RESEARCH

MELBOURNE CBD TENANT MIGRATION

OFFICE MARKET INSIGHT OCTOBER 2015

HIGHLIGHTS

37% of Melbourne's net absorption over the past decade has resulted from incoming tenants. A total of 59 tenants, totalling 326,695m² have migrated, adding directly to net absorption.

Occupiers previously from the suburbs accounted for 48.4% of the total space absorbed by migrating tenants, leasing 158,236m² of CBD office stock since 2005.

Property & Business Services (17.4%) based tenants led all sectors, followed by Government (16.2%) and Technology, Media & Telecommunications (15.5%) occupiers.

KEY FINDINGS

37% of Melbourne's net absorption over the past decade has resulted from incoming tenants

In 2015, 13 tenants totalling 89,692m^2 are expected to relocate into the CBD, a decade high result

Most migrating tenants relocated into **A-grade (71.3%) and Premium grade (15.6%)** accommodation

The **Docklands precinct accounted for 52.8%** of total space leased by migrating tenants over the past 10 years

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INTRODUCTION

Over the year to December 2014, Melbourne became Australia's biggest-growing city adding 95,600 residents, and Victoria has overtaken Western Australia to become Australia's fastest-growing state. Over the same period, Victoria also recorded the highest net interstate migration figure, with a net 9,340 new arrivals from interstate, supporting economic growth, the housing market and the office market.

In addition to the strong levels of population growth, white collar employment growth in the Melbourne CBD has outpaced all other Australian cities over the past decade, with net growth of over 60,000 employees, more than four times the growth recorded in the Sydney CBD and even outpacing the combined growth in the resource boom cities of Brisbane and Perth.

The Melbourne CBD is the second largest office market in Australia (behind Sydney), currently comprising 4.4 million square metres of office space. Over the past decade to July 2015, the Melbourne CBD has absorbed a total of 870,554m^2, compared to 516,908m^2 in Sydney and 195,886m^2 in Brisbane.

Melbourne CBD's net absorption levels have been boosted by strong migration into the CBD by fringe and suburban tenants. Including 2015 projections, 37% of Melbourne's absorption over the past decade has resulted from incoming tenants. A total of 59 tenants, totalling 326,695m^2 have migrated, adding directly to net absorption.

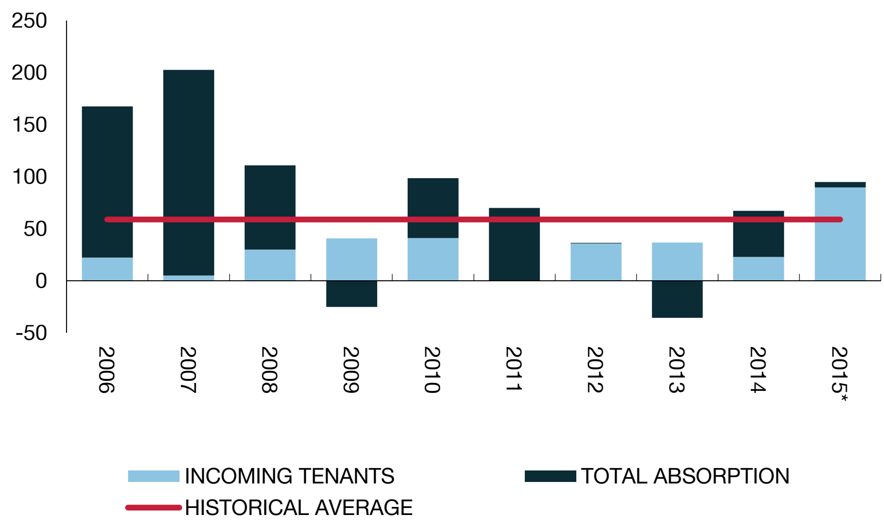
The emergence of the Docklands precinct, providing low cost, campus style options has also aided this attraction into the CBD office market. The Melbourne Docklands precinct has grown from a stock base of zero to 812,499m^2 over the past 12 years. In comparison the entire Sydney CBD office market has increased by 500,306m^2, while Brisbane has grown by 496,634m^2 and Perth CBD office stock risen by 391,455m^2 over the same period.

