

SEPTEMBER 2013

ST KILDA RD &  
SOUTHBANK

Office Market Brief

## HIGHLIGHTS

- The St Kilda Road office market vacancy increased from 9.3% to 10.8% as at July 2013 – largely as a result of MLC’s relocation from 509 St Kilda Road to the Docklands precinct. Looking ahead, the vacancy rate within the St Kilda Road precinct is expected to increase further, impacted by additional major tenant vacancies including AAMI. In contrast Southbank’s total office vacancy rate fell to 6.7%, with A-grade vacancy tight at 1.4%, with only 3,457m<sup>2</sup> vacant.
- Limited by the lack of available prime vacant accommodation, net absorption within the Southbank office market was 3,217m<sup>2</sup> in the six months to July 2013, predominately as a result of the absorption of sublease space. Within the St Kilda Road office market net absorption over the first half of 2013 was negative reflecting the tenant relocations and subdued tenant demand. Rents softened across both office markets, with incentives rising for prime accommodation and net face rental levels easing for secondary office space.
- Notwithstanding the muted tenant demand, increasingly investors are moving up the risk scale into non-core markets such as St Kilda Road and Southbank seeking assets that offer repositioning or residential development opportunities.

Table 1  
St Kilda Road & Southbank Office Market Indicators as at September 2013

Grade	Market	Total Stock (m <sup>2</sup> ) <sup>^</sup>	Total Vacancy Rate (%) <sup>^</sup>	Annual Net Absorption (m <sup>2</sup> ) <sup>^</sup>	Annual Net Supply (m <sup>2</sup> ) <sup>^</sup>	Average Net Face Rent (\$/m <sup>2</sup> )	Incentive (%)	Core Market Yield Range (%)
Prime	St Kilda Road	245,325	11.6	-10,611	0	310 – 330	25 – 30	8.00 – 8.75
	Southbank	248,819	1.4	-299	0	380 – 440	25 – 30	7.25 – 7.75
Secondary	St Kilda Road	493,207	10.4	2,646	-5,500	240 – 270	25 – 30	8.25 – 8.75
	Southbank	178,637	14.2	358	0	260 – 290	25 – 30	8.50 – 9.00
<b>Total Market</b>	<b>St Kilda Road</b>	<b>738,532</b>	<b>10.8</b>	<b>-7,965</b>	<b>-5,500</b>			
	<b>Southbank</b>	<b>427,456</b>	<b>6.7</b>	<b>59</b>	<b>0</b>			

Source: Knight Frank/PCA <sup>^</sup> as at July 2013

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

## Supply & Development Activity

While the St Kilda Road office market comprises 738,532m<sup>2</sup> making it Australia's 10<sup>th</sup> largest office precinct; lettable space continues to diminish as a result of the withdrawal of buildings for residential conversion. Office supply in the St Kilda Road market peaked in 1992 and has now contracted by 15% over the past 20 years.

In contrast, the Southbank office market has grown by 137,557m<sup>2</sup> over the past 20 years to now reach 427,456m<sup>2</sup> with 47,408m<sup>2</sup> withdrawn over the same period. Although, there has been no new supply added in the Southbank office market since the second half of 2010, further development is mooted for the precinct. Subject to the approval of Parliament, the Federal Government will provide the Australian Broadcasting Corporation a loan to assist the construction of a purpose-built 26,000m<sup>2</sup> office development at 102 Sturt Street. The new headquarters will consolidate several operations, the majority of which are from buildings in suburban locations. Residential conversion often offers the higher and better use in both markets, as demonstrated by the pending sale of 38 Freshwater Place likely for residential development rather than utilise the approval for an office development.

