RESEARCH

SEPTEMBER 2011

MELBOURNE CBD

Office Market Overview

Knight Frank

HIGHLIGHTS

- The Melbourne CBD office market absorbed 84,699m^2 of office space over the year to July 2011. Highlighting the continued flight to quality assets, prime net absorption was 101,348m^2, whilst secondary net absorption was -16,649m^2.
- Approximately 247,829m^2 of new office space is expected to be constructed over the 2012 and 2013 calendar years. Gross additions as a percentage of total stock in CY12 and CY13 will be 3% p.a. compared with the long term average of 3.7% p.a. Developers are actively seeking tenant pre-leases to launch the next wave of construction; likely to commence from 2014.
- Despite sales volumes for the 2011 year to date (YTD) falling from cyclical highs experienced in the last six months of 2010, investor activity remains strong with $731.0 million worth of sales in thirteen transactions.

MELBOURNE CBD OVERVIEW

Table 1
Melbourne CBD Office Market Indicators as at July 2011

Market	Total Stock (m²) ^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²) ^	Average Prime Net Face Rent ($/m²)	Incentive (%)	Average Prime Core Market Yield (%)
Prime	2,469,658	4.4	101,348	75,091	420 – 500	14 - 20	7.00 – 7.50
Secondary	1,638,992	8.0	-16,649	-14,433	285 – 355	18 - 24	7.50 – 8.75
Total	**4,108,650**	**5.8**	**84,699**	**60,658**			

Source: Knight Frank/PCA ^ as at July 2011

SUPPLY & DEVELOPMENT ACTIVITY

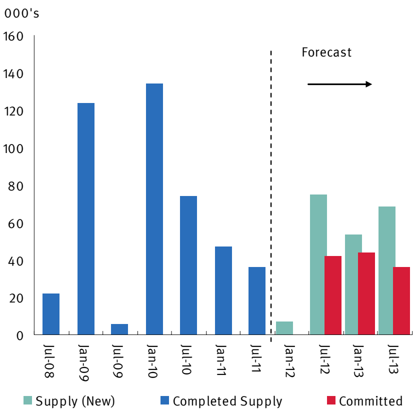
The second half of 2011 is shaping up as a significant period when examined in the context of timing and duration of the next CBD office supply cycle. It marks the bottom of what has been a relatively modest supply cycle, a direct result of the GFC and, the beginning of the next cycle that's size and longevity could be impacted as global volatility threatens to cool demand and further contract financial markets.

Confirmed new developments will ensure the next cycle extends to at least 2013 as 254,966m² of new office space is slated for completion. With strong levels of pre-leases anchoring new developments over the next two years, just 73,941m² (or 29%) of space is yet to be committed. Historically, the Melbourne CBD office market adds approximately 3.7% of gross supply to the stock base each year. Over CY12 and CY13 the market will add an average of 3.0% p.a.

With the exception of a number of small refurbishments, 2011 will deliver no new supply. Cromwell's property at 321 Exhibition Street has been included in the first half completions and is fully leased to Origin Energy. The second half of 2011 will return 7,137m² of refurbishment space back into the market; however this has been fully leased to new tenants.

Looking ahead to 2012, the completions will deliver 128,919m² of new and refurbished space. As much as 61% of this space will be constructed in the Docklands precinct. Improved amenity & access to large floor plates have been contributing factors in attracting new tenants to pre-commit to new developments in the precinct. Of the 78,340m² of space expected to be delivered in Docklands over 2012, 83% has been taken by pre-lease tenants.

Figure 1
Melbourne CBD Forecast Supply
(m²) Major New & Refurbished Gross Supply



Source: Knight Frank / PCA

The remaining 50,579m² of office space to be constructed in 2012 will be located in the "traditional" CBD. Australand is expected to complete works on their spec redevelopment at 357 Collins Street by Q2 2012. A strong Collins Street location has assisted the developer in securing several tenants to this building, leaving just 56% of space available. Juilliard Group's development at 555 Bourke Street will result in an additional 20,172m² being added to the CBD legal precinct. Holding Redlich have pre-leased 28% of this space and will re-locate from their temporary accommodation upon completion.

