Melbourne CBD Office Market
with Southbank & Docklands update

September 2024

The market is quieter, but stability seems to be coming with net absorption declines moderating and prime yields flat.

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Key Insights

Market nears its nadir with yields flat, net absorption declines falling and expectations of growth for 2025.

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Partner, Research & Consulting

18.0%

Latest vacancy - CBD

Total vacancy rate increases from 16.6% (restated from 16.4%) to 18.0% as at H1 2024. The vacancy rate for prime stock has risen 1.7% and now sits at 17.4%.

-53K

Annual net absorption

Net absorption was -15,435 sqm for H1 2024, an improvement on the restated -37,435 sqm recorded in H2 2023. Prime net absorption was -7,737 sqm.

69k

Sqm of new supply in 2024

One new development (MQT) was completed in H1-2024, nothing else is expected to land for the rest of the year. Two new developments and three refurbishments will be delivered in 2025 totaling 156,150 sqm.

6.4%

Yield Q2'24 – prime basket

Prime office yields remained flat q/q. Secondary yields pushed out further to 7.31%, up 13 bps from Q1.

2.4%

Prime Face Rental Growth 2024 y/y - Basket

Prime net face growth y/y = +2.4%

Secondary growth y/y = -1.8%

Prime net effective growth y/y = -6.3%

Secondary growth y/y = -15.8%

47.0%

Prime Incentives

Prime incentives have continued to rise, up 1.0% on the quarter and up 5.2% in the last 12 months.

Melbourne CBD Office Market Indicators – July 2024

Grade	Total Stock sqm	Vacancy Rate %	Annual Net Absorption sqm	6-monthly Net Additions sqm	Average Net Face Rent $/sqm	Average Incentive %	Net Effective Rent Growth % q/q	Core Market Yield %*
Prime	3,793,643	17.4	-21,062	69,000	716	47.0	0.4	6.3-6.5
Secondary	1,444,203	19.6	-31,667	0	537	47.9	-3.6	7.1-7.6
Total	5,237,846	18.0	-52,729	69,000				

Source: Knight Frank Research/PCA * assuming WALE 5 years

Melbourne's economy

STRONG RECOVERY EXPECTED GOING FORWARD

In line with the rest of the country, the Melbourne economy has slowed markedly since 2023. Whilst Melbourne's GDP appears to have held up better in 2024, it is still below its long-run average. Melbourne's economy is expected to rebound strongest of the major markets reaching a peak of 4.4% growth by 2026.

POPULATION GROWTH PROPS UP ECONOMY

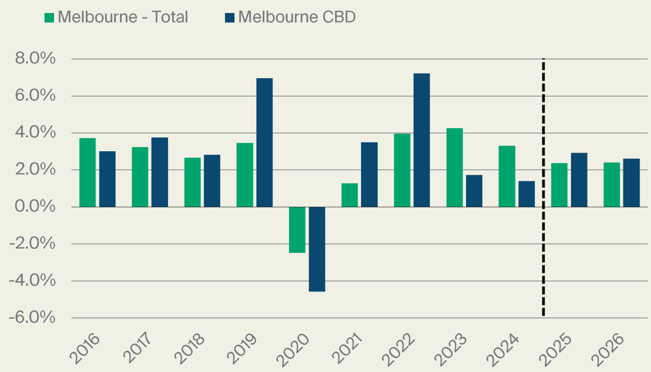
Strong population growth is one of the mainstays supporting the Melbourne economy. As Australia's population is forecast to grow by 2.0% in 2024, Melbourne's will be growing at 3.1%. It is then expected to return to its pre-Covid position, consistently growing 0.5% p.a. above the country level, ensuring a steady growth premium for the city. However, uncertainty concerning government policy on student numbers may cause this to be revised.

EMPLOYMENT GROWTH IN CBD SET TO RECOVER

Following several years with well below average employment growth in the CBD, growth is forecast to double in 2025 from the 1.4% seen in 2024 to 2.9%. It is expected that the return to more substantial employment growth, combined with a wider continued trend to return to the office will revitalize the weekday CBD and support stronger net absorption. Added to this business conditions, which have been trending downwards in the last two years as the economy weakened, have slowed their fall and even risen slightly. They remain positive, whilst at the same time business confidence continues hovering around zero. All this indicates a slowing not stopping economy.