Melbourne's CBD office market has also benefited from organizations' focusing on attracting and retaining the best talent from around the metropolitan area. The radial nature of Melbourne's suburban railway line network ensures that the CBD is the best location to attract a wide range of employees.

FIGURE 1

Annual Net Absorption

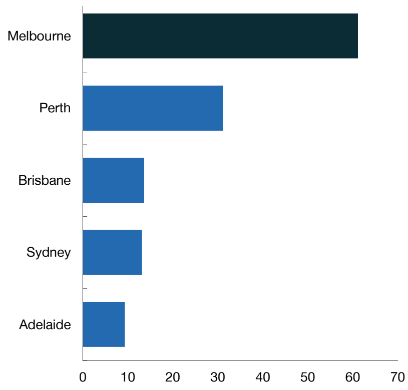
CBD Office (000's m^2)



Source: Knight Frank Research/PCA *Projection

MELBOURNE IN CONTEXT

FIGURE 2
White Collar Employment 2006-2015
By CBD Office Market (000's employees)



Source: Knight Frank Research

Melbourne's strong employment growth stems from a diverse occupancy profile, insulating the CBD from the recent volatility of the mining and financial service sectors, and providing a very resilient office leasing market. The two largest industry sectors represented within the Melbourne CBD are: Professional Services (22%) and Finance & Insurance (18%). Within these sectors, there is a wide spread of sub-sectors including banking, superannuation, legal, consultancy services and engineering. In contrast the two largest industry sectors represented within both the Sydney and Brisbane CBD office markets account for more than 55% of the employment base. The Sydney CBD office market is heavily exposed to the Finance and Professional Services sectors, whereas the Brisbane CBD is closely aligned to the Government and Professional Services sector.

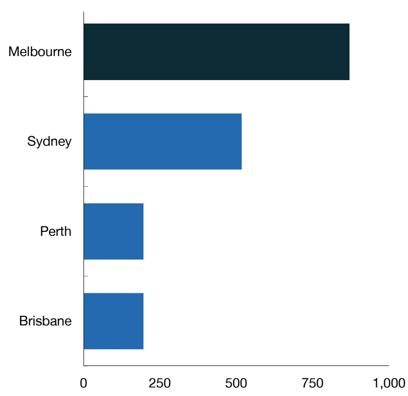
Services have represented a growing share of employment in Australia over the past decade, benefiting from the trend towards outsourcing and closer global connections. Over the past 10 years employment in the Professional Services sector has grown more in the Melbourne CBD office market easily outstripping all other Australian CBD office markets.

Australia's structural adjustment away from mining-led activity has also been highlighted by the level of net absorption in the Melbourne and Sydney CBD office markets recently, in contrast to the other CBD office markets. Along with Sydney, net absorption recorded in the six months to July 2015 in the Melbourne CBD office market was twice the historical average. In the six months to July 2015, net absorption in the CBD office market totalled 60,906m^2, a five-year high, equating to 98,828m^2 absorbed over the 12 months to July 2015.

Over the 10 years to July 2015, net absorption within the Melbourne CBD office market has totalled 870,554m^2, 68% higher than the levels achieved in the Sydney CBD office market. In fact, over the past 10 years, Melbourne's level of net absorption has accounted for 33% of all the total office space absorbed across all of Australia's CBD office markets.

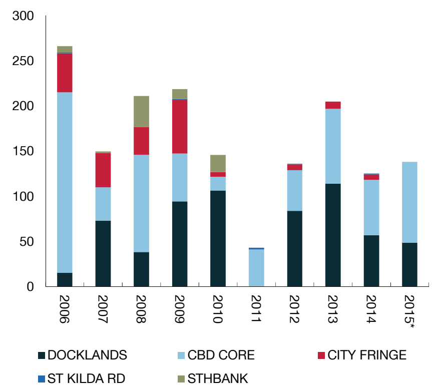
Within the Melbourne CBD office market, the Docklands precinct has experienced the greatest absorption of space. Over the 10 years to July 2015, the Docklands precinct alone recorded net absorption of 570,690m^2, accounting for 65% of Melbourne's net absorption over the past decade. With the first building completed in 2004, the 200-hectare mixed use urban

