

ST KILDA ROAD & SOUTHBANK

OFFICE MARKET BRIEF APRIL 2017

Key Findings

Vacancy in the Southbank office market is the lowest across all major Australian office markets.

St Kilda Road office market **stock has now shrunk by 21%** from its peak in 1992.

42,929m² is mooted to be withdrawn from St Kilda Road and Southbank office markets over the next 12 months.

Investment activity in 2016 reached a record high with \$1.58 billion transacted in St Kilda Road and Southbank.



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After six years of no new supply in the Southbank office market, 21,000m² was completed in the precinct in the second half of 2016, of which 100% was pre-committed.

Development Activity

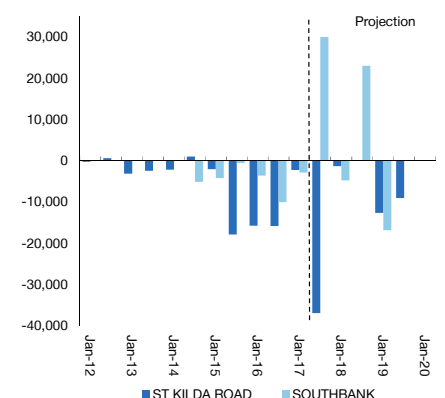
The second half of 2016 saw 21,000m² of new office supply added to the Southbank precinct, underpinned by the completion of Mirvac/ISPT's 2 Riverside Quay. This was the first new office development completed in the Southbank precinct in six years. Looking ahead, a further 30,000m² is currently under construction at 102 Sturt Street, scheduled for completion in mid 2017, pre-committed by the Australian Broadcasting Corporation. Despite recent completion, stock in the Southbank office market declined in the six months to January 2017, falling by 2,855m² with 2 Southbank Boulevard (23,000m²) withdrawn for partial refurbishment and 43-49 Bank Street (1,359m²) withdrawn for residential conversion.

Office space in the St Kilda Road precinct continued to decrease with 2,239m² withdrawn from the market in the six months to January 2017. Office stock in the St Kilda Road precinct is now at its lowest level in 27 years having shrunk by 18,014m² in 2016 as five buildings were withdrawn for alternative uses. Withdrawals in the past 12 months for residential development include 499 St Kilda

Road (11,099m²), 20 Queens Road (4,276m²) and 74 Eastern Road (1,252m²). Office stock in the precinct has now decreased by 21% from its peak of 871,030m² in 1992.

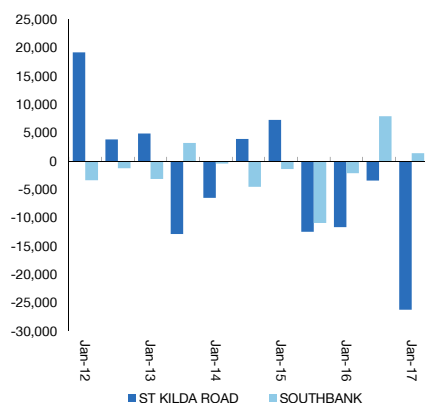
Looking ahead, office space is forecast to continue to decrease along St Kilda Road with 59,735m² anticipated to be withdrawn by 2019 for residential development.

FIGURE 1
St Kilda Rd & Southbank Net Supply
Per six month period (m²) - Office



Source: Knight Frank Research/PCA

FIGURE 2

Net AbsorptionPer six month period (m²) Office

Source: Knight Frank Research/PCA

Net Absorption & Vacancy

The total vacancy rate in the St Kilda Road office market increased to 13.2% in the second half of 2017 up from 9.7% in July 2016. The increase in total vacancy resulted from negative net absorption of 26,216m² in the six months to January 2017 impacted by 35,945m² of backfill space returning to the market. Major vacancies included 412 St Kilda Road (16,285m²) vacated by the Victoria Police, 5 Bowen Crescent (8,342m²) vacated by Tabcorp and 457 St Kilda Road (9,346m²) vacated by Computershare.

Nevertheless, the total vacancy rate in the St Kilda Road office market is forecast to decline in 2017 with many of the offices identified for residential conversion currently incorporating some levels of backfill space.

In contrast, positive net absorption was recorded in the Southbank office market

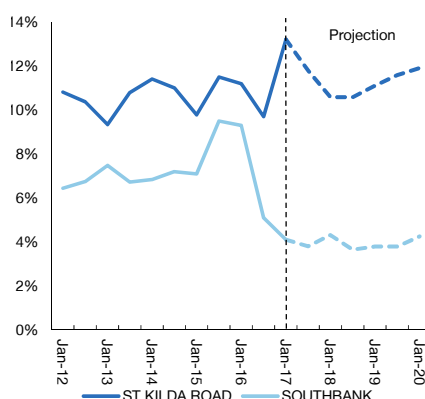
in the second half of 2016, leading to total vacancy falling to 4.1% as at January 2017, down from 9.3% in January 2016. The fall in vacancy resulted largely from the withdrawal of five secondary grade buildings for conversion to residential, combined with a rebound in absorption of A-grade stock.

