recent Leasing Activity Melbourne CBD

Address	Precinct	NLA (m ²)	Term (yrs)	Lease Type	Tenant	Sector	Start Date
477 Collins Street	Western	15,000	12	Precom	Deloitte	Business Services	Q2-20
242 Exhibition Street	Nth Eastern	65,717	11	Renewal	Telstra	TMT	Q2-20
447 Collins Street	Western	8,300	U/D	Precom	King & Wood Mallesons	Legal	Q4-19
380 La Trobe Street	Flagstaff	8,164	12	New	Maurice Blackburn	Legal	Q4-18
700 Collins Street	Docklands	2,682	8	New	Open Universities	Education	Q1-17
168 Exhibition Street	Nth Eastern	3,772	5	New	Acknowledge Education	Education	Q1-17
485 La Trobe Street	Flagstaff	8,400	6	New	Salmat	Business Services	Q1-17
247 Collins Street	Civic	1,664	10	New	Discover English	Education	Q1-17
55 Collins Street	Eastern	1,035	10	New	MIPS	Business Services	Q4-16
696 Bourke Street	Spencer	3,900	10	New	The Hub	Real Estate	Q4-16
720 Bourke Street	Docklands	4,205	10	New	Electronic Arts*	TMT	Q4-16
717 Bourke Street	Docklands	2,317	10	New	Telecomm. Industry Ombudsmen	TMT	Q4-16
555 Lonsdale Street	Western	1,950	7	New	Kliger Partners	Legal	Q4-16
570 Bourke Street	Western	8,782	13	New	Legal Aid	Legal	Q4-16
700 Collins Street	Docklands	15,500	10	Renewal	Bureau of Meteorology	Government	Q2-16

*Tenant relocating to CBD

TMT refers Technology Media & Telecommunications

U/D refers undisclosed

Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Investment sales activity (above \$10 million) in 2016 to date within the Melbourne CBD office market currently totals \$687.5 million from 12 properties. Although investor appetite remains intense for CBD assets, transactional volume levels recorded in 2016 are 56% below those achieved over the preceding time period in 2015. Excluding the record levels achieved between 2013-2015, the current levels of transactional activity are inline with those achieved in the Melbourne CBD office market over the past 10 years. With a number of significant transactions currently being marketed, investment sales activity in 2016 is on target to surpass \$1 billion and register at least the fourth highest transactional annual level on record.

In contrast to the past three years, in 2016 to date, there have been no transactions in excess of \$200 million which have boosted sales levels between 2013 and 2016. Whereas, there have been two transactions recorded in the Southbank precinct in excess of \$200 million with ARA Asset Management & Entities purchase (including Suntec REIT) of the Southbank complex for \$578 million and JP Morgan's acquisition of 28

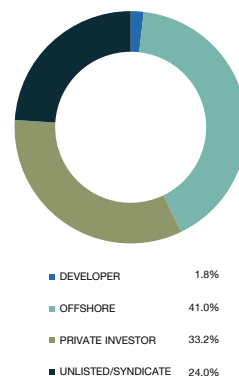
Freshwater Place for \$286 million.

Offshore groups lead all purchaser types accounting for 41% of sales by value, spending more than \$282 million. Given the record levels of offshore investment achieved in past three years in the Melbourne CBD office market, offshore investment is unlikely to match those levels this year. Major acquisitions made by offshore groups this year were led by Singaporean investor Philip Lim's acquisition of 380 La Trobe Street for approximately \$157 million from Invesco. In addition, Malaysia-based Tune Hotels purchased 539-545 Flinders Lane for \$18.5 million and Swiss group Fidinam's acquisition of 533 Little Lonsdale Street for \$35.25 million.

In 2016 to date, Asian-based purchasers have accounted for 81% of cross-border investment into the Melbourne CBD office market with Fidinam's acquisition, the only non-Asian based cross-border transaction.

Interestingly, local private investors continued their resurgence, spending \$228.1 million in the CBD office market in 2016 to date. Domestic private investor

FIGURE 5
Melbourne CBD sales by purchaser
\$10 million+ sales — YTD2016



Source: Knight Frank Research

spending in the CBD market over 2016 is predicted to reach their highest annual level in seven years. In 2016 to date, local private investors have purchased four CBD offices, highlighted by Harry Stamoulis' purchase of 1 Collins Street for \$125 million.

Despite the strong purchasing activity of local private investors, they also remain net sellers of Melbourne CBD office assets, divesting \$331.8 million in 2016 to date.

TABLE 4

Recent Sales Activity Melbourne CBD

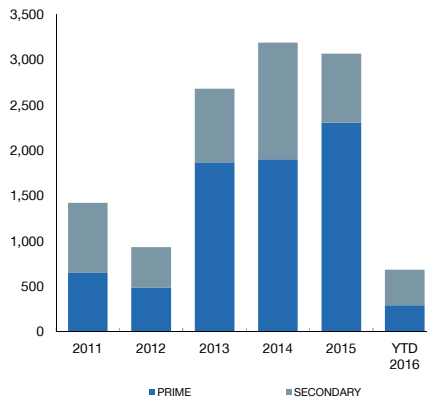
Address	Price (\$ mil)	Core Mkt Yield (%)	NLA (m ²)	\$/m ² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
3 Southgate Ave [^]	578.00	U/D	76,208 ^a	7,585	4.5	DEXUS Property	ARA Asset Management ^{>}	Aug-16
380 La Trobe St	157.00	5.50	21,558	7,283	9.0	Invesco	Offshore Investor	Jul-16
539-545 Flinders Ln [#]	18.50	VP	3,300	5,606	VP	NM Computer Services	Tune Hotels	Jun-16
51 Queen St	25.00	N/A	4,657	5,368	N/A	Offshore Investor	MARA	Jun-16
33-35 King St [‡]	12.35	VP	850	14,529	VP	Asia One	BPM	Apr-16
120 Spencer St	165.00	7.00*	33,258	4,961	N/A	Harry Stamoulis	Anton Capital	Apr-16
533 Little Lonsdale St	35.25	6.25	6,599	5,299	2.8	Vantage Property	Fidinam (Aust)	Mar-16
1 Collins St	125.00	5.36	14,006	8,925	3.1	Overland Properties	Harry Stamoulis	Feb-16
406 Collins St	23.10	5.30	3,742	6,173	2.6	Private Investor	Private Investor	Jan-16
55 King St	78.50	5.84*	12,666	6,198	3.6	LaSalle Asia Opportunity Fund IV (LAOF IV)	Charter Hall (CHOF)	Dec-15
380 Docklands Dr	80.40	7.20	14,368	5,596	3.9	Fitzpatrick Investments	LaSalle (LIM)	Dec-15
520 Bourke St	25.03	5.75	5,717	4,377	N/A	Offshore Investor	Fife Capital	Dec-15