Docklands will continue to deliver the majority of new supply into 2013 when both Marsh Mercer and NAB move into their new accommodation at Walker's Collins Square project and the Cbus development at 700 Bourke Street respectively. Charter Hall/Cbus will jointly develop the Eastern precinct's first tower in twenty years at 171 Collins Street, supplying an additional 29,057m² of office space which is due to be completed by mid 2013.

Backfill space is expected to provide an additional 80,620m² of available space for prospective tenants through to the end of 2012. With tight vacancy and a lack of alternative options, the majority of this space should be successfully absorbed.

MAJOR OFFICE SUPPLY

1 321 Exhibition St # - 30,824 m² (Origin Energy)
Cromwell - Q2 2011 - 100% committed.

2 555 Bourke St - 20,172 m² (Holding Redlich)
Juilliard - Q3 2012 - 28% committed.

3 357 Collins St - 30,407 m² (Commonwealth Bank)
Australand - Q2 2012 - 48% committed

4 990 Latrobe St - 12,200 m² (Melbourne Water)
MAC (SA) - Q2 2012 - 100% committed.

5 Collins Square B1 North - 38,000 m² (ATO)
Walker - Q2 2012 - 90% committed.

6 850 Collins St - 15,840 m² (Aurecon)
Lend Lease - Q4 2012 - 60% committed.

7 The Goods Shed - 11,000 m² (Pearson)
Walker - mid/late 2012 - 73% committed.

8 Bourke Junction, Nth Tower - 62,000 m² (NAB)
Cbus Property - Q2 2013 - 100% committed.

9 Collins Square B2 North - 35,000 m²+ (Marsh Mercer)
Walker - Q2 2013 - 65% committed.

10 171 Collins St - 29,057 m² (BHP)
Charter Hall/Cbus - Q2 2013 - 47% committed.

