



ST KILDA ROAD & SOUTHBANK

OFFICE MARKET BRIEF MARCH 2018

Key Findings

Vacancy in the St Kilda Road office market **fell to the lowest level** since July 2008.

St Kilda Road office stock has now **shrunk by 26% from its peak** in 1992.

15,814 sq m is mooted to be withdrawn from the St Kilda Road and Southbank office markets over the next 12 months.

Investment activity in the St Kilda Road office market in 2017 **surpassed levels recorded in 2016 by 25.3%**.



JANE WONG
Research Analyst

The St Kilda Road office market recorded positive net absorption for the first time in three years, while positive net absorption levels in the Southbank office market were the highest in 12 years.

Development Activity

In the six months to January 2018, the Southbank office market had 27,410 sq m of new supply added to the market, underpinned by the Australian Broadcasting Corporation (ABC) Centre at 120 Southbank Boulevard (20,210 sq m) and partial refurbishment at 2 Southbank Boulevard (7,200 sq m) reaching completion.

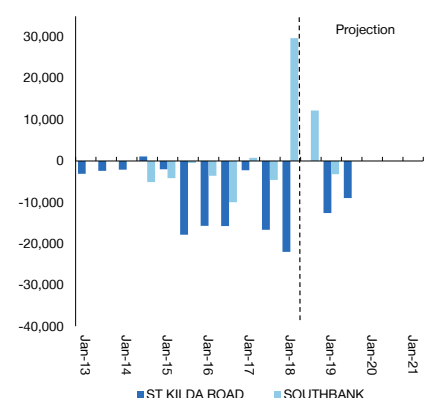
Looking forward, 12,200 sq m of new supply will be added to the Southbank office market in Q1 2018, following further partial refurbishment at 2 Southbank Boulevard.

Office stock in the St Kilda Road market in the six months to January 2018 fell by 21,979 sq m as two properties, 409 St Kilda Road (8,389 sq m) and 7 Bowen Crescent (4,244 sq m), were withdrawn for residential conversion. The ongoing withdrawal of stock has caused total stock in the St Kilda Road office market to fall by 26% from its peak of 871,030 sq m in 1992.

Looking ahead, the strong demand for residential development sites combined with no new upcoming developments scheduled will result in further stock withdrawals in the

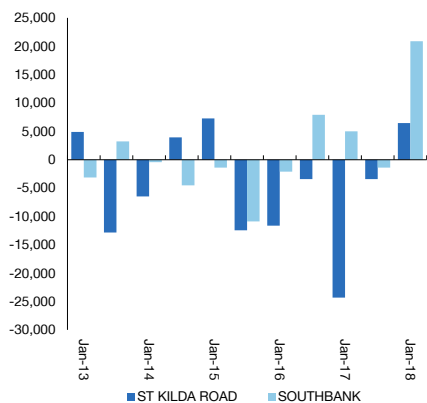
St Kilda Road office market. Over the next 12 months, a further 12,608 sq m is anticipated to be withdrawn from the market.

FIGURE 1
St Kilda Rd & Southbank Net Supply
Per six month period (sq m) - Office



Source: Knight Frank Research/PCA

FIGURE 2
Net Absorption
Per six month period (sq m) - Office



Source: Knight Frank Research/PCA

Tenant Demand

Tenant demand for Southbank and St Kilda Road office space increased as both markets continue to benefit from their close proximity to the CBD and amenity, and discounted rents in comparison to the CBD office market.

Net absorption in the Southbank office market in the six months to January 2018 was positive at 20,882 sq m, the highest level since January 2006. Tenant demand over the past 12 months was driven by the Government, Business Services and Finance sectors, with notable transactions including Cliftons leasing 2 Southbank Boulevard (1,806 sq m) and Commonwealth of Australia leasing 40 City Road (1,290 sq m).

In the St Kilda Road office market, net absorption in the six months to January 2018 was positive for the first time since January 2015, measuring 6,464 sq m. This was underpinned by strong tenant demand, particularly from tenants

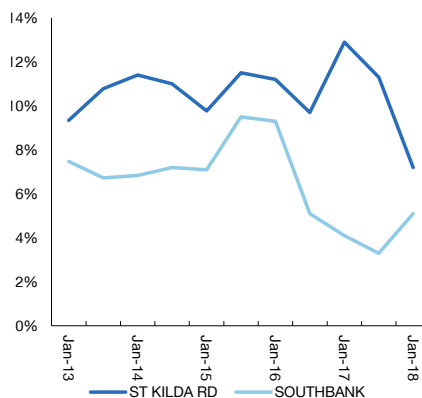
seeking a flight to quality, tenants occupying buildings identified for residential conversion wanting to remain within the St Kilda Road precinct and tenants looking to relocate from surrounding suburbs. Notable transactions over the past 12 months made by those previously located within immediate surrounding suburbs included Crawford & Company (Southbank), Veolia (South Melbourne) and Deluxe Australia (South Melbourne). Additionally, recent lease renewals from St Kilda Road tenants, including Frasers Property Group, WPP and Sodexo, reinforce the market's strong tenant retention.

