RESEARCH

MARCH 2012

MELBOURNE SUBURBAN

Office Market Overview

Knight Frank

678 Victoria Street, Richmond

HIGHLIGHTS

- A marked reduction in the construction of new office space during 2011 has generated an immediate lack of new supply in the Melbourne suburban office market. Only 32,232m² was added over the year, 16% down on 2010. The current vacancy rate in the suburban market is now 5.7%, which is in line with the rate recorded in mid 2011, but down from 7.6% in early 2010.
- Partially constrained by a lack of supply, annual net absorption was 40,290m² in the year to January 2012, down from 73,950m² in the year to July 2011. Despite leasing demand moderating in the second half of 2011, there were still a significant number of pre-lease deals confirmed throughout the year. The Outer East alone recorded five major pre-lease deals in 2011 that will see 25,600m² of office space delivered across five new buildings over 2012-2013. A patchy demand environment may be balanced by a lower quantum of supply in 2012.
- Investor activity experienced a lull in 2011 with just fourteen major sales totalling $120.9 million. There was just one sale greater than $20 million as owners of major assets were reticent to come to market with such volatility in business sentiment. Private investors and owner occupiers were the most prevalent purchaser type.

MELBOURNE SUBURBAN

Office Market Overview

Table 1

Melbourne Suburban Office Market Indicators January 2012

Market	Total Stock (sq m)	Vacancy Rate (%)	Annual Net Absorption (sq m)	Average Prime Net Face Rent ($/ sq m)	Average Secondary Net Face Rent ($/ sq m)	Average Prime Core Market Yield (%)	Average Secondary Core Market Yield (%)
City Fringe	1,017,670	5.6	8,119	320 - 340	240 - 280	8.00 - 8.75	8.75 - 9.25
Inner East	538,464	5.3	9,656	310 - 340	250 - 300	8.00 - 8.75	8.75 - 9.25
Outer East	738,118	6.4	17,451	260 - 295*	195 - 250	8.25 - 8.75	9.00 - 10.00
South East	265,067	5.0	5,064	205 - 250	160 - 230	8.50 - 9.00	9.50 - 10.50
Total Market / Average	**2,559,319**	**5.7**	**40,290**	**275 - 310**	**210 - 265**	**8.25 - 8.80**	**9.00 - 9.75**

Source: Knight Frank Research * Upper range reflects achieved pre-lease rents.

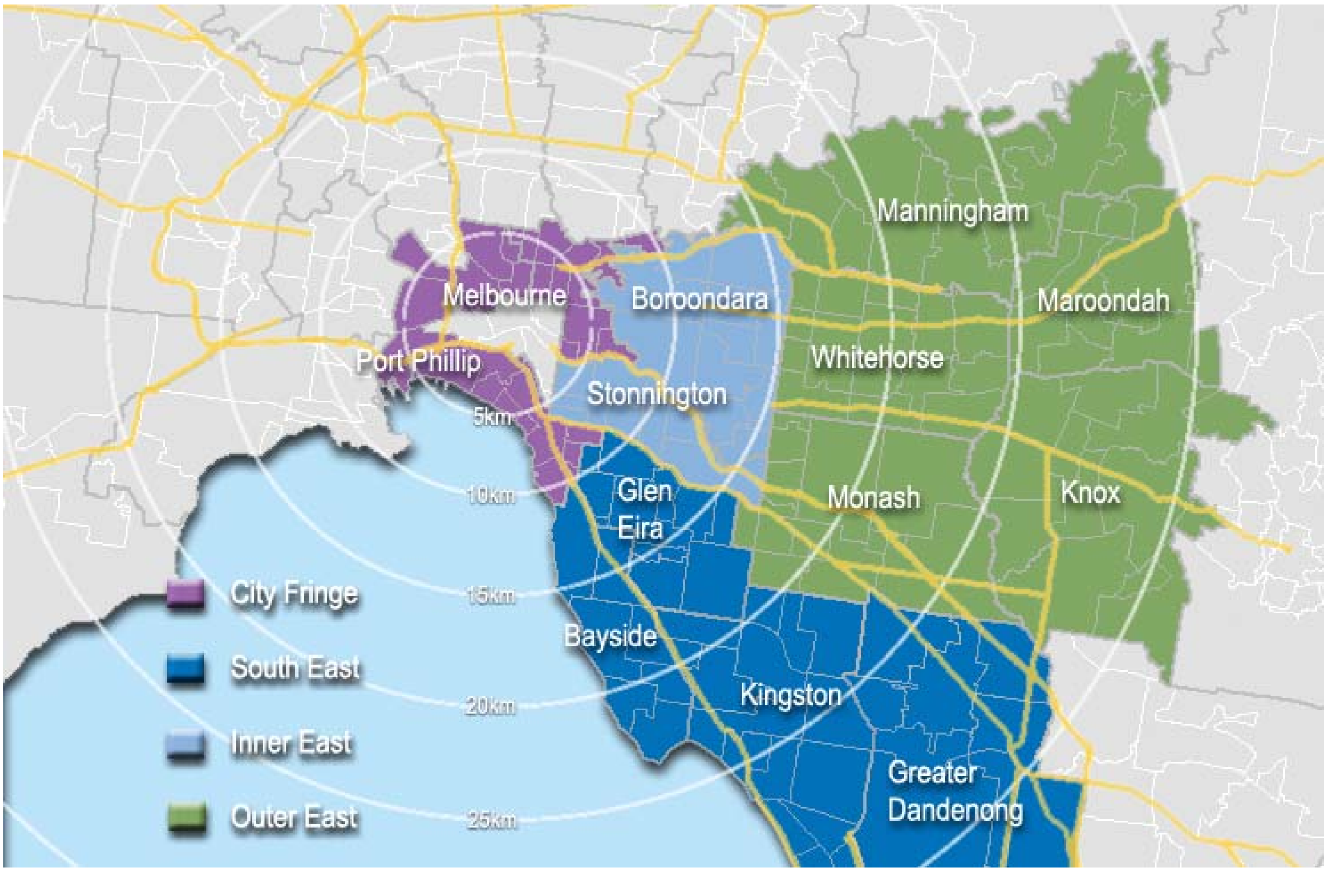
Definition: Grade: Prime includes office assets of A-grade quality whilst Secondary includes office assets of B, C & D quality grade