11 685 Latrobe St - 33,000 m²
Charter Hall & Flagship - 2014+

12 555 Swanson St - 36,000 m² (CUB Site)
Grocon - 2014+

13 Collins Square B2 South - 50,000 m²
Walker - 2014+

14 Collins Square B1 South - 20,000 m²
Walker - 2014+

15 385 Bourke St - 27,000 m²
Colonial First State - 2014+

16 80 Collins St - 38,000 m²
Queensland Investment Corporation (QIC) - 2015+

17 360 Collins St - 20,000m²
Dexus - 2015+

18 150 Collins St - 15,000 m²
APN - 2014+

19 567 Collins St - 52,000 m²
APN/Leighton Properties - 2015+

20 275 Lonsdale St - 22,000 m²
Colonial First State - 2015+

21 300 Lonsdale St - 25,000 m²
GPT Group - 2015+

22 664 Collins St - 45,000 m²
Mirvac - 2015+

23 395 Docklands Dve - 22,000 m²
MAB - 2015+

24 1000 Latrobe St - 32,500 m²
Digital Harbour - 2015+

25 North Wharf - 20,000m²
WTC Asset Management - 2015+

26 399 Bourke St - 63,000 m²
Brookfield - 2016+

27 Sites 5 & 6B - 100,000 m²
Vicurban - 2016+

28 680 Collins St - 40,000 m²
Vicurban - 2017+

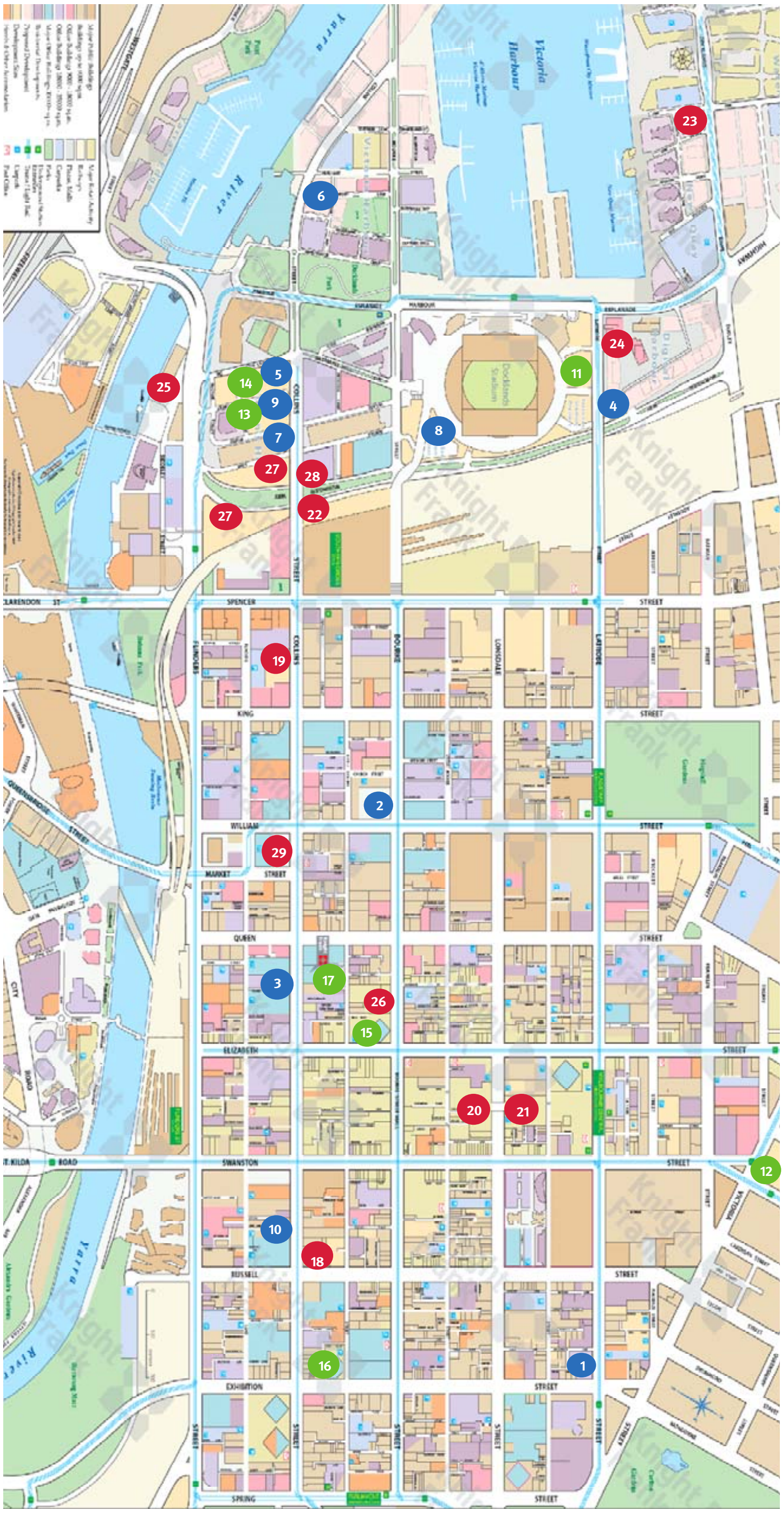
29 447 Collins St - 80,000 m² (AXA Site)
ISPT - 2017+

Under Construction/Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates
Major tenant precommitment in brackets
Major refurbishment
Office NLA quoted



Source of map: Knight Frank

TENANT DEMAND & RENTS

Despite recent softness in activity, tenant demand over the past six months has been consistent with Melbourne's long term average. With take up outstripping new supply, the vacancy rate experienced a drop from a revised 6.6% in January 2011 to 5.8% in July 2011. Prime grade space continues to be the most sought after with the vacancy rate declining from 5.6% at the commencement of 2011 to a low of 4.4% at July. There remains an underlying demand for large prime contiguous space; however with limited options, tenants will find securing suitable accommodation increasingly difficult over the medium term. Conversely, vacancy in secondary stock has increased as tenants continued their transition to quality stock.

Short term and project space has created another tier of demand to the market over the six months to July 2011. A number of landlords have been accommodating short term requirements to capture immediate revenues with the view that expiries will coincide with a marked increase in market rents. Examples of this include AGL and CGU taking space at 601 Bourke Street and Origin at 303 Collins Street.