FIGURE 3
Net Absorption 2006—2015
By CBD Office Market (000's employees)



Source: Knight Frank Research/PCA

FIGURE 4
New Office Supply 2006—2015
By Office Market (000's m^2)



Source: Knight Frank Research *Projection

renewal project has produced 812,499m^2 of office space. Adjacent to the traditional CBD Core, the Docklands precinct has provided organisations the opportunity to pre-commit to low-rise office buildings with large floor plates offering unparalleled access to public transport and infrastructure. Tenants were also drawn to the Docklands precinct with limited alternatives in other Melbourne office markets. While the Docklands has grown substantially over the past 10 years, the St Kilda Road office market shrunk by 47,995m^2 and the Southbank office market has only grown by 53,457m^2 through the addition of three buildings. In addition, increasingly sites for potential commercial development located within the Suburban and fringe office markets are being repositioned for residential development, further reducing options for tenants seeking new space.

In contrast, tenants in other Australian CBD office markets have the benefit of other metropolitan office hubs to accommodate major new office developments. The Brisbane Fringe (1,198,568m^2), North Ryde (868,295m^2) and North Sydney (823,351m^2) office markets are all larger than the St Kilda Road office market and have all grown over the past decade. Often these alternative markets also offered occupiers the opportunity to reduce real estate costs within new developments.

TENANT MIGRATION DRIVERS

Having been named the world's most liveable city for a fourth consecutive year according to the Economist Intelligence Unit's liveability survey, Melbourne's cost competitiveness is another factor that has attracted tenants into the CBD office market.

Global Connection

Melbourne's new residential land is cheaper than most other cities in Australia and has aided population and subsequently employment growth into the state. With Australia's only curfew free international airport, a seaport that handles 35% of Australia's container trade and where 33% of international students are enrolled in Victorian education institutions; Melbourne's global connections makes the state (and CBD office market by association) an attractive proposition for a diverse range of businesses to set up and expand.

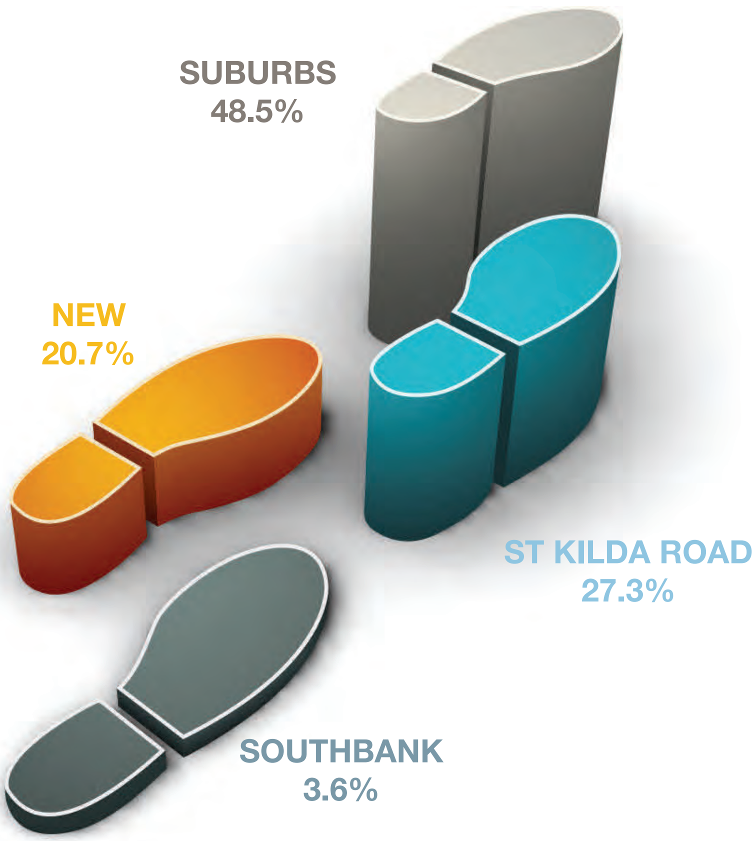
Next Generation Workplace

Another driver behind the shift into the CBD office market has been the next generation of employees who bring new traits and requirements to employers and workplaces. Increasingly the workplace is about staff retention, and the war for talent means the balance of power in the modern workplace has shifted towards the employee with staff demanding to be close to shops, cafés and increasingly where they live, which is in Inner City locations.

