



HIGHLIGHTS

- The St Kilda Road office market vacancy continued to rise, increasing from 10.8% to 11.4% as at January 2014. Looking ahead, while the total vacancy rate within the St Kilda Road precinct is expected to increase further, prime vacancies are forecast to fall as tenants upgrade their office accommodation. Limited by large vacant prime options, Southbank's total office vacancy rate increased marginally to 6.8% from 6.7% six months prior.
- Fuelled by demand from developers, outdated offices have been increasingly purchased for residential conversion, which will result in office stock levels in both markets falling over the next three years. However, construction has commenced on the Australian Broadcasting Corporation's new 20,210m² Southbank headquarters which is scheduled to be completed in early 2017.
- Investment sales activity (above \$10 million) in the year to date within the Southbank and St Kilda Road office markets has already surpassed the value of sales achieved in the entire year of 2013, boosted by demand from developers, typically offshore based. Given the increased levels of demand from a variety of investors, yields have also tightened, with repositioning opportunities particularly sought after.

Table 1
St Kilda Road & Southbank Office Market Indicators as at April 2014

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	244,267	10.9	-12,456	-1,058	330 – 350	25 – 30	7.75 – 8.25
	Southbank	248,819	2.8	49	0	380 – 430	25 – 30	7.00 – 7.50
Secondary	St Kilda Road	492,151	11.6	-6,877	-3,456	240 – 270	25 – 35	8.00 – 8.50
	Southbank	178,637	12.3	2,716	0	260 – 290	25 – 35	8.25 – 8.75
Total Market	St Kilda Road	736,418	11.4	-19,333	-4,514			
	Southbank	427,456	6.8	2,765	0			

Source: Knight Frank/PCA ^ as at January 2014

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

Supply & Development Activity

Having peaked in 1992, office stock in the St Kilda Road precinct has fallen by 15% over the past 22 years. In the six months to January 2014, office space within the St Kilda Road precinct fell further, decreasing by 2,114m². Typically, offices have been withdrawn for residential development, with recent withdrawals including: 470 St Kilda Road (6,510m²*), 505 St Kilda Road (5,619m²*) and 401 St Kilda Road (1,515m²*). In addition to the strong appetite for residential development; withdrawals for conversion to an alternative uses are planned for other office buildings including: 387-389 St Kilda Road (1,056m²*), for the expansion of the Royce Hotel and 553 St Kilda Road (10,953m²*) into a proposed medical facility. Looking ahead, there are no new office developments forecast for the precinct in the near future.

In contrast, the Southbank office market has grown by 137,557m² since 1992. While there has been no new supply added to the precinct since 2010, construction has now commenced on the Australian Broadcasting Corporation's new 20,210m² headquarters; which will include office space in addition to specialised studio space. The development is scheduled to be completed in early 2017 and is fully pre-committed by the ABC. Buoyed by low A-grade vacancies, which have averaged below 5% over the last 10 years; Mirvac has submitted a proposal to redevelop a current Southbank carpark at 2

Riverside Quay. Mirvac's plans incorporate an additional 20,100m² of office space above the existing carpark. Residential conversion is also established in Southbank, particularly for secondary office buildings with residential development proposed for 158 City Road (4,014m²*) and 68-70 Dorcas Street (2,432m²*).

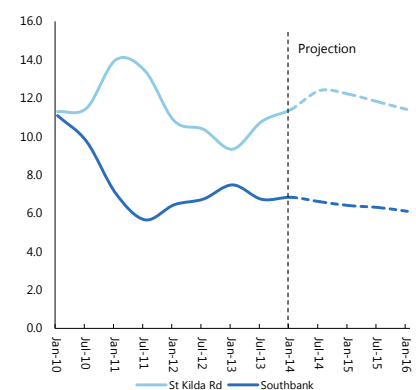
Tenant Demand & Rents

For a second consecutive half-year period, negative net absorption was recorded in the St Kilda Road office market; leading to total vacancy rising from 10.8% to 11.4% as at January 2014. While total vacancy within the St Kilda Road office market increased, prime and secondary office vacancies diverged. Over the six months to January 2014, prime office vacancy fell to 10.9% from 11.6% whereas secondary vacancies in St Kilda Road offices increased to 11.6% from 10.4%. Looking ahead, recent leasing commitments indicate that this flight to quality will continue with most tenants relocating into A-grade accommodation. As a result of these tenant relocations, A-grade vacancy in the St Kilda Road office market is forecast to continue to decrease over the next 12 months. Despite a flurry of large leasing commitments, the majority involve existing St Kilda Road tenants and as such won't significantly reduce the total vacancy rate. Impacted by Suncorp's upcoming vacation of 601 St Kilda Road later this year, vacancy in the St Kilda Road office market will rise further. However, the outlook of improving white collar employment in the precinct coupled with withdrawals of office stock will

aid a fall in total vacancy in the medium term.