Employment growth

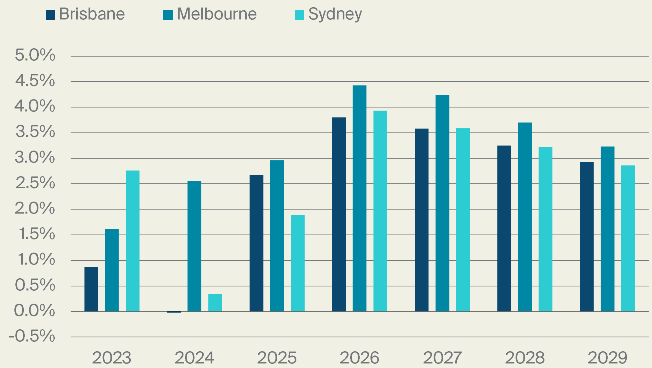
by locale, % change y/y



Source: Knight Frank Research, Oxford Economics

Forecasted GDP growth

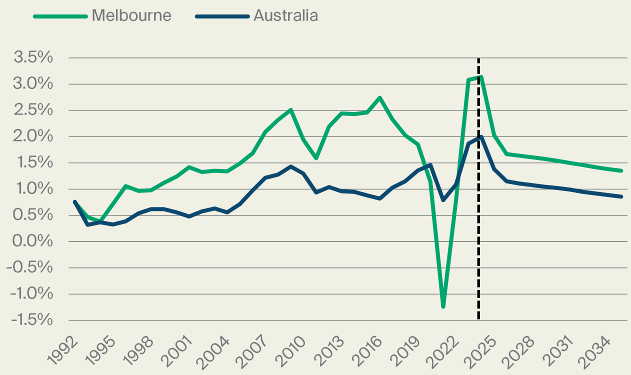
by capital city, % change y/y



Source: Knight Frank Research, Oxford Economics

Population growth

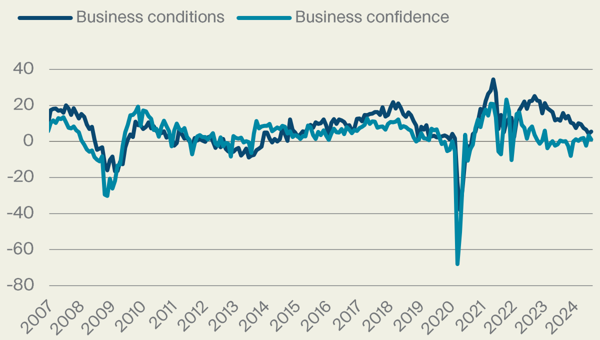
by locale, % change y/y



Source: Knight Frank Research, Oxford Economics

Business confidence and conditions

net balance of positive and negative responses



Source: Knight Frank Research, Macrobond

Demand

NET ABSORPTION IMPROVES BUT WE ARE NOW TWO YEARS IN THE NEGATIVE

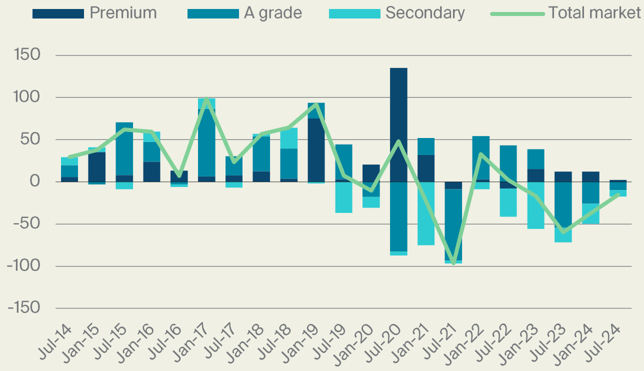
Net absorption came in at -15,435 sqm in H1-2024. Whilst the trend has been upward over the last 18 months, it still means that there has been two years of negative net absorption. This basically underlies the impact of the weaker than average CBD office employment growth and post-Covid uncertainty on space usage resulting in downsizing by some institutions. Once again however, net absorption for premium space remained positive, continuing to highlight the appetite for quality space even in a quieter market.

ENQUIRIES COMING IN SOFTER

The latest quarter's enquiries are expected to come in slightly lower than last quarters as the quietness in the market continues. Lease size requests are also expected to be down.

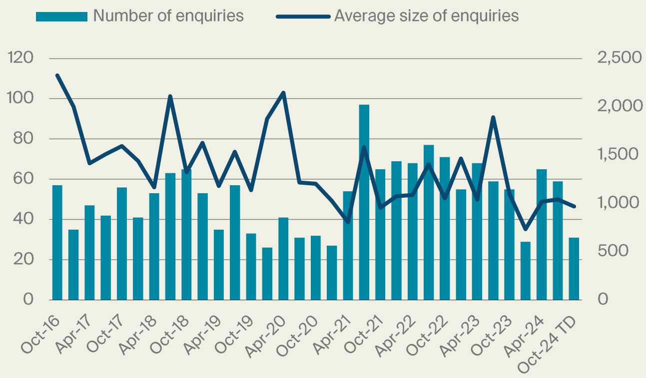
In a sign that the slowing market may be coming to an end, there is a noticeable change in magnitude of requests in companies that are resizing. Looking at companies that have completed leasing deals showed a 21% decline in space requirements compared to what they previously occupied. However, more recently received enquires show only a 3.1% decline on average. This is much more in line with a slight slowing in the economy, compared to a wholesale re-evaluation of space required. It also hints at the fact that a good amount of the major reshaping of the large occupiers has now taken place.