FIGURE 6

Origin of Melbourne CBD Migrating Tenants 2006—2015

By Former Office Market (%)

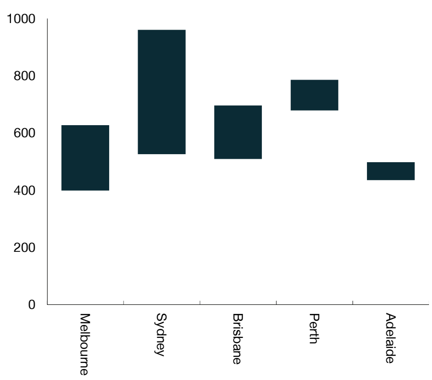


Source: Knight Frank Research

FIGURE 5

Prime Gross Face Rent Differential

CBD vs Suburban Office Markets ($/m^2)



Source: Knight Frank Research

Cost Competitiveness

While occupancy costs represent a relatively minimal component compared to employee attraction and retention costs, the cost of office space in the Melbourne CBD is lower than most other Australian CBD office markets. In fact Sydney CBD average prime gross rental levels are 53% greater than average levels in Melbourne, with Brisbane and Perth rental levels also remaining higher.

Additionally, in contrast to most other Australian CBD office markets, the average rental spread between prime gross face rents in the CBD and Melbourne suburban office locations is not as prohibitive for incoming migrating tenants as some other Australian CBD office markets .

While current vacancy levels are relatively similar to 10-years ago, impacted by the GFC; average prime incentive levels have risen from 20% to 30%, enabling non-CBD tenants to fund relocation and fitout costs.

TENANT MIGRATION TREND

Despite the subdued tenant demand and modest state employment growth recorded since the GFC, the Melbourne CBD office market has surpassed the historical net absorption average in all but three years over the past decade. Much of this growth in occupied space came from the migration of non-CBD tenants into the market rather than organic growth of existing CBD tenants.

The flow of non-CBD tenants relocating to the CBD continues to gather momentum with 2015 set to be a record for migrating tenants. In 2015, 13 tenants totalling 89,692m^2 are expected to relocate into the CBD, which is around 50% higher than the long term annual average net absorption of the market. Tenants to migrate to the CBD this year include: VECCI from East Melbourne, Engineers Australia from North Melbourne and Victoria Police from St Kilda Road.

Over the past decade, occupiers from the suburbs accounted for 48.4% of the total space absorbed by migrating tenants, leasing 158,236m^2 of CBD office stock. With the average suburban office building size being 3,100m^2, compared to the average incoming suburban tenant lease size of 5,100m^2; tenants were compelled to look to other markets to satisfy their requirements. Major relocations from the suburban office market included: SKM (which leased 10,400m^2) moving from Armadale, Pearson (7,200m^2) from Camberwell & Port Melbourne and BUPA (11,750m^2) from Hawthorn. Highlighting Melbourne's cost competitiveness is the proportion of migrating tenants which have leased space within the CBD having no previous exposure to any Melbourne office market. Businesses that have opened offices in the CBD include: the Australian Institute of Music (3,190m^2) expanding from Sydney; while The Age (16,620m^2) vacated former industrial space.

In addition to migrating into the CBD office market, the vast majority of space leased was within A-grade (71.3%) and Premium grade (15.6%) accommodation. Tenants that migrated into Premium grade space included: Evans & Partners (171 Collins Street) and CrownBet (120 Collins Street).