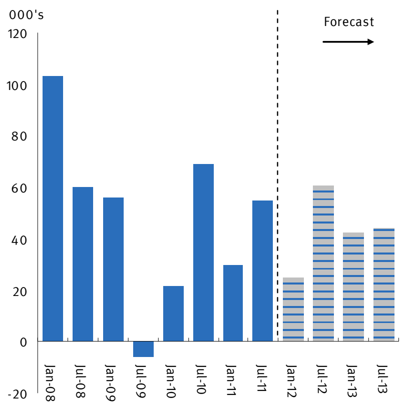
Table 2
Melbourne CBD Vacancy Rates
January 2011 – July 2011

Grade	Jan-11 %	Jul-11 %
Premium	5.8	4.7
A Grade	5.6	4.3
B Grade	7.8	7.6
C & D Grade	8.0	8.6
Total	6.6	5.8

Source: PCA

Net Absorption

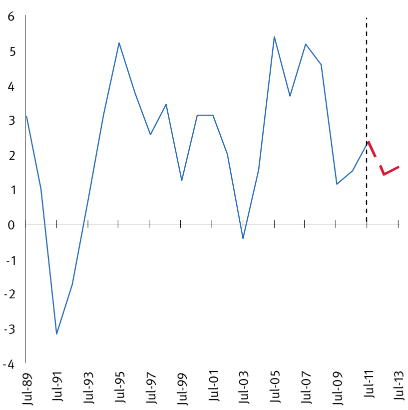
Figure 2
Melbourne CBD Net Absorption
(m²) January 2008 – July 2013



Source: Knight Frank

Indicating a relatively sound performing market, the net absorption figure for the year to July 2011 was 84,699m². This falls marginally short of the long term average annual amount (90,196m²) of space absorbed. Supporting the trend of a flight to quality premises, total net absorption for prime stock was 101,348m²; whilst net

Figure 3
White Collar Employment
(%) Melbourne CBD annual growth

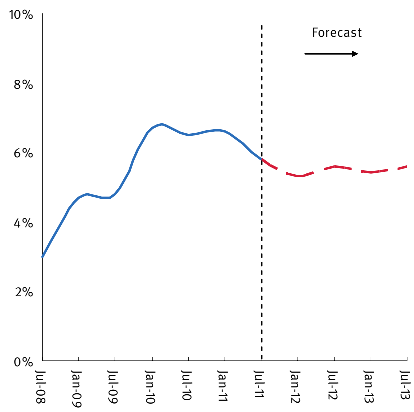


Source: Deloitte Access Economics / Knight Frank

absorption for secondary space was minus 16,649m². This highlights the sustained demand for large quality office buildings. During the six months to July 2011, Flagstaff and the Docklands precincts experienced the greatest demand for space with a combined net absorption figure of 67,644m² or approximately 80% of the CBD total

Recent volatility in global markets has been the catalyst for a paring back in forecasts on white collar employment growth with demand relatively soft at present. However, we anticipate white collar growth to run at an average 1.6% p.a. over the next two years as suburban tenants such as Aurecon, Melbourne Water and Pearson move from the suburbs to CBD accommodation. Additionally, demand for project space should boost absorption over the next two years.

Figure 4
Melbourne CBD Vacancy
(%) total vacancy



Source: PCA / Knight Frank

Anticipated Vacancy Levels

The PCA Office market survey has recorded declining vacancies in the Melbourne CBD for three consecutive periods. With no new supply being delivered until Q2 2012, vacancies are expected to decline marginally, before troughing at 5.4% at January 2012. New supply and a revised demand outlook will lead to upward pressure on the vacancy rate over the two years to July 2013, albeit our base forecasts reflect only a marginal increase. Despite a forecast rise, primarily caused by vacant secondary stock, a vacancy rate sub 6% is still reflective of a sound market.