Melbourne CBD net absorption
by grade, 000's sqm



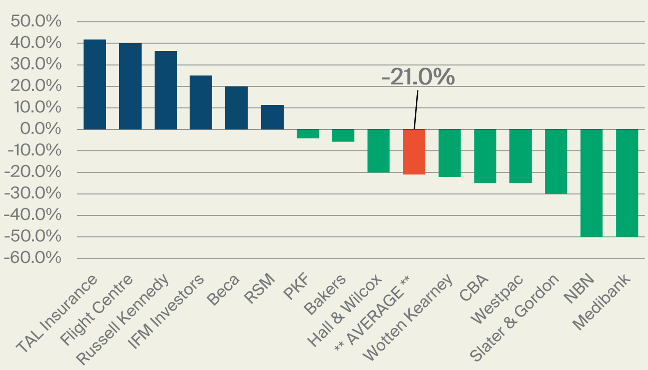
Source: Knight Frank Research, PCA

Melbourne CBD lease enquiries
by no. of enquiries (LHS), and avg. size (RHS); excl. >20,000 sqm



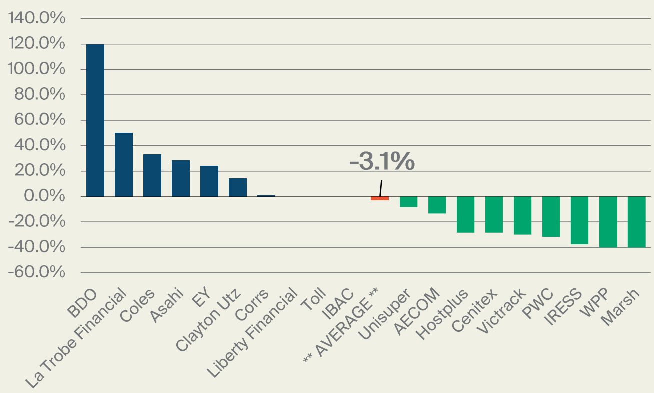
Source: Knight Frank Research

Change in size of new office deals
by company, % change in size from last deal



Source: Knight Frank Research

Change in size of new office enquiry
by company, % change in size from last deal



Source: Knight Frank Research

Supply

VACANCY RATE CONTINUES TO RISE

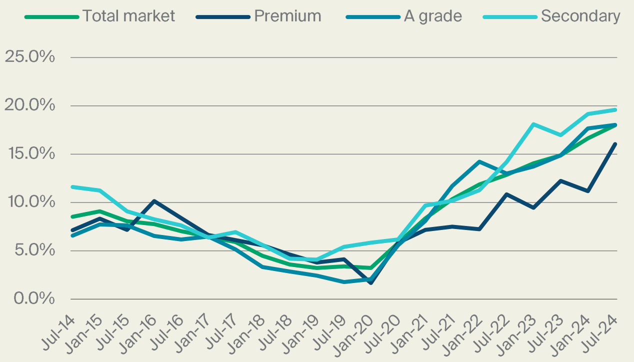
The vacancy rate rose from 16.4% to 18.0% in H1. This was mainly caused by a large jump in premium vacant space (from 11.2% to 16.1%) as the Melbourne Quarter Tower (MQT) was completed with 70.5% vacant space. Whilst grade A and secondary vacant space also rose, this was marginal (up 0.3% and 0.6% respectively). There is no more space dropping in H2 2024 so Melbourne may be reaching a peak in its vacancy rate. Indeed, a return to positive net absorption at the next data point would see the vacancy rate fall in H2.

At the same time sub-leasing returned to its downward trend and is now just 25,000 sqm above its 10-year average. After a surprise uptick at the end of 2023, sub-leasing has continued to fall from its 132,528 sqm high. There is, in practice, more space available, but the situation is more fluid than it was in 2021/22. Some space which was up for sub-leasing has been removed as the return to the office has meant firms have revised their requirements several times.