## Tenant Demand & Rents

As at July 2013, total vacancy in the St Kilda Road office market rose to 10.8%, largely as a result of MLC's relocation from 509 St Kilda

Road into NAB's recently completed Docklands office. Although total vacancy has risen, its current level remains below the historical average. As a result of subdued tenant demand, A-grade office vacancy rose, and secondary vacancies in St Kilda Road offices remained relatively steady in the six months to July 2013. Looking ahead, total vacancy in St Kilda Road is expected to continue to rise, impacted by the relocation of AAMI from the precinct to the CBD.

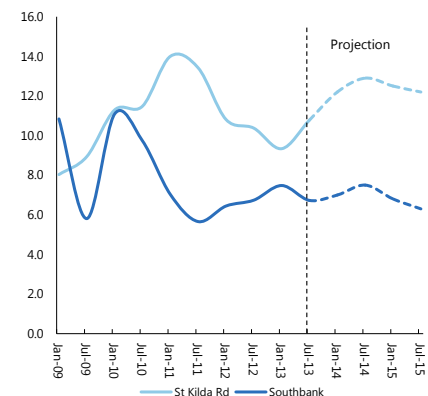
Sublease vacancy in the St Kilda Road office market remains moderate at 0.6% in July 2013 – well below previous peaks. Sublease vacancy is forecast to remain stable with quality fitted space continuing to attract tenant interest as demonstrated by Experian and DST Global Solutions both taking sublease space offered by Spotless at 549 St Kilda Road.

In the absence of migrating tenants into St Kilda Road, as experienced in 2011 and 2012, weakening demand resulted in negative net absorption of 12,861m<sup>2</sup> in the six months to July 2013.

Despite limited opportunities for tenants in A-grade office space, total vacancy in the Southbank office market fell to 6.7% in July from 7.5% in January 2013. With the exception of C-grade office space, vacancies fell across all grades in the six months to July 2013. Vacancies in all grades (again with the exception of C-grade accommodation) in Southbank are also below their 10-year averages. Insulated by sparse prime space vacancies in the Southbank office precinct,

vacancy is forecast to remain relatively steady over the next two years.

Figure 1  
St Kilda Rd / Southbank Office Vacancy (%) 2009-2015



Source: Knight Frank / PCA

Following strong rental growth over 2012; as a result of the soft tenant demand in 2013, incentive levels have increased in A-grade St Kilda Road and Southbank office stock. As a result of the heightened incentive levels, net effective rental levels have eased in 2013. Prime net face office rents in the St Kilda Road office market range between \$310/m<sup>2</sup> and \$330/m<sup>2</sup> with prime net face rents in Southbank ranging between \$380/m<sup>2</sup> and \$440/m<sup>2</sup>. Within secondary grade accommodation, net face rents have eased in both St Kilda Road and Southbank office markets as a result of the increased competition resulting from a rise in CBD office vacancy coupled with the sporadic tenant demand.

## Investment Activity

While investor interest has been strong, albeit hindered by limited opportunities and prime assets on offer, investment sales activity in 2013 to date is below that for the same period in 2012. In 2013 to date there have been six sales in excess of \$10 million in the St Kilda Road and Southbank office markets with a total transactional value of \$177.3 million.

The largest transaction has been the acquisition of 636 St Kilda Road by Blackstone as part of a seven property portfolio offered by GE Real Estate that also included assets in Sydney, Brisbane and Perth. Boosted by the acquisition of 636 St Kilda Road; offshore groups accounted for 45% of sales volume transacted. Attracted by the high yields on offer (relative to other

global and Victorian office markets), unlisted trusts, syndicates and private investors were also active purchasers.

Despite the soft leasing market, increased investment appetite, particularly for assets offering repositioning propositions, has resulted in yield compression during the year to date. Recent transactions indicate that prime core market yields for St Kilda Road and Southbank offices have compressed by around 25 basis points during 2013 with additional compression also observed in the secondary market.

## Outlook

With no new commercial office projects expected in the short term in St Kilda Road and only one fully pre-leased development planned for Southbank, landlords will be

required to upgrade their buildings through refurbishment to attract new tenants for backfill space.