TABLE 1

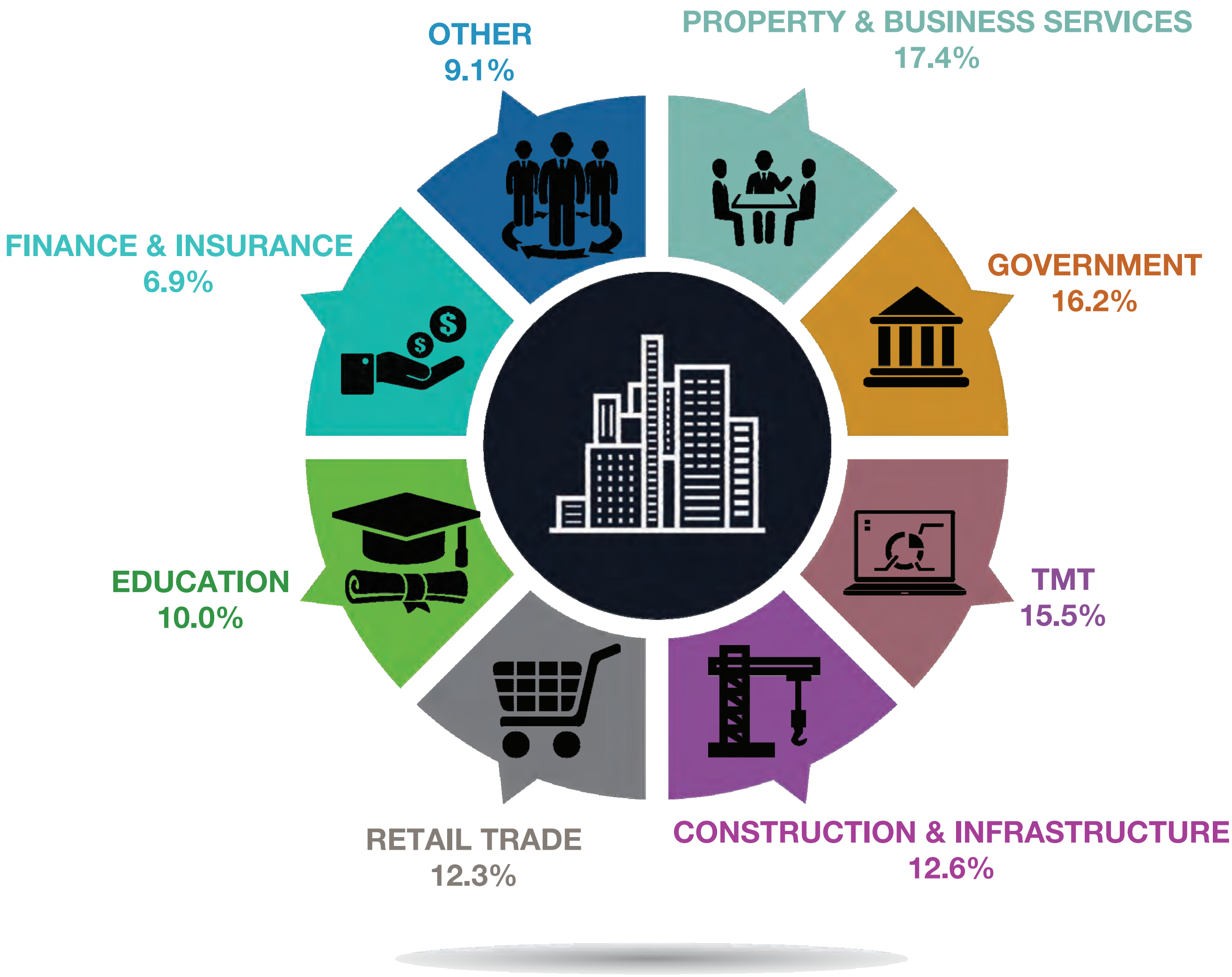
Selected Migrating CBD Office Tenants

Address	Precinct	NLA (m^2)	Tenant	Industry	Former Suburb/ Office Precinct	Date
452 Flinders Street	Western	10,400	SKM*	Property & Business Services	Armadale	2009
990 La Trobe Street	Docklands	12,650	Melbourne Water	Government	East Melbourne	2012
850 Collins Street	Docklands	9,200	Aurecon	Property & Business Services	St Kilda Road	2012
171 Collins Street	Civic	1,693	Evans & Partners	Finance & Insurance	East Melbourne	2013
357 Collins Street	Western	7,500	Service Stream	Property & Business Services	West Melbourne	2013
11 Exhibition Street	Eastern	11,750	BUPA	Health	Hawthorn	2013
180 Lonsdale Street	Civic	2,600	Linking Melbourne	Government	Mt Waverley	2013
35 Collins Street	Eastern	1,639	Salta Property	Property & Business Services	Port Melbourne	2013
55 Collins Street	Eastern	997	GTA Consultants	Property & Business Services	Kew	2013
120 King Street	Western	3,190	Aust. Institute of Music	Education	N/A	2013
35 Collins Street	Eastern	1,690	Federation Centres	Property & Business Services	Glen Waverley	2013
180 Lonsdale Street	Civic	10,768	Australia Post	Government	West Melbourne	2014
501 Swanston Street	Civic	4,700	Cardno	Property & Business Services	Hawthorn	2014
120 Collins Street	Eastern	3,378	CrownBet	Arts / Rec Services	Southbank	2015
720 Bourke Street	Docklands	4,400	Viva Energy Australia	Manufacturing	Hawthorn East	2015
720 Bourke Street	Docklands	5,700	NEC	TMT	Mulgrave	2015
720 Bourke Street	Docklands	2,800	Porter Davis	Construction & Infrastructure	Clayton	2015
150 Collins Street	Civic	2,800	VECCI	Property & Business Services	East Melbourne	2015