SUPPLY TO REMAIN RESTRAINED

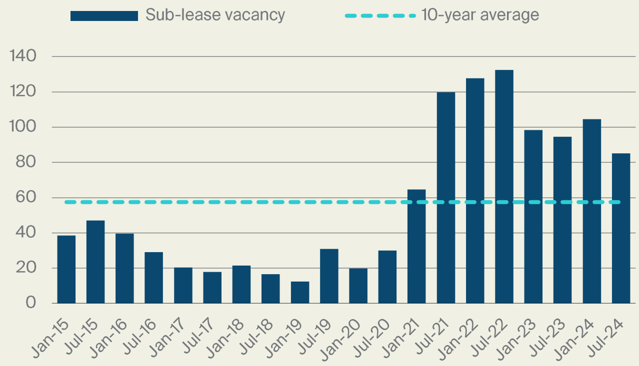
Given the uncertainty concerning the economy it is unsurprising to see little change in our development pipeline. This year's 69,000 sqm is well below the 10-year average of 142,000 sqm and whilst next years is above that (156,150 sqm), 800 Collins St has already been fully let to the Department of Defence. 2026 totals 131,000 sqm, meanwhile, all that has appeared for 2027 is a 56-storey tower at the State Library Exchange with 10,000 sqm of office in a mixed-use design. There are a plethora of other buildings in the offing for 2028+, but there is much uncertainty about which will get started in time. The most likely to be delivered is 600 Collins St where the site is cleared and ready to go.