Having increased by 150 basis points in the first half of 2013, total vacancy for the St Kilda Road office market is forecast to continue to rise over the next 12 months. Whereas, limited by the lack of available vacant prime accommodation, vacancy in the Southbank office market is anticipated to remain relatively stable over the next 12 months. With increased competition from the CBD, the relative affordability of the St Kilda Road office market has diminished over the past 12 months. In order to offer an attractive option to migrating incoming tenants, net face rentals will remain under downward pressure over the next 12 months.

Table 2

### Recent Sales Activity St Kilda Road & Southbank

Address	Price (\$ mil)	Core Market Yield (%)	NLA (m <sup>2</sup> )	\$/m <sup>2</sup> of NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
636 St Kilda Road ~	51.3	6.41 <sup>^</sup> #	17,174	2,987	4.1	GE Real Estate	Blackstone	Aug-13
71 Queens Road	25.6	8.40	8,444	2,970	6.6	Charter Hall	Private Investor	Apr-13
615 St Kilda Road	29.1	7.85	8,532	3,410	10	BlackRock Property Trust	Private Investor	Mar-13
324 St Kilda Road	22.0	9.32	7,101	3,098	3.5	Overland Properties	Local Syndicate	Mar-13
10 Queens Road	21.3	9.33	9,004	2,371	0.8	Private Investor	Private Investor	Mar-13
541 St Kilda Road	28.0	8.60 <sup>^</sup>	8,229	3,403	n/a	Stockland	APN	Feb-13
332 St Kilda Road	18.6	8.80	5,418	3,433	4.3	Overland Properties	Private Investor	Dec-12
14 Queens Road	13.0	7.99 <sup>^</sup>	8,158	1,594	0.7	Denison Funds Management	Hallmarc	Dec-12
570 St Kilda Road	23.8	9.52	7,688	3,096	2.7	Private Investor	Podco Property	Oct-12

Table 3

### Recent Leasing Activity St Kilda Road & Southbank

Address	Precinct	Area (m <sup>2</sup> )	Estimated Net Face Rent (\$/m <sup>2</sup> )	Tenant	Start Date
570 St Kilda Road	St Kilda Road	3,000	240	Simonds Homes	Q4-13
549 St Kilda Road *	St Kilda Road	1,570	n/a	DST Global Solutions	Q4-13
390 St Kilda Road	St Kilda Road	1,512	265	Toll Transport	Q3-13
390 St Kilda Road	St Kilda Road	754	260	Pental	Q3-13
479 St Kilda Road	St Kilda Road	668	260	Ramsay Healthcare	Q3-13
615 St Kilda Road	St Kilda Road	8,532	280	Cancer Council Victoria	Q3-13
549 St Kilda Road *	St Kilda Road	3,143	390g	Experian	Q3-13
509 St Kilda Road	St Kilda Road	1,700	n/a	Webjet	Q3-13
60 City Road	Southbank	721	395	Adecco Australia	Q2-13
380 St Kilda Road	St Kilda Road	2,692	345	John Holland	Q1-13

Source: Knight Frank ~ As part of a seven property portfolio sale # Low passing yield due to 33% vacancy ^ Passing Yield \* Sublease g Gross

**Americas**

USA  
Bermuda  
Brazil  
Canada  
Caribbean  
Chile

**Australasia**

Australia  
New Zealand

**Europe**

UK  
Belgium  
Czech Republic  
France  
Germany  
Hungary  
Ireland  
Italy  
Monaco  
Poland  
Portugal  
Romania  
Russia  
Spain  
The Netherlands  
Ukraine

**Africa**

Botswana  
Kenya  
Malawi  
Nigeria  
South Africa  
Tanzania  
Uganda  
Zambia  
Zimbabwe

**Asia**

Cambodia  
China  
Hong Kong  
India  
Indonesia  
Macau  
Malaysia  
Singapore  
South Korea  
Thailand  
Vietnam

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