Source: Knight Frank Research

* initial yield [^] Located in the Southbank office market, excluded from CBD analysis and charts ^a includes 9,806m² retail space
[‡] bought for potential hotel/residential redevelopment [#] bought for potential hotel redevelopment
[>] ARA Asset Management & Entities (including Suntec REIT) LIM refers Lasalle Investment Management

FIGURE 6

Melbourne CBD Sales \$10 million+ By grade (\$m)



Source: Knight Frank Research

Limited by opportunity rather than investor appetite, prime grade assets have accounted for 43% of sales activity by value, despite only two A-grade assets transacting. In contrast, secondary grade offices accounted for the majority of transactional activity by value and number. By number of sales, secondary assets made up 83% sales in 2016 to date with transactions in the Melbourne CBD totalling \$392.5 million. The vast majority of secondary assets transactions were acquired by domestic funds and local private investors.

Analysis of transactions in 2016 to date reveal that investor motivation/focus for the offices transacted were predominately for value add assets rather than immediate redevelopment opportunities. Buildings transacted with redevelopment purposes in the near future only accounted for 13% of total transactions. Local developer BPM purchased 33 King Street for \$12.35 million from Malaysian developer Asia One. Currently the wholly vacant building comprises office NLA of 850m² and was sold with a permit for 120 apartments; however BPM plans to revise the scheme for a mixed-use development comprising a luxury hotel, retail and apartments.

Fewer buying opportunities coupled with the positive rental outlook has further heightened the weight of capital seeking Melbourne CBD office investments. As a result of the increasingly broadening pool of investors, yields have compressed for

both prime and secondary assets.

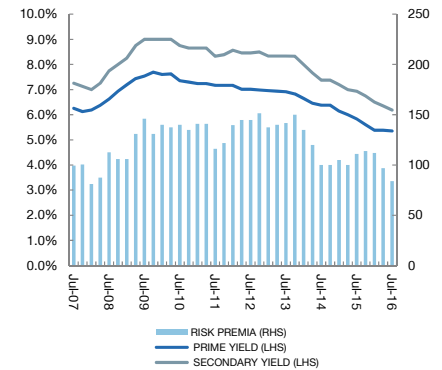
As at July 2016, over the past 12 months average prime office yields compressed by 48 basis points to 5.35% and range between 5.00% and 6.00%. Average prime yields now stand 135 basis points lower than the 10-year average.

The average prime yield range was supported by a number of recent transactions including: the sale of 1 Collins Street having transacted on a core market yield of 5.36% and 380 La Trobe Street having sold on a core market of 5.5% further demonstrating the significant compression of prime asset yields over the past 12 months.

Similar to prime CBD office assets, secondary yields also tightened considerably over the year to July 2016. Average secondary yields compressed by 75 basis points in the 12 months to July 2016 to range between 5.75% and 6.75%. Secondary yields have now fallen

FIGURE 7

Melbourne CBD Yields & Risk Spread Core Market Yields & Prime vs Secondary Spread (bps)



Source: Knight Frank Research

to 30-year lows with the risk spread between prime and secondary assets falling to eight-year lows with the spread currently sitting at 84

Outlook

- Buoyed by falling interest rates and a lower dollar, the Victorian economy is growing faster and stronger than any other Australian state. Victorian total employment has grown by 3.2% over the year to July 2016, almost double the 10-year average. The Victorian economy is forecast to grow by 2.6% in 2016/17 and on average by 2.7% per annum over the next five years.
- Over the next three years, white collar employment within the CBD is forecast to grow by 25,573 employees. White collar employment growth in the Melbourne CBD office market is forecast to be driven by growth in the Accommodation & Food Services, Finance and Government sectors.
- Between 2016 and 2020, gross supply added to the market will average 2.3% of total stock per annum, well below the historical annual gross supply average of 3.5%. Of the space that is under construction, 56% is already pre-committed. The next supply cycle is anticipated to begin in late-2019.
- The CBD vacancy rate is forecast to trend down from January 2017 and remain below its historical average until the new construction cycle of 2020.
- With new supply levels relatively constrained until 2020, supported by positive net absorption, prime net effective rent levels are forecast to average growth of 7.3% per annum with secondary net effective rents to record average growth of 4.8% over the next three years.
- Investment sales activity over 2016 is projected to surpass \$1 billion and register at least the fourth highest transactional annual level on record with limited investment opportunities maintaining the low yield environment.



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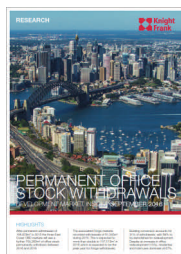
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