Melbourne CBD vacancy rate
by grade, %



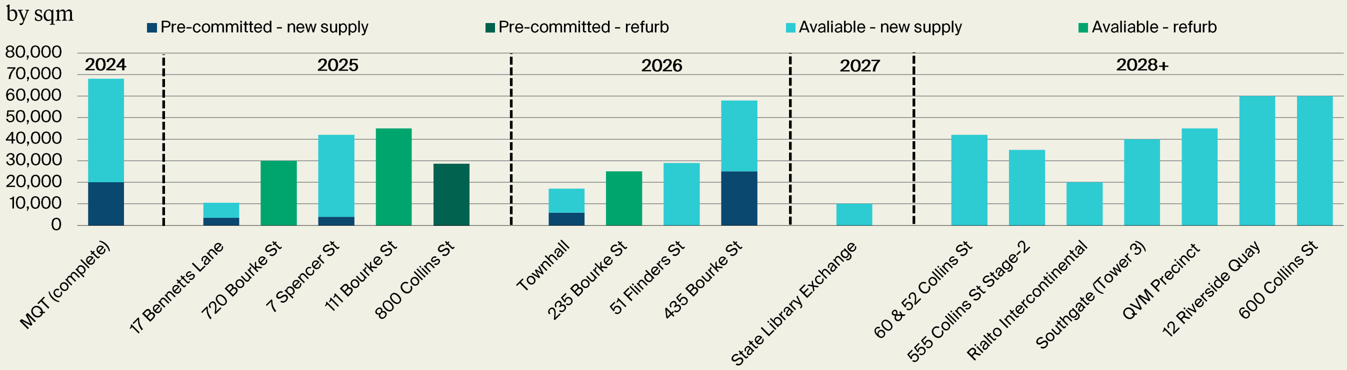
Source: Knight Frank Research, PCA

Melbourne CBD sub-lease vacancy
in 000's sqm



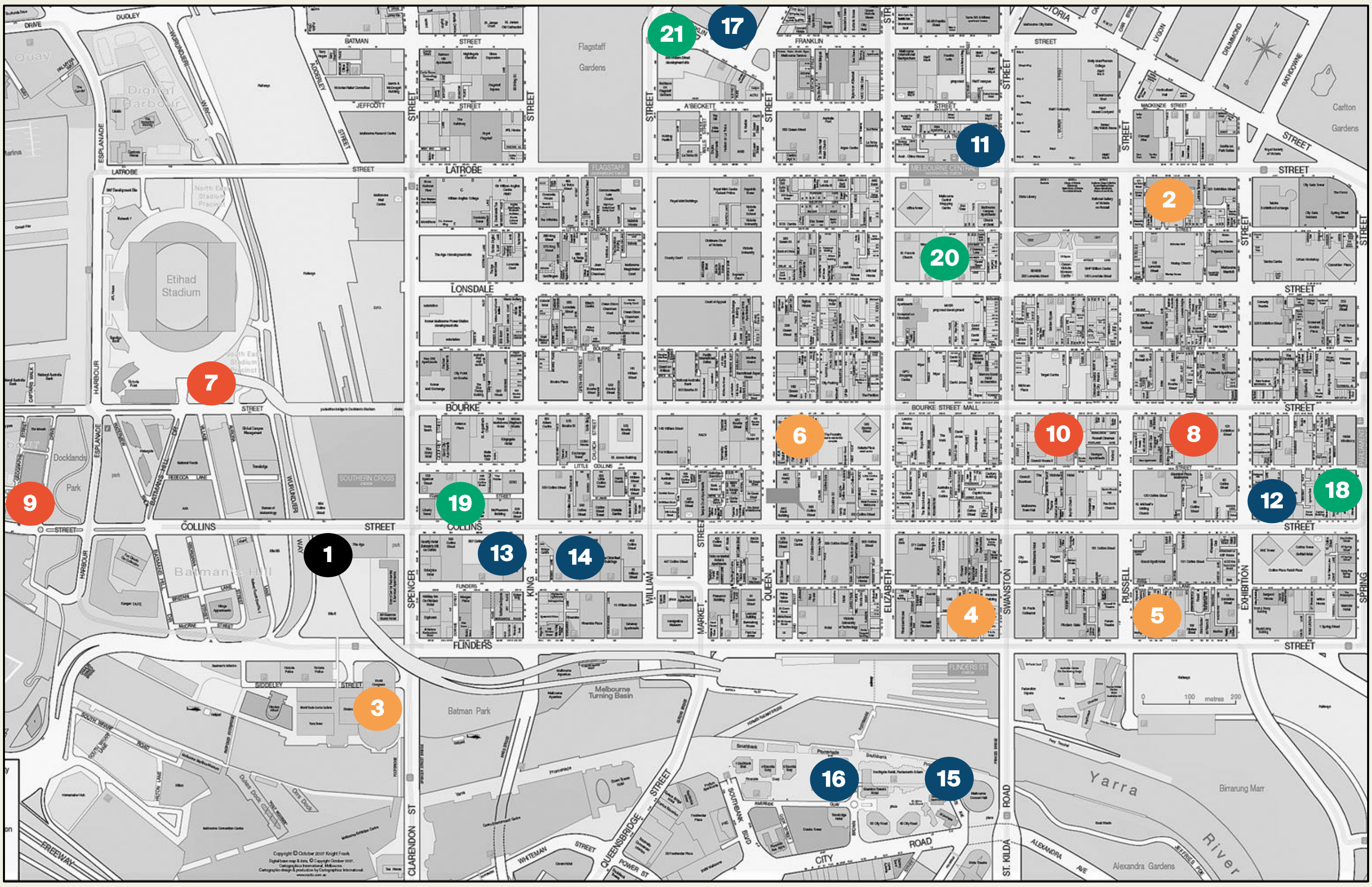
Source: Knight Frank Research, PCA

Development pipeline 2024+
by sqm



Source: Knight Frank Research

Major office supply



Recently completed

#	Address	SQM	Completion	Developer
1	Melbourne Quarter Tower	69,000	Complete	Lendlease

New developments (under construction)

#	Address	SQM	Completion	Developer
2	17 Bennetts Lane	10,500	H1 2025	Pellicano
3	7 Spencer Street	42,000	H2 2025	Mirvac
4	Melbourne Townhall	17,000	H1 2026	Lendlease
5	51 Flinders Street	29,000	H1 2026	GPT
6	435 Bourke Street	60,000	H2 2026	CBUS

Refurbishments

#	Address	SQM	Completion	Developer
7	720 Bourke Street	30,000	H2 2025	CBUS
8	111 Bourke Street	45,000	H2 2025	Charter Hall / Brookfield
9	800 Collins Street	28,650	H2 2025	Manulife
10	235 Bourke Street	25,000	H1 2026	Futuro

Development Approved

#	Address	SQM	Completion	Developer
11	State Library Exchange	10,000	H1 2027	Scape
12	60 & 52 Collins Street	42,000	H1 2028	Dexus
13	555 Collins Street (Stage 2)	35,000	H1 2028	Charter Hall
14	Rialto Intercontinental	20,000	H1 2028	Salter Brothers
15	Southgate Tower 3	40,000	H1 2028	ESR
16	12 Riverside Quay	60,000	H2 2028	Nice Future
17	QVM Precinct	45,000	H2 2028	Lendlease

Mooted

#	Address	SQM	Completion	Developer
18	85 Spring Street	10,000	2028+	Pelligra
19	600 Collins Street	60,000	2028+	Hines
20	300 Lonsdale Street	22,500	2028+	GPT
21	388 William Street	25,000	2028+	MIT Group Holdings

Rents / deals

FACE RENTS TICK UP…

Net face rents rose by 2.3% q/q (2.4% y/y) to $716/sqm. However, all this growth came in the Eastern Core as the long-reported flight to quality continued. At the same time prime incentives rose to 47.0% (from 46.0%). All precincts, including even the Eastern Core, are now averaging over 40%, though there is the odd tower below that. Flagstaff, the North Eastern Core and Docklands now average 50% or above, again with a few notable exceptions in top quality buildings. Secondary rents held flat at $537/sqm (-1.8% y/y). Having held steady for the last few quarters, secondary incentives jumped to 47.9% (from 45.8%).

