



HIGHLIGHTS

- Historically low vacancy rates in the Melbourne CBD have led tenants to look elsewhere to fulfil their accommodation requirements. Office vacancies continued their fall in the St Kilda Road office market and are forecast to reach their lowest levels in four years by mid-2013. While Southbank office vacancies rose over the first half of 2012, A-grade vacancy is a mere 1.3%.
- Net absorption is forecast to surge in the second half of 2012 within the St Kilda Road office market as a number of major tenants occupy leased accommodation. While tenant demand for the Southbank office market is solid, net absorption in the short term will be constrained by the limited vacancies in the precinct.
- Due to the significant leasing activity over the past 12 months in the St Kilda Road office market, prime net face office rents have risen by 13% in the past 12 months. In response to the positive outlook, transactional activity in the St Kilda Road and Southbank precincts is also increasing.

Table 1
St Kilda Road & Southbank Office Market Indicators as at July 2012

Grade	Market	Total Stock (m ²)	Total Vacancy Rate (%)	Annual Net Absorption (m ²)	Annual Net Supply (m ²)	Average Net Face Rent (\$/m ²)	Incentive (%)	Core Market Yield Range (%)
Prime	St Kilda Road	245,325	7.3	9,897	0	280 – 320	15 – 20	8.00 – 8.50
	Southbank	248,819	1.3	-2,459	0	350 – 410	18 – 22	7.50 – 8.00
Secondary	St Kilda Road	498,707	11.9	13,103	401	250 – 280	15 – 20	9.00 – 9.50
	Southbank	178,637	14.3	-2,166	0	270 – 310	18 – 22	8.50 – 9.50
Total Market	St Kilda Road	744,032	10.4	23,000	401			
	Southbank	427,456	6.7	-4,625	0			

Source: Knight Frank/PCA

Definition: Grade: Prime includes office assets of Premium and A quality whilst Secondary includes office assets of B, C & D quality

Supply & Development Activity

The St Kilda Road office market comprises 744,032m² making it the third largest non-CBD office market in Australia (behind North Sydney and North Ryde). As a result of the withdrawal of sites for residential conversion, the St Kilda Road office market has contracted by 17% over the past 20 years. The last major development in the St Kilda Road office market was the strata re-development at 1 Queens Road completed in 2003. Prior to this, the last major commercial development built on St Kilda Road was 417 St Kilda Road in 1991. While a number of buildings have been refurbished more recently including 636 St Kilda Road, there are no new major office developments or refurbishments forecast for the precinct in the near future.

In contrast, since July 2005 within the Southbank office market, 130,623m² has been added to the market with 14,323m² withdrawn. The most recent office development completed in the Southbank office market was that of South Wharf's commercial tower, completed in 2010, adding more than 22,000m² of office space to the precinct. While a third office tower at Australand's Freshwater Place has been proposed, the 42,000m² development is likely to require significant pre-commitment prior to construction.

Tenant Demand & Rents

Office vacancies continued their fall in the St Kilda Road office market, declining to 10.4%

as at July 2012 down from 10.8% six months earlier. Strong demand from major tenants seeking high quality St Kilda Road office accommodation has largely resulted from a lack of adequate contiguous space options available within the CBD and surrounding fringe office markets in the preceding 12 months. The relative affordability of the St Kilda Road office market has been another strong attraction for tenants.

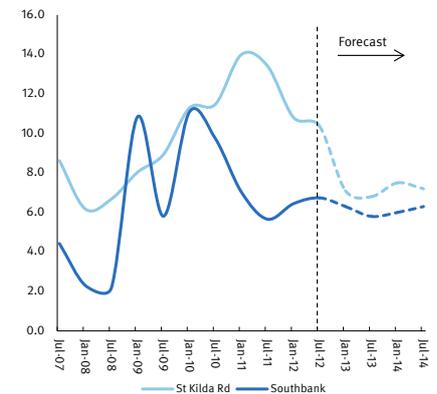
In the six months to July 2012, net absorption in the St Kilda Road office market totalled 3,826m², resulting in 23,000m² absorbed in the past 12 months, the fifth largest on record. Looking forward, net absorption is forecast to surge in the final half of the year as tenants such as Target, John Holland, Transfield and Hertz all occupy leased accommodation along St Kilda Road.

As a result of subdued tenant demand and limited A-grade vacancies, total vacancy within the Southbank office market eased slightly, rising to 6.7% in July from 6.4% as at January 2012. A-grade office vacancies in Southbank rose marginally to 1.3%, but remain well below 10-year averages with a mere 3,158m² vacant. In contrast, secondary office vacancies continued to rise in Southbank, having risen to 14.4% in the six months to July 2012 – its highest level since January 2004.

With a limited supply pipeline over the short term in Melbourne's fringe office markets, steady tenant demand is expected to continue to put pressure on vacancy rates

and rental levels in the St Kilda Road and Southbank office precincts.

Figure 1
St Kilda Rd / Southbank Office Vacancy (%) 2007-2014



Source: Knight Frank / PCA

Due to the significant leasing activity over the past 12 months in the St Kilda Road office market, prime net face office rents have risen to a current range of \$280/m² to \$320/m², up on average by 13% over the past 12 months. This upward trend is forecast to continue in the medium term, coupled with improved net effective rents through a slight reduction in incentive levels. Whereas, despite the vacancy rate increasing slightly in Southbank; the low prime vacancy rate has resulted in prime rents also increasing in the precinct. Currently, average prime net face rents in Southbank range between \$350/m² and \$410/m², with incentives levels between 18% and 22%.