The current Southbank A-grade vacancy rate at 4.4% is now below the long term average of 6.4%. One notable A-grade leasing transaction in the second half of 2016 was CGI Technologies leasing 1,289m² at 40 City Road. The Southbank office market has the lowest overall vacancy rate across all Australian office markets (surveyed by the PCA). Looking ahead, total vacancy is forecast to sit below the long term average through to 2020.

Rents

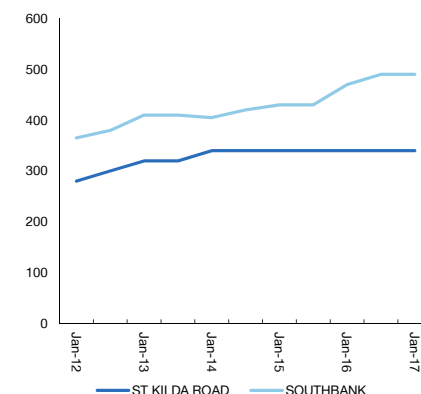
With vacancy above the 10-year average, prime and secondary net face rents in the St Kilda Road office market have

FIGURE 3

St Kilda Rd & Southbank Vacancy
 2012-2020 (%) - Office


Source: Knight Frank Research/PCA

FIGURE 4

Average Prime Net Face RentsSt Kilda Rd & Southbank (\$/m²) - Office

Source: Knight Frank Research

remained stable over the past three years. As at April 2017, prime net face rents average \$340/m² with prime incentives ranging between 20% and 25%. However, there is currently a shortage of large contiguous prime vacant options in the St Kilda Road office market with just three contiguous options offering in excess of 1,000m². In the secondary market, office net face rents average \$275/m² as at April 2017.

In contrast, the Southbank office market has recorded solid rental growth over the past two years, underpinned by the positive net absorption of A-grade stock. As at April 2017, prime net face rents average \$490/m² having increased by 14% since January 2015. There are currently only two prime options in the Southbank office market offering contiguous space in excess of 2,000m². Prime incentives remained stable ranging between 25% to 30%.

TABLE 1

St Kilda Road & Southbank Office Market Indicators as at April 2017

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	6.0	2,278	0	330–350	20–25	6.00–6.50
	Southbank	248,263	4.4	8,742	-556	430–550	25–30	5.75–6.25
Secondary	St Kilda Road	438,611	17.2	-31,915	-18,041	250–300	15–25	6.50–7.00
	Southbank	157,474	3.7	561	-12,857	260–310	20–25	6.75–7.25
Total Market	St Kilda Road	683,936	13.2	-29,637	-18,014			
	Southbank	405,737	4.1	9,303	-12,857			

Source: Knight Frank Research/PCA

*As at January 2017

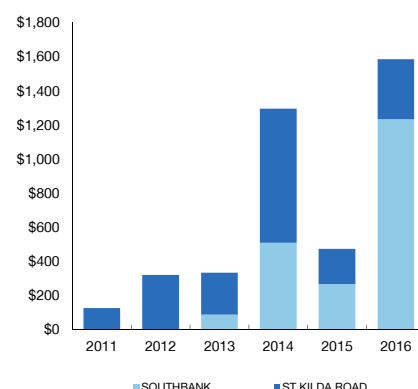
Investment Activity & Yields

Office investment activity in the 2016 calendar year reached an all time-time high in the St Kilda Road and Southbank office markets. Transaction volumes in excess of \$10 million in 2016 totalled \$1.58 billion from 12 transactions. The volume of sales was 242% higher than the long term average, with this investment accounting for 35% of all office transactions (by value) across all of Melbourne's office markets.

Sales in the Southbank and St Kilda Road office market were boosted by a higher than average number of transactions in excess of \$100 million. In 2016 there were five sales in excess of \$100 million recorded, accounting for 82% of the total sales volume. Offshore groups lead all purchaser types, accounting for 76% of sales by value, spending \$1.20 billion. Volumes were

underpinned by ARA's acquisition of the Southgate Complex for \$578 million. A-REITs were also active, accounting for 10% of sales by value with Growthpoint purchasing 75 Dorcas Street in South Melbourne for \$166 million.

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



Source: Knight Frank Research

Over the past 12 months, average prime St Kilda Road office yields have compressed by 50 basis points to range between 6.00% and 6.50%. Prime Southbank office yields compressed by 25 basis points in the 12 months to January 2017 to range between 5.75% and 6.25%.