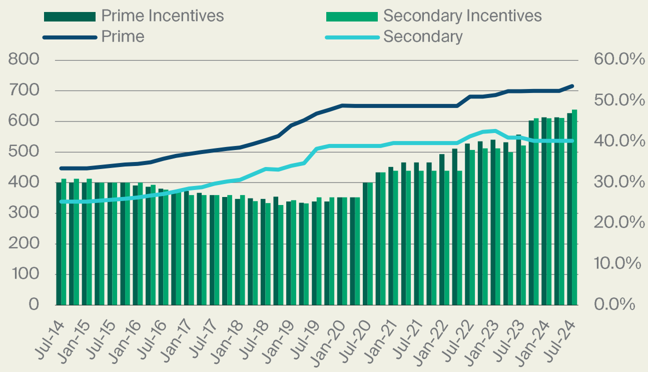
…AS EFFECTIVE RENTS FALL

The large increase in incentives throughout the year has meant that across the precincts effective rents have fallen. Even the 'Paris End' has shown a 0.2% decline with the Western Core 'only' falling 6.5%. However, the other precincts have fared worse. With no rental increase to speak of and marked increases in incentives in some precincts, effective rents have fallen by as much as 16.5% in the North Eastern Core. Overall, the basket for prime offices has seen a y/y fall of 8.3%, whilst secondary rents have fallen 15.8%.

QUALITY CONTINUES TO HOLD UP

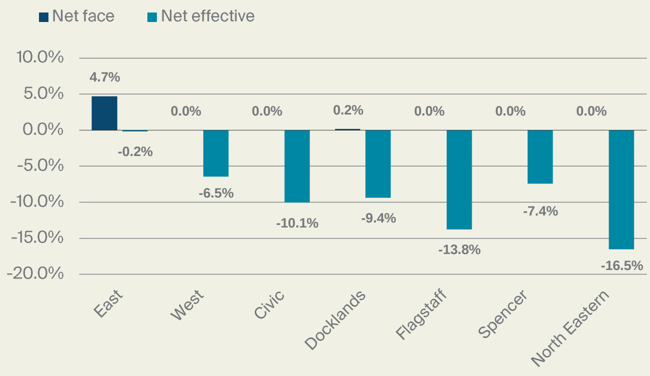
The attractiveness of quality locations and building offerings continues to be evident in the deals being done. The major deal of the quarter was Corrs who are moving from the Western Core to 120 Collins St in the East. They are taking 8 floors or ≈ 9000 sqm high up in the skyrise, signing a 10-year lease. Though the quarter was quieter for deals done, there are many in the offing, but with choice available, tenants are taking longer to agree terms and sign.

Melbourne CBD rents and incentives
by grade, net face rents $/sqm (LHS), and % (RHS)



Source: Knight Frank Research

Melbourne CBD rental growth y/y
by precinct and type



Source: Knight Frank Research

Recent significant tenant commitments

Occupier	Property	Precinct	Size sqm	Face Rent $/sqm	Incentive %	Term yrs	Start Date
Corrs Chambers Westgarth	120 Collins Street	Eastern Core	9,000	Conf.	Conf.	10.0	Dec-25
Lonsdale Chambers	140 William Street	Western Core	1,260	Conf.	Conf.	10.0	May-25
Victorian Building Authority	242 Exhibition Street	North Eastern	2,900	500	74.0	5.0	Dec-24
JLL	101 Collins Street	Eastern Core	3,660	Conf.	Conf.	Conf.	Jul-24
Holding Redlich	500 Bourke Street	Western Core	3,942	715	43.0	12.0	Jul-24

\# Pre-commitment ^ Sublease ~ Direct * Renewal (g) gross face
Source: Knight Frank Research

Docklands & Southbank Update

MQT COMPLETES IN THE DOCKLANDS

Vacancy rates jumped in the Docklands to 19.7%, as the MQT completed. The MQT continues to fill with Channel 7 confirming a move to two floors (4,300 sqm) in the tower, joining Medibank health insurers. It is expected that the Dockland's vacancy rate will drop back as more deals are signed. Going forward there is one more new development expected next year (7 Spencer St) which is already letting out. 800 Collins St is being refurbished and is already pre-let and 720 Bourke St, by the Marvel Stadium. is also being refurbished.