Vacancy

The total vacancy rate in the Southbank office market increased from 3.3% to 5.1% in the six months to January 2018, as new supply from 2 Southbank Boulevard (7,200 sq m) outweighed strong tenant demand.

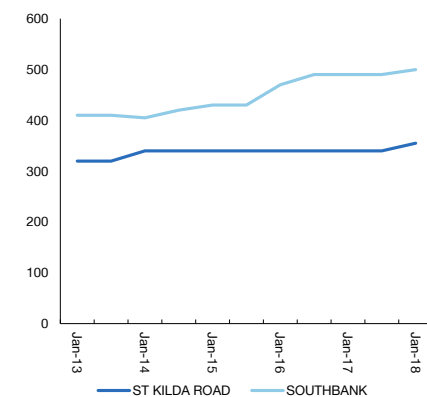
Vacancy in the Southbank office market

FIGURE 3
St Kilda Rd & Southbank Vacancy
2013-2018 (%) - Office



Source: Knight Frank Research/PCA

FIGURE 4
Average Prime Net Face Rents
St Kilda Rd & Southbank (\$/sq m) - Office



Source: Knight Frank Research

is anticipated to remain below the 10-year average of 6.6%, with multiple floors currently under offer at 2 Southbank Boulevard. However, once ExxonMobil vacates 12 Riverside Quay in 2018, there is a potential for 20,250 sq m of backfill space, although it may be withdrawn from the market for hotel conversion.

The total vacancy rate in the St Kilda Road office market fell sharply to 7.2% in the six months to January 2018, down from 11.3%, to reach the lowest level since July 2008. The fall in vacancy was underpinned by the withdrawal of stock for residential conversion, totalling 21,979 sq m, coupled with strong leasing activity.

Looking forward, overall vacancy in the St Kilda Road office market is expected to decline further as more stock gets permanently withdrawn and tenants compete for limited options.

TABLE 1
St Kilda Road & Southbank Office Market Indicators as at March 2018

Grade	Market	Total Stock	Total Vacancy Rate (%)*	Annual Net Absorption	Annual Net Additions	Average Net Face	Average Incentive	Average Core Market Yield (%)
Prime	St Kilda Road	245,325	3.2	5,746	0	340-370	20-22	5.75-6.00
	Southbank	279,273	4.5	25,783	27,410	450-550	25-28	5.50-6.00
Secondary	St Kilda Road	399,977	9.7	-2,694	-38,264	250-300	15-22	6.00-6.50
	Southbank	155,188	6.3	-6,302	-2,286	280-340	20-25	6.25-6.75
Total Market	St Kilda Road	645,302	7.2	3,052	-38,634			
	Southbank	434,461	5.1	19,481	25,124			

Source: Knight Frank Research/PCA

*as at January 2018

Rents

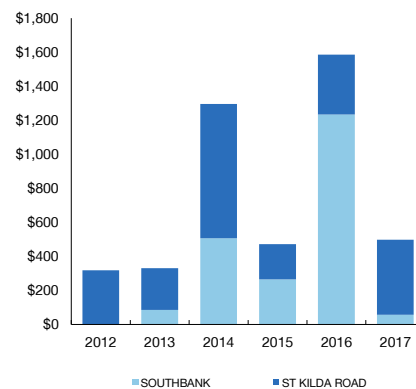
The Southbank office market recorded rental growth across its prime and secondary markets, underpinned by CBD vacancy tightening and limited available stock. As at March 2018, prime net face rents average \$500/sq m, having increased by 2% in the preceding 12 months. Secondary net face rents increased by 8.7% in the past 12 months to average 310/sq m.

With falling vacancy levels and landlords investing in their assets to compete with the CBD and Southbank office stock, prime net face rents in the St Kilda Road office market increased by 4% in the past 12 months, averaging \$355/sq m as at March 2018. However, there is currently a shortage of large contiguous options in the market. Secondary net face rents remained steady, averaging \$275/sq m.