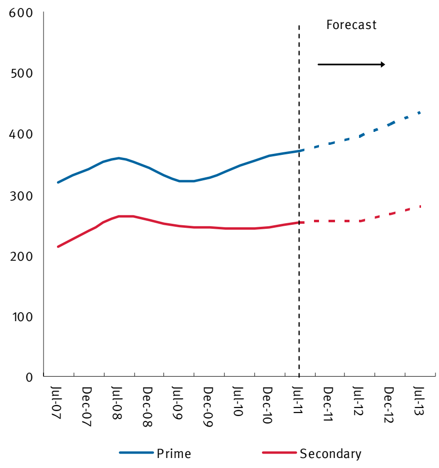
Tenant Demand

Melbourne's diverse workforce has underpinned a strong state labour market over the past year with growth coming from all but a few sectors. Growth in public administration employment has been evident as government spending on new projects like NBN have created the need for additional staff numbers. Organisations involved in Financial Services such as NAB, ANZ and Commonwealth Bank have also sought to expand. Additionally, Victoria's appeal as a hub for peripheral support services to both the domestic mining industry and Asia's growing infrastructure industry have seen local engineering and architecture firms expand. With significant investment being made on the state's energy infrastructure, utility companies are also increasing staff.

Rental Levels

Face rents across both prime and secondary markets experienced a rise over the first six months of 2011. Despite incentives remaining stable across both grades, there is enough transactional evidence to suggest that a tightening in vacancies of prime stock is starting to drive a moderate rise in net effective rents. Average prime net effective rents were recorded at $371/m² in July 2011. This result indicates that levels have now surpassed the peaks reached in October 2008. Secondary net effective rents experienced a slight rise over the past six months and now average $254/m². With a significant number of secondary options still available to tenants, face rental growth is expected to remain relatively muted until some additional space is absorbed.

Figure 5
Melbourne CBD Rents
($) p.a average net effective rent



Source: Knight Frank

Table 3
Recent Leasing Activity (New Leases & Significant Renewals over 2,000m²) Melbourne CBD

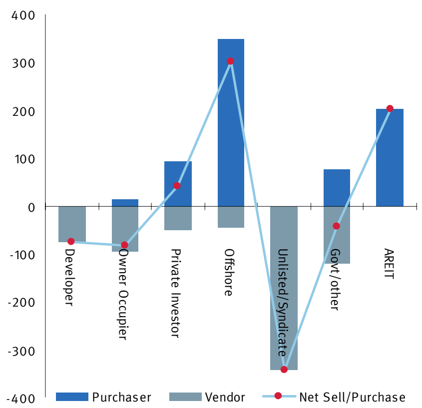
Address	Region	Estimated Net Face Rent ($/m²)	Area (sqm)	Term (yrs)	Tenant	Start Date
700 Bourke Street *	Docklands	375	62,000	10	NAB	Q3-13
745 Collins Street *	Docklands	400	39,500	10	Marsh Mercer	Q2-13
735 Collins Street *	Docklands	430	38,000	12	ATO	Q2-12
171 Collins Street *	Eastern	580	11,913	10	BHP	Q2-13
661 Bourke Street ^	Spencer	350^	19,027	Undis	Commonwealth Govt	Q3-12
2 Lonsdale Street	North East	380	11,200	5	State Government Vic	Q4-12
Lvl 6-10, 357 Collins Street	Western Core	385	8,500	10	Commonwealth Bank	Q2-12
628 Bourke Street ^	Spencer	360^	7,000	5	QBE	Q2-12
303 Collins Street ›	Western	385g ›	4,380	1	Origin	Q2-11
215 Spring Street	North East	330	3,800	5	Alcatel Lucent	Q1-12
161 Collins Street	Civic	365	3,200	10	Griffith Hack	Q3-11
222 Exhibition Street	Eastern Core	395	2,600	5	State Government	Q1-11
601 Bourke Street ›	Western Core	320 ›	2,340	2	CGU	Q3-11
601 Bourke Street ›	Western Core	320 ›	2,340	2	AGL	Q3-11
535 Bourke Street ›	Western Core	470g ›	2,228	2.9	NBN	Q2-11
Level 5, 111 Bourke Street	Eastern Core	350	2,193	8	DIISR	Q3-11
575 Bourke Street	Western Core	335	2,096	10	LSL	Q4-11
171 Collins Street	Civic	580	1,700	11	Evans & Partners	Q2-13
Lvl 41, 385 Bourke Street	Western Core	460	1,389	10	Robert Walters	Q4-11
31 Queen Street ›	Western Core	465g ›	1,345	1	Gallagher Basset	Q2-11
360 Collins Street	Western Core	510	1,200	3	Marsh Mercer	Q3-11
150 Lonsdale	North East	330	1,130	10	Entity Solutions	Q1-12
350 Collins Street	Western Core	400g ›	1,100	2	Worley Parsons	Q3-11
575 Bourke Street	Western Core	325	1,050	5	EO Financial Services	Q3-11