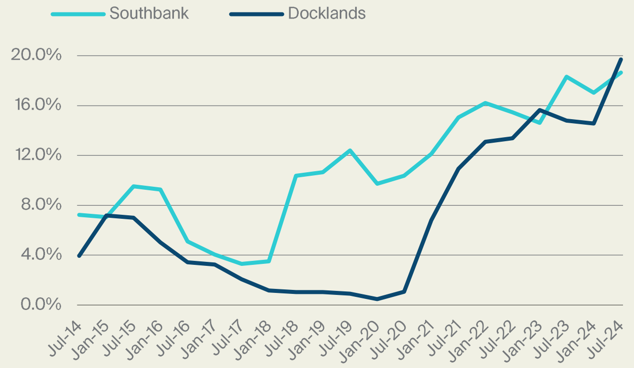
Net absorption was slightly negative in H1 2024 (-4,786 sqm) but in line with the rest of Melbourne, premium absorption was positive at 1,782 sqm. Face rents edged up (+$10 to $630/sqm) but a 1% increase in incentives means effective rents fell slightly (down $1 to $309/sqm). Overall, the market is appearing fairly balanced, particularly the area near the CBD and Southern Cross station.

SOUTHBANK NET ABSORPTION NEGATIVE

Southbank saw net absorption of -10,024 sqm in H1 2024. Despite a small number of withdrawals for residential conversion, this led to a rise in vacancy rates to 18.6%. The only development is 12 Riverside Quay (the old Esso House), which is slowly being demolished, though completion will almost certainly get pushed out from its 2028 target.

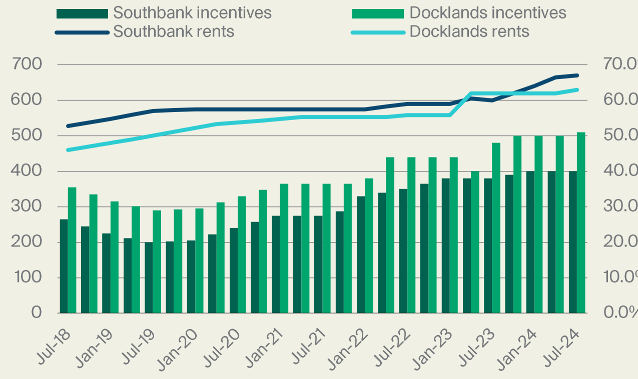
As with the Docklands, the market is quiet with quite a few leases being signed but most are smaller sizes. Face rents edged up here as well (+$5 to $670/sqm) and with incentives unchanged, this saw effective rents rise to $402/sqm. Both markets are needing a bit more life in the CBD overall to show more life in themselves.

Office vacancy rate
by locale, %



Source: Knight Frank Research, PCA

Prime rents and incentives
by locale, net face $/sqm (LHS), and % (RHS)



Source: Knight Frank Research

Recent significant tenant commitments

Occupier	Property	Precinct	Size sqm	Face Rent ($/sqm)	Incentive %	Term (yrs)	Start Date
Channel 7	MQT	Docklands	4,300	Conf.	Conf.	10.0	Nov-24
BASF Australia	40 City Road	Southbank	1,167	675	43.0	7.0	Sep-24
North Western Primary Health	737 Bourke Street	Docklands	2,080	540	48.0	6.0	Jul-24

Pre-commitment ^ Sublease ~ Direct * Renewal (g) gross face (c) circa
Source: Knight Frank Research

Investment

SALES TO RISE FROM WEAK 2023

As we pass the halfway point in the year it is clear that 2024 will have low investment volumes, but better than 2023. Volumes currently stand at $792m compared to $832m for the whole of last year. However, we are still some way off the multi-billion-dollar markets of yore. Ongoing economic and interest rate uncertainty are continuing to pause the investment market, with campaigns delayed/suspended and more time spent reviewing assumptions in DDs.

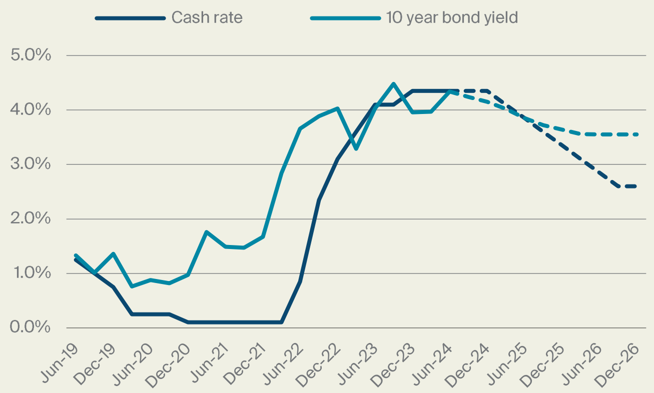
MAJOR DEALS OF H1 HIGHLIGHT YIELD SPREAD