313 Spencer Street	Docklands	27,000	Victoria Police	Government	St Kilda Road	2015
567 Collins Street	Western	12,000	Jemena	Construction & Infrastructure	Mt Waverley	2015

Source: Knight Frank Research TMT refers Technology Media & Telecommunications *Acquired by Jacobs

TENANT MIGRATION ANALYSIS

FIGURE 7
Migrating Melbourne CBD Tenants by Industry Sector
2006—2015 (%)



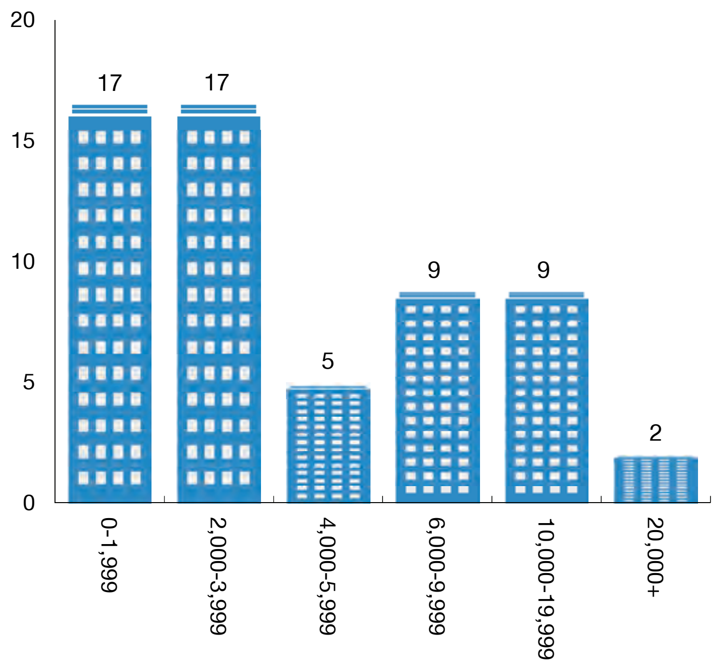
Source: Knight Frank Research

By industry sector, the space absorbed by migrating tenants was led by Property & Business Services (17.4%), followed by Government (16.2%) and TMT (15.5%) occupiers. Major relocations from Property & Business Services corporates included: SKM (which leased 10,400m^2) moving from Armadale, Aurecon (9,200m^2) from the St Kilda Road office market and Cardno (4,700m^2) from Hawthorn.

Of interest, Education tenants are also increasingly migrating into the CBD office, capitalising on the growth of Inner city residential development to cater for international students. Since 2012, migrating education tenants have absorbed 27,172m^2. Recent commitments by those from the Education sector include: Haileybury College (383 King Street), La Trobe University (360 Collins Street) and AIE (18 Siddeley Street).

Driven by the opportunity to upgrade into better quality accommodation and take advantage of competitive rental terms, a number of migrating tenants pre-committed to new buildings. Tenants which underpinned major developments included: Victoria Police (313 Spencer Street), Melbourne Water (990 La Trobe Street) and Jemena (567 Collins Street).

FIGURE 8
Migrating Melbourne CBD Tenants 2006—2015
By Lease Size (No.)