Investment Activity

Transactional activity in the St Kilda Road and Southbank precincts is increasing in response to the positive outlook on vacancy and rental levels, which is evidenced by the \$58.0 million acquisition of 441 St Kilda Road by Centuria Property Funds in March 2012 at a core market yield of 9.78%.

An uplift in transaction activity in the St Kilda Road and Southbank office markets from mid-2011 demonstrates investor appetite in the precinct. Private investors have been the dominant purchasers of assets over the past 12 months and are likely to continue to be active during the year ahead. In the 12 months to August, a total of \$220 million was transacted across six properties, up from \$161 million in the preceding 12 months.

Valuation benchmarks indicate that both prime and secondary assets within the St Kilda Road and Southbank office markets

remain attractive against long term averages. The spread between prime office yields and the real bond rate (risk premium) has increased to 720 basis points, compared to the 10-year average of 530 basis points.

Outlook

The fundamentals of both the St Kilda Road and Southbank office markets remain solid. With the lack of any new commercial development in the two precincts coupled with white collar employment forecast to increase, vacancies are expected to remain below 10-year averages in the medium term.

Total vacancies for the St Kilda Road and Southbank office markets are forecast to fall to 7.1% and 6.3% respectively by January 2013. With A-grade office vacancies in Southbank currently sitting at 1.4%, St Kilda Road A-grade vacancies are also expected to contract significantly by the end of 2012. Looking forward, A-grade vacancies in both precincts are likely to remain below 5% for the

next two years.

Net absorption within St Kilda Road is forecast to pick up in the second half of 2012, boosted by the incoming tenants occupying space previously leased. A lack of options in the Southbank market will ensure absorption is muted over the remainder of 2012. Over the medium term, constrained by the decreasing vacancies and rapidly increasing rental levels, particularly within A-grade accommodation, net absorption levels in Melbourne's fringe office markets will be tempered.

As a result of the falling vacancies the rental outlook is healthy. Having already experienced growth of over 10% over the past year, net face rents are anticipated to continue to strengthen, with incentives levels also forecast to fall slightly over the next 12 months.

Table 2

Recent Sales Activity St Kilda Road & Southbank

Address	Price (\$ mil)	Core Market Yield (%)	NLA (m ²)	\$/m ² of NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
1-7 Palmerston Cres	9.00	VP	2,971	3,029	VP	Royal College of General Practitioners	Alpha Partners/Jak Investment Group	Aug-12~
437 St Kilda Rd	27.00	7.90	6,536	4,130	1.94	Opus	Private Investor	Jul-12
180 Albert Rd	8.80	7.16*	2,246	3,918	N/A	Denison Wilson Property Trust	Private Investor	Jun-12
607 St Kilda Rd	28.54	8.02	7,207	3,960	6.10	Centuria Property Funds	Private Investor	Apr-12
441 St Kilda Rd	58.00	9.78	16,137	3,586	4.08	AXA Wholesale Property	Centuria Property Funds	Mar-12

Table 3

Recent Leasing Activity St Kilda Road & Southbank

Address	Precinct	Area (m ²)	Estimated Net Face Rent (\$/m ²)	Tenant	Start Date
380 St Kilda Road	St Kilda Road	2,692	345	John Holland	Q1-13
636 St Kilda Road	St Kilda Road	2,375	285	Hertz	Q4-12
541 St Kilda Road	St Kilda Road	6,398	260	seek.com.au ^	Q3-12
324 St Kilda Road	St Kilda Road	4,457	275	Target	Q3-12
509 St Kilda Road	St Kilda Road	3,350	280	Transfield	Q3-12
616 St Kilda Road	St Kilda Road	2,040	250	Lowe Lippmann	Q3-12
636 St Kilda Road	St Kilda Road	954	285	Bravura Solutions	Q2-12
55 Southbank Boulevard	Southbank	1,290	295	Data 3	Q2-12
607 St Kilda Road	St Kilda Road	2,400	260	Alfred Health	Q2-12
58 Queensbridge Street	Southbank	7,403	285	TWE	Q2-12

Source: Knight Frank * Passing Yield ^ Lease Renewal ~ Settlement October 2012



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Knight Frank Research

Matt Whitby

National Director – Head of Research & Consulting
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

Richard Jenkins

Director – Research VIC
+61 3 9604 4713
Richard.Jenkins@au.knightfrank.com

Valuation Contacts

Joe Perillo

Joint Managing Director – Victoria
+61 3 9604 4617
Joe.Perillo@vic.knightfrankval.com.au

Michael Schuh

Director – Victoria
+61 3 9604 4726
Michael.Schuh@vic.knightfrankval.com.au

Commercial Agency Contacts

Paul Henley

Managing Director – Commercial Sales & Leasing
+61 3 9604 4760
Paul.Henley@au.knightfrank.com

Simon D'Arcy

Associate Director – Commercial Sales & Leasing
+61 3 9604 4668
Simon.D'Arcy@au.knightfrank.com

Caitlin Murdoch

Executive – Commercial Leasing
+61 3 9604 4647
Caitlin.Murdoch@au.knightfrank.com

Langton McHarg

Director – Commercial Sales
+61 3 9604 4619
Langton.Mcharg@au.knightfrank.com

Marcus Quinn

Director – Commercial Sales
+61 3 9604 4638
Marcus.Quinn@au.knightfrank.com

James Templeton

Managing Director – Victoria
+61 3 9604 4724
James.Templeton@au.knightfrank.com

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