Source: Knight Frank * Pre-Lease deal ^ Lease Renewal g Gross Lease › Project/Short term space

INVESTMENT ACTIVITY & YIELDS

Despite a decline from the previous half, investment activity within the Melbourne market remained strong 2011 YTD with $731.0 million exchanged across thirteen properties. This result reflects a sustained appetite by investors for Melbourne CBD office assets. Figure 6, highlights the net buy/sell position of investors in 2011 YTD for CBD office sales.

Figure 6
Melbourne CBD Purchaser/Vendor
($ million) sales over $5million, 2011 YTD



Source: Knight Frank

The four most recent major investment sales provide a suitable representation of who is currently active in the Melbourne CBD office market. As has been the case since the first half of 2010, cashed up local private investors and offshore funds have been the most notable participants in this year's major market transactions. Unlisted funds divested non core assets, while AREITs were net buyers, despite only two transactions in 2011.

Offshore investors haven't been dissuaded by a strong AUD, investing $347.0 million in the Melbourne CBD market over the year to date. Economic uncertainty in the US and European Union is benefiting Australian commercial investment. Equity rich off-shore investors are moving to capture what's considered good value in domestic CBD assets. The focus for this purchaser type remains core assets, as illustrated by CIMB's and National Pension Service of Korea's acquisitions of two of Investa's assets at 469 Latrobe Street and 595 Collins Street respectively. In some cases offshore investors have chosen to repatriate funds on the sale of assets, however, the majority will recycle funds for the acquisition of new buildings. We expect foreign investors to remain active in the Melbourne office market given the upside expected from a forecast rise in market rents.

As illustrated in Figure 6, major domestic funds have been net sellers in 2011 with Investa, AMP Capital and FKP Core Plus Fund all choosing to divest CBD assets during the first half of 2011. Challenger Diversified Trust bucked this trend by purchasing 31 Queen Street for $81.0 million. More recently Brookfield Prime Property Fund completed the acquisition of a 50% stake in 111 Bourke Street for $120.0 million. Despite most AREITs now maintaining stronger balance sheets, the investment opportunities for listed entities remains limited as their cost of capital remains restrictive, preferring to focus on share buybacks whilst NTA's remain low.

Private investors continue to seek buildings sub $50 million. Acquisitions have been typically value add investments with high capital growth prospects supported by strong tenant profiles. Kador's acquisition of 85 Spring Street for $47.05 million was the most notable recent transaction from a private investor.

Table 4
Major Sales Transactions Melbourne CBD

Address	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE (Years)	Vendor	Purchaser	Sale Date
51 Exhibition St	8.00	6.58^	1,643	4,869	4.5	Owner Occupier	Private Investor	Jul-11
85 Spring St	47.05	6.45	10,435	4,508	3.2	AMP (Property Fund)	Kador Group	Jun-11
538 Collins St	14.00	VP	3,510	3,989	VP	Private Investor	Owner Occupier	Jun-11
111 Bourke St (SX West)#	120.00	7.17^	47,265	5,076	8.2	MTAA	Brookfield Prime	Jun-11
469 La Trobe St	84.00	7.75^	19,813	4,240	4.5	Investa	CIMB Trust Capital	Apr-11
222 Bourke St (Target Centre)^^	88.00	9.00^	21,183	4,153	n/a	Wesfarmers	Private (offshore)	Apr-11
595 Collins St	130.00	8.60	31,929	4,072	4.4	Investa	National Pension Service (Korea)	Mar-11
95 Queen St	7.00	6.46›	1,694	4,137	2.0	Private Investor	Private Investor	Mar-11
470 Collins St	30.50	8.64	10,837	2,814	1.3	Opus Capital	Suleman Family	Feb-11
31 Queen St	81.00	8.32	19,212	4,216	2.7	FKP (Core plus Fund)	Challenger	Feb-11
990 La Trobe St (Melbourne Water bldg)	76.50	7.10	12,794	5,706	14.5	Digital Harbour	MAC (SA)	Feb-11*
199 William St	45.00	VP	19,500	2,308	VP	Memo Corporation	Hengyi Australia	Jan-11