The vacancy rate in the Southbank office market remained steady in the six months to January 2014, increasing marginally to 6.8%. While vacancies of A-grade office space in the precinct increased to 2.8%, the level remains below its 10-year average of 4.9%. Given that A-grade space accounts for more than half of the Southbank office stock, total vacancy is forecast to be insulated by the scarce level of A-grade vacancies.

Figure 1
St Kilda Rd / Southbank Office Vacancy (%) 2010-2016



Source: Knight Frank / PCA

With leasing activity relatively muted, rental levels across both the Southbank and St Kilda Road office markets also remained steady. Although effective rents have fallen as a result of a slight rise in incentives levels, the lack of large prime vacant contiguous options suggest that incentives have peaked.

* Refers NLA of office area which was withdrawn

Investment Activity

Collectively, investment sales (above \$10 million) in 2014 year to date within the Southbank and St Kilda Road office markets total \$292.4 million across nine properties. Transactions in 2014 to date have already surpassed sales achieved in the entire year of 2013. Transactional volumes are expected to exceed the previous record achieved in 2007, with a 50% share of Freshwater Place as part of Dexus' purchase of the Commonwealth Property Office Fund still yet to settle.

In the first four months of 2014, offshore groups have dominated purchases, accounting for 59% of sales by value in the St Kilda Road and Southbank office markets. The vast majority of the properties acquired by these offshore buyers were office buildings that can be repositioned for

residential development.

Whilst the majority of transactions in the Southbank and St Kilda Road office markets consist of buildings earmarked for residential development; anecdotally prime yields have compressed by 25 to 50 basis points over the six months to April 2014. Average prime core market yields range between 7.00% and 8.25%. Looking forward, properties currently on the market suggest that yield compression is on-going.

Secondary assets have also experienced some yield compression, albeit to a lesser degree, tightening on average by 25 basis points to range between 8.75% and 9.25%.

Outlook

With the highest and best use for many properties in both St Kilda Road and

Southbank precincts considered to be residential, office stock levels are forecast to contract in both markets over the next three years. Whilst prime vacancies in the Southbank office market are well below long term averages, new development is unlikely to commence without significant pre-commitment.

Although this contraction of stock will constrain a significant rise in vacancy, total vacancy in the St Kilda Road office market is forecast to rise and peak at 12.3% in mid-2014 before trending down.

While market rental levels have stalled in both office markets over the past year, the anticipated fall in vacancies should encourage modest rental growth from late 2014, particularly for prime space.

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
68-70 Dorcas Street^	17.00	4.60*	2,462	6,905	n/a	Private Investor	Offshore Developer	Apr-14
450 St Kilda Road	20.00	n/a	4,579	4,368	n/a	Carter family	Golden Age Group	Apr-14
541 St Kilda Road~	35.75	8.10*	8,229	4,350	3.0	APN	International Healthway Corp.	Mar-14
20-22 Queens Road^	35.00	3.51*	4,180	8,373	0.6	Private Investor	Private Investor	Mar-14
553 St Kilda Road~	45.00	7.40	10,953	4,108	2.7	Montgreen Holdings	International Healthway Corp.	Mar-14
66-70 Southbank Blvd. ^	42.30	VP	1,382	30,608	0.0	Nonda Katsalidis	Aspial Corporation	Jan-14
1-7 Palmerston Cres.	14.35	6.30	3,108	4,617	9.0	JAK Holdings	Offshore Private Investor	Jan-14
390 St Kilda Road	56.0	8.10	17,174	3,261	3.3	Charter Hall (PFA Div. Property Trust)	Forte Street (Aust. Property Opportunities Fund)	Jan-14
420 St Kilda Road	45.28	7.00	10,528	4,301	2.0	Queen Central P/L	CEL Australia	Dec-13

Table 3

Recent Leasing Activity St Kilda Road & Southbank

Address	Precinct	Area (m ²)	Estimated Net Face Rent (\$/m ²)	Tenant	Start Date
60 City Road#	Southbank	11,485	n/a	IBM	Q1-16
509 St Kilda Road	St Kilda Road	6,800	285	AIA Australia	Q2-15
Freshwater Place#	Southbank	3,185	n/a	Microsoft	Q4-14
380 St Kilda Road	St Kilda Road	1,284	320	Excelis	Q2-14
380 St Kilda Road	St Kilda Road	1,156	330	Hitachi	Q2-14
484 St Kilda Road	St Kilda Road	3,278	325	SAP	Q1-14
600 St Kilda Road	St Kilda Road	950	320	LASA	Q1-14
47 City Road	Southbank	1,200	216g	Mercy Mission	Q4-13
390 St Kilda Road	St Kilda Road	1,470	n/a	Quest Apartments	Q4-13
390 St Kilda Road	St Kilda Road	1,512	265	Toll Transport	Q4-13

Source: Knight Frank ^ Bought for residential development ~ Bought for conversion to medical use * Passing Yield # Renewal 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

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