The recent sale of 28 Freshwater Place transacting on a core market yield of 5.91%, is evidence of this strong yield compression. JP Morgan Asset Management purchased the asset for \$286 million from GPT/Frasers Property.

Secondary yields also recorded compression of 50 basis points over the past 12 months in both the St Kilda Road and Southbank office markets. Secondary yields range between 6.50% and 7.00% in St Kilda Road and 6.75% and 7.25% in Southbank.

TABLE 2

Recent Leasing Activity St Kilda Road & Southbank

Address	NLA	Term	Lease	Tenant	Sector	Date
40 City Road, Southbank	1,289	5.0	New	CGI Technologies	T.M.T	Q3-17
468 St Kilda Road, Melbourne	441	5.0	New	Finsure Financial	Finance	Q2-17
11 Queens Road, Melbourne	520	3.0	New	HCL Australia	T.M.T	Q2-17
484 St Kilda Road, Melbourne	1,342	10.0	New	Bayside Group	Professional Services	Q1-17
324 St Kilda Road, Melbourne	1,800	6.0	New	Crawford and Co.	Insurance	Q1-17
111 Coventry Street, South Melbourne	1,295	3.0	New	Huawei Technologies	T.M.T	Q1-17
2 Southbank Boulevard, Southbank	1,375	7.0	New	VMware	T.M.T	Q4-16
21 Moray Street, Southbank	700	5.0	New	Jing Ying	Real Estate	Q3-16

TABLE 3

Recent Sales Activity St Kilda Road & Southbank

Address	Price (\$ mil)	Core Market	NLA (m ²)	\$/m ² NLA	Vendor	Purchaser	Sale Date
5 Queens Road, Melbourne	116.3	5.90	17,720	6,563	Charter Hall	Tong Eng Group	Dec-16
553 St Kilda Road, Melbourne	70.0	7.30*	10,316	6,786	IHC	Nick Andrianakos	Nov-16
541 St Kilda Road, Melbourne	47.7	6.60	8,229	5,803	IHC	Bayley Stuart Capital	Nov-16
457 St Kilda Road, Melbourne	55.0	VP	9,346	5,885	Private Investor	Premier Investments	Nov-16
12 Riverside Quay, Southbank	160.0	U/D	20,250	7,901	Exxon Corporation	Loi Keong Kuong	Oct-16
3 Southgate Ave, Southbank	578.0	U/D	76,208 ^a	7,585	DEXUS	ARA Asset Management>	Aug-16
28 Freshwater Pl, Southbank	286.0	5.91	33,541	8,526	GWOFF/Frasers	JP Morgan Asset Management	Aug-16
75 Dorcas St, South Melbourne	166.0	6.85	23,811	6,972	SachsenFonds	Growthpoint Properties	Jun-16

Source: Knight Frank Research U/D undisclosed * Initial market yield ^a includes 9,806m² retail space [∞] TMT refers Technology Media & Telecommunications >ARA Asset Management & Entities (including Suntec REIT)

Outlook

The Metro rail project, which includes the new Domain station under St Kilda Road, will commence construction in 2018 and is due to be operational by 2026. Upon completion, the Domain station will offer greater access to the St Kilda Road and Southbank office precincts with 33,000 jobs and 17,000 residents anticipated to be located within 800 metres of the Domain station by 2031.

While the new Domain station will significantly improve access to St Kilda Road, residential development will continue, resulting in stock levels falling further in the St Kilda Road and Southbank office markets. Over the next three years, the St Kilda Road office market is forecast to lead all other Melbourne office markets for withdrawals. A total of 59,735m² is anticipated to be withdrawn between 2017 and 2019, accounting for 9.1% of the current stock base. Of the mooted withdrawals, 40% is within B-grade stock, with the remainder in C-grade accommodation. As a result the overall St Kilda Road office vacancy

rate is forecast to fall below the long term average of 10.4% between 2018-2019.

The office vacancy rate in the Southbank office market is anticipated to remain below 4% until mid 2019, underpinned by limited new supply coming online, combined with permanent stock withdrawals totalling 9,468m² between 2017 and 2019.

The lack of contiguous prime space for lease within both the St Kilda Road and Southbank office markets coupled with the continued reduction of office stock is expected to encourage rental growth, particularly in the prime market.

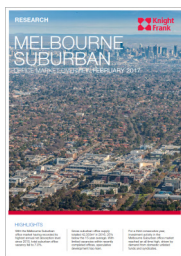
With vacancy levels forecast to continue to decline combined with existing yield spread between CBD and City Fringe offices, investment demand for St Kilda Road and Southbank offices is anticipated to intensify further. In addition, Melbourne's population growth will also maintain developer interest for potential residential redevelopment opportunities of offices within the St Kilda Road and Southbank office precincts.

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