Investment Market

Following a record high of \$1.58 billion in sales transactions in 2016, transaction volumes (\$10 million+) in the St Kilda Road and Southbank office markets in 2017 totalled \$497.9 million across eight

FIGURE 5
St Kilda Rd & Southbank Sales
By office market \$10 million+



Source: Knight Frank Research

transactions. The fall in investment activity was a result of large anomalous sales in the previous year, rather than a lack of investor appetite in 2017.

Transaction volumes in the St Kilda Road office market in 2017 totalled \$441.5 million, surpassing transaction volumes recorded in 2016 by 25.3%. The six properties sold will be retained for commercial use as investors capitalise on the declining vacancy and lifted rents.

Offshore purchasers led all purchaser types, accounting for 72% of total sales volumes. The largest transaction was made by Singaporean-based Mapletree Investments acquiring 417 St Kilda Road for \$144.7 million.

Over the past 12 months, prime St Kilda Road office yields compressed by 63 basis points to range between 5.75% and 6.00%. Prime Southbank office yields compressed by 25 basis points to range between 5.50% and 6.00%.

TABLE 2
Recent Leasing Activity St Kilda Road & Southbank

Address	NLA (sq m)	Term (yrs)	Lease Type	Tenant	Sector	Date
2 Southbank Boulevard, Southbank	1,806	7.0	New	Cliftons	Business Services	Q3-18
40 City Road, Southbank	1,290	10.0	New	Commonwealth of Australia	Government	Q2-18
464 St Kilda Road, Melbourne	2,842	1.0	New	Toll Group	Transport & Logistics	Q3-17
432 St Kilda Road, Melbourne	1,400	6.0	New	Bruel & Kjaer EMS	Other Services	Q3-17
476 St Kilda Road, Melbourne	2,140	10.0	New	Deluxe Australia	TMT	Q3-17
484 St Kilda Road, Melbourne	1,360	10.0	New	Bayside Group	Recruitment	Q2-17

TABLE 3
Recent Sales Activity St Kilda Road & Southbank

Address	Price (\$ mil)	Core Market	NLA (sq m)	\$/m ² NLA	Vendor	Purchaser	Sale Date
312 St Kilda Road, Melbourne	74.10	5.07*	9,854	7,524	Myer Family Investments	Tong Eng Group	Nov-17
1 Bowen Crescent, Melbourne	14.00	U/D	3,700	7,084	Malcolm Freake	Private Investor	Oct-17
324 St Kilda Road, Melbourne	42.00	5.80*	U/D	7,102	Lester Group	Glorious Sun	Sep-17
390 St Kilda Road, Melbourne	97.85	5.95*	16,307	6,000	APOF>	Rockworth	Aug-17
420 St Kilda Road, Melbourne	68.84	5.72	10,458	6,582	U/D	Vantage Property	Jul-17
417 St Kilda Road, Melbourne	144.70	6.10*	20,135	7,186	Newmark Property Group	Mapletree Investments	Jul-17
10-16 Dorcas Street, South Melbourne	37.00	6.50*	7,608	4,863	Crescent Wealth	Private Investor	Jun-17
31 Market Street, South Melbourne	19.40	5.40*	2,565	7,563	Property Bank Australia	Private Investor	Apr-17

Source: Knight Frank Research U/D undisclosed *initial market yield >Australian Property Opportunities Fund TMT refers to Technology, Media & Telecommunications

Outlook

- With CBD office vacancy currently at the lowest level in 10 years and further tightening forecast to occur over the next two years, demand for St Kilda Road and Southbank office space is anticipated to continue. As a result, Southbank office vacancy is expected to remain below 6.6%, despite anticipated new supply and backfill space additions over the next 12 months. St Kilda Road office vacancy is anticipated to fall further as ongoing office stock withdrawals leave tenants with limited options.
- Strong white collar employment growth will also fuel demand for St Kilda Road and Southbank office space. Over the next three years, white collar employment growth in the CBD alone is forecast to be driven by Public Administration (+5.9%), Professional Services (+3.5%) and Education (+2.0%).
- Off the back of Melbourne's growing population, residential development will continue, resulting in stock levels falling further in the St Kilda Road and Southbank office markets. Over the next 12 months, 12,608 sq m and 3,206 sq m is anticipated to be withdrawn from the St Kilda Road and Southbank office markets respectively.
- With vacancy levels forecast to fall coupled with existing yield spread between the CBD and City Fringe office markets, investment demand for the St Kilda Road and Southbank office buildings is anticipated to intensify further.

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