Source: Knight Frank ^ Passing Yield VP Vacant Possession # 50% interest * Settlement in 2012
› Building sold with 48% vacancy & large retail component ^^ B-Grade office component makes up 52% of GLA (11,113m²) , with remaining retail

Figure 7

Melbourne CBD Average Yields

(%) Prime & Secondary Core Market Yields

Source: Knight Frank

Yields for prime stock have shown a modest tightening bias since their peak in Q3 2009. The sale of the Melbourne Water Building at 990 La Trobe Street, Docklands announced back in late February (settling upon completion in early/mid 2012 - 6.8% initial; 7.1% core market yield) alluded to a degree of firming for prime, passive assets in the Melbourne CBD on a like for like basis. Currently, average prime yields in the Melbourne CBD range from 7.00% - 7.50%, while secondary transactions are indicating core market yields between 7.50% - 8.75% which reflects a slight tightening of the upper yield range over the past six months. B-grade assets below $50 million have been well sought after recently with some inconsistency in pricing occurring depending upon the asset price. Two secondary transactions below $10 million achieved yields sub 7%, however 95 Queen St was 48% vacant with a large retail component, skewing the yield.

Kador Group Holdings purchased 85 Spring Street for $47.05 million on a 6.45% Core Market Yield

OUTLOOK

The market outlook is relatively sound despite expectations for a more downbeat demand scenario for the Melbourne CBD office market. Recent volatility in the global economy and its immediate effect on business confidence, have caused markets to revise growth prospects down on leading market indicators. Gross State Product forecasts have moderated, as have expectations on growth in white collar employment. Deloitte Access Economic's forecasts for the Melbourne CBD have been revised back by approximately 0.5% p.a. for the upcoming two years as expectations on business expansion become more conservative. Nevertheless, absorption should remain relatively stable and at levels just below the ten year average (90,196m² p.a.). Looking ahead, half yearly net absorption is expected to peak (60,398m²) in mid 2012 as non-CBD and expansion tenants move in to preleased accommodation at 990 Latrobe Street, Collins Square, 850 Collins Street and 357 Collins Street.

Anecdotally, there is still evidence of solid underlying demand with numerous large requirements still active in the market. There are at least five requirements above 20,000m² with major tenants such as Victoria Police, Medibank and Westpac actively seeking new office space. A reasonable amount of this will be CBD expansion space, suggesting there may be some upside should the market re-gain confidence and businesses seek to grow.

There has been a number of recent deals to support the emergence of a recent trend towards the growth in short term/contract space. There are mutual benefits in the current market to both the landlord and tenant for the use of this type of accommodation. For the tenant, the opportunity to lease growth space over a 2-3 year term enables them to progress expansion plans whilst mitigating risk associated with long term commitment; particularly given current market volatility.

Conversely, landlords have the advantage of filling a vacancy until a period were the market will be more conducive to higher market rents. We anticipate further demand for this space, particularly from utility companies and professional services firms.

Average prime net effective rents are forecast to rise 11.5% by the end of 2012 as a staggered growth pattern between prime and secondary rents becomes apparent. Growth in secondary rents will continue to be impacted by higher levels of vacancy brought about by tenant's relocating to prime stock. Knight Frank forecast secondary net effective rents to rise by 6% by the end of 2012.

With the current supply cycle culminating in 2013; the next wave of supply is unlikely to commence before 2014, although a number of developers are actively progressing plans for projects. The market will continue to be demand led, requiring a major pre-commitment in order for a developer to proceed on a new build. A number of prominent sites along the highly sought after Bourke-Collins corridor have been the subject of interest by large tenants and could proceed if a deal is brokered. Docklands also presents a strong alternative with a podium level on two sites at Walker's Collins Square enabling the developer to deliver a building at least six months faster than any alternative.

Walker Group's Collins Square South development in Docklands could deliver an additional 70.000m²

A relatively positive outlook for owners of Melbourne CBD commercial property, suggests the year ahead should continue to attract healthy levels of investment activity. We anticipate continued interest from domestic private investors and offshore buyers.

RESEARCH

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