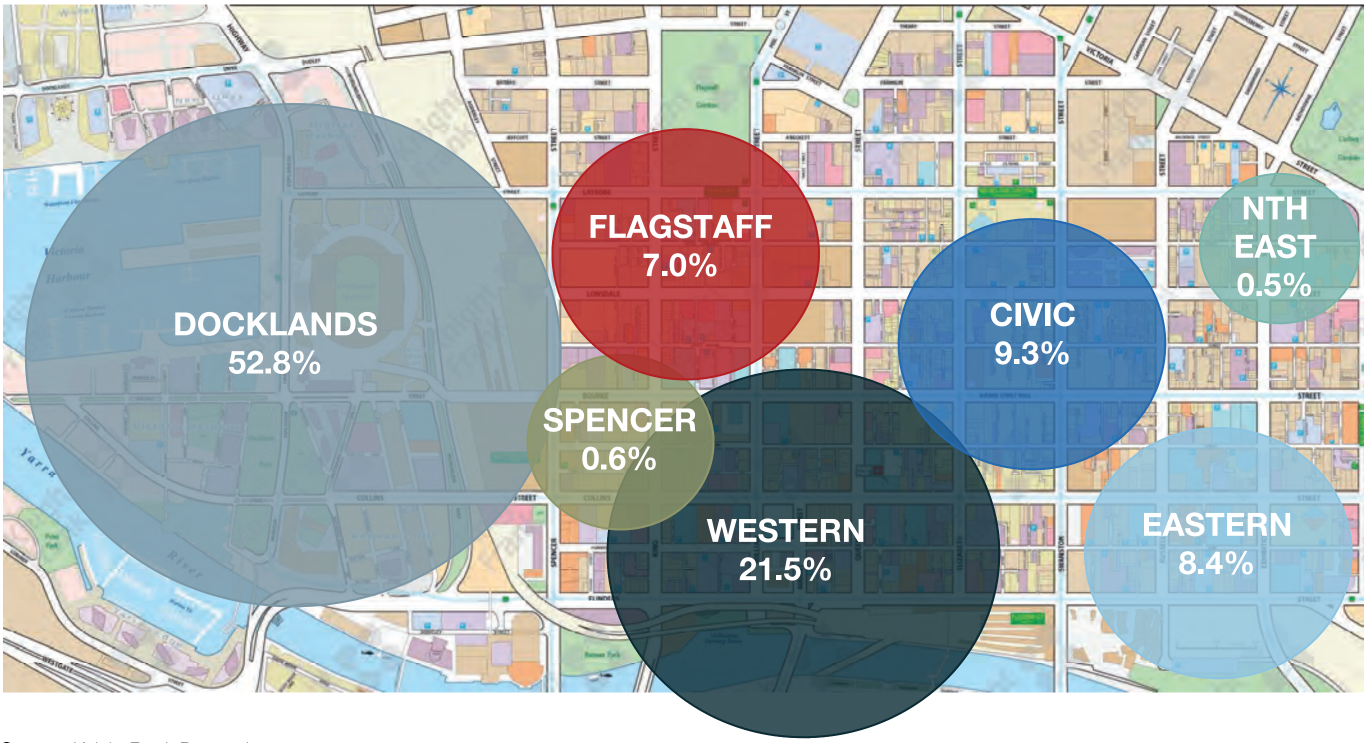


Source: Knight Frank Research

Having underpinned a number of new developments, unsurprisingly the Docklands precinct was the focal point for the majority of migrating tenants into the CBD. The Docklands precinct accounted for 52.8% of space leased, totalling 172,583m^2. The Western Core followed the Docklands precinct where 70,133m^2 (21.5%) was absorbed by incoming tenants over the past 10 years.

Over the past decade, the majority of migrating tenants leased less than 4,000m^2 with 17 tenants less than 2,000m^2 and 17 tenants committing between 2,000m^2 and 4,000m^2. At the other end of scale, there were only two tenants which migrated into the CBD which leased more than 20,000m^2. Overall, the average commitment by migrating tenants was 5,519m^2.

FIGURE 9
Destination of Melbourne CBD Migrating Tenants 2006—2015
By CBD Precinct (%)



Source: Knight Frank Research

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