Two deals stand out as a good example of the market. The grade A sale of 367 Collins St for $301m by Mirvac to PAG off a 7.0% yield and the sale of grade B building 628 Bourke St off an 8.2% yield by AFIAA to Bailey Stuart. The yield spread between prime and secondary is returning to the sector as uncertainty continues within the market. Prime yields were flat in the quarter and up only 14bps from the start of the year, indicating that the peak may have been reached. Meanwhile secondary yields continued to move out up 13bps on the quarter and 33bps this year. Since their lows in early 2022 prime yields have moved out 179bps, whilst secondary have seen a 243bps movement. A final deal of note was 200 Queen St which was purchased by its major tenant, Barristers Chambers Ltd, who exercised their first right of refusal to acquire and so not as reflective of market pricing.

PRIME CAPITAL VALUES STABILISING

Prime capital values were unchanged last quarter after a 22.7% decline since peaking in Q2 2022. Secondary values fell 1.6% and are down 33.4% from their peak. Price stability may have come to the prime market at least, it seems.

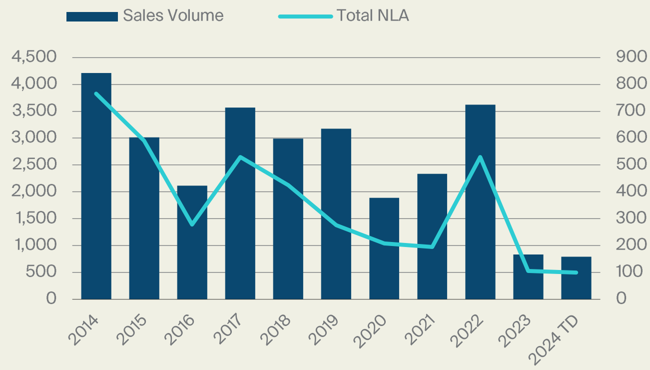
Interest rates expected to fall in 2025-26



Source: Knight Frank Research, Oxford Economics

Melbourne CBD office sales $10m+

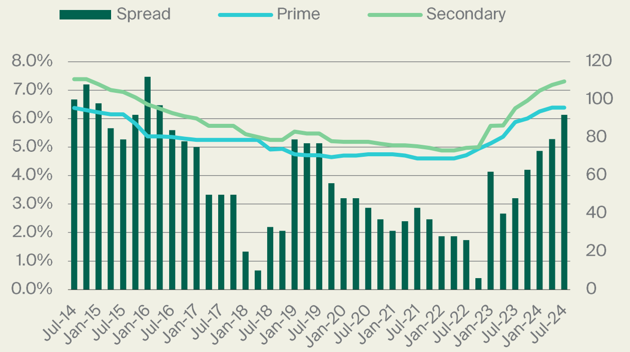
by volume in $M (LHS), and total NLA in 000's sqm (RHS)



Source: Knight Frank Research, RCA

Melbourne CBD office yields

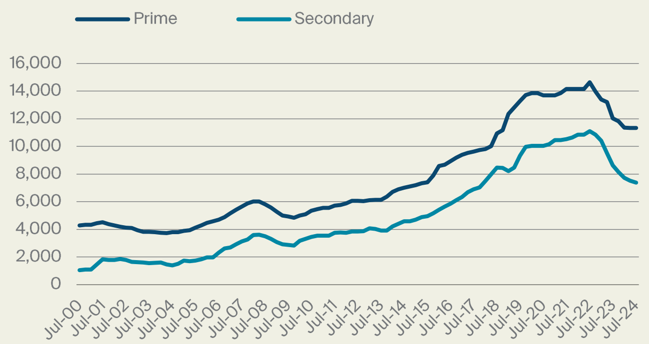
by grade % (LHS), and spread in bps (RHS)



Source: Knight Frank Research

Melbourne CBD capital values

by grade, $/sqm



Source: Knight Frank Research

Recent significant sales

Property	Interest	Price ($M)	Core Market Yield %	NLA sqm	$/sqm NLA	WALE	Purchaser	Vendor	Sale Date
200 Queen Street	100%	170.0	7.0	19,736	9,120	2.5	Barristers Chambers Ltd	Charter Hall	Jun-24
628 Bourke Street	100%	115.2	8.2	24,127	4,775	2.3	Bayley Stuart	AFIAA	Jun-24
367 Collins Street	100%	301.0	7.0	37,878	8,448	2.9	PAG	Mirvac	Jun-24

*Net sale price

Source: Knight Frank Research, RCA

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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