Core Market yield: The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc)

Net Absorption: The change in the volume of occupied stock.

Note: Data analysed as at January 2012

MELBOURNE SUBURBAN OFFICE REGIONS



Source: Knight Frank Research

CITY FRINGE

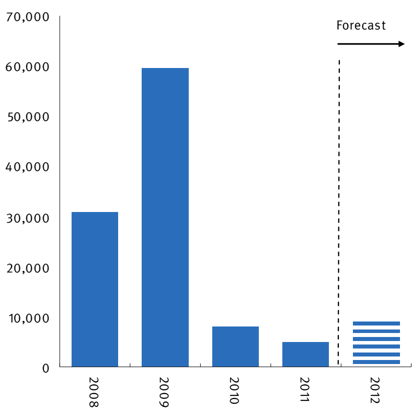
The City Fringe market accounts for 40% of the total Melbourne Suburban office space. This region covers suburbs surrounding the CBD, spanning from Port Melbourne to Richmond and Collingwood.

Development Activity

New development in the City Fringe contributed just 5,000m² of new office space to the market in 2011. This marks the bottom of the supply cycle and is the smallest annual increase in over a decade. This trend towards lower construction levels reflects the focus developers have had on advancing residential projects in the Fringe while stalling commercial development until conditions are more conducive.

With the exception of 1,100m² at 49-61 Coppin St, Richmond (Mixed use), the market has been devoid of speculative development. With a glut of new residential projects and tight office vacancies, developers are likely to revisit plans to deliver some of the 61,000m² of office space mooted for the Fringe.

Figure 1
City Fringe Major New Office Supply
2008-2012 (space › 5000m²)



Source: Knight Frank Research

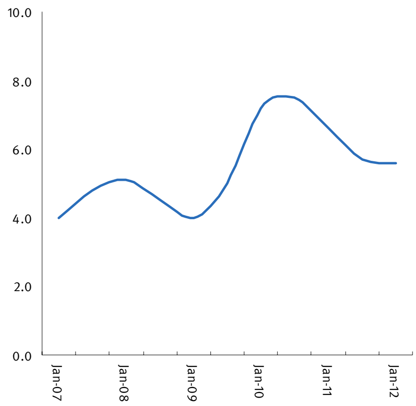
Vacancy & Tenant Demand

Vacancy in the City Fringe office market has been in decline since the beginning of 2010 as sustained demand and little new supply was added. The total amount of vacant space at January 2012 was 56,533m² or 5.6% of total stock. Within the fringe, Richmond tightened from 8.2% in July 2011 to 6.2% in January 2012, largely impacted by carsales.com.au new occupancy of 5,124m² at 449 Punt Rd. Carlton remains tight with just 2.9% of vacant office space available. The only significant suburb in the fringe to experience a rise was South Melbourne which rose from 9.7% in July 2011 to 11.2% in January 2012.

Net absorption over the twelve months to January 2012 was 8,119m², down on the long term average. Despite a softening in demand, vacancies remain tight which is generating a relatively competitive leasing environment. This is compounded by diminishing options for tenants seeking large contiguous space. Indicating demand for fitted space, there has been evidence of deals being finalised while a sitting tenant is still in place.

Prime net face rents in the City Fringe experienced a rise of 3.1%; broadly in line with the CPI recorded for 2011. Growth in Secondary net face rents was more subdued; rising by 2.0% over the same period.

Figure 2
City Fringe Office Vacancy
2007-2012 (%)



Source: Knight Frank Research

Investment & Yields

Emphasising the lull in transactional activity in the greater suburban market in H2 2011, the City Fringe, typically a highly sought after sub market, experienced a marked drop in sales volume. There were just three major sales totalling $23.0 million in 2011.

Table 2
Major office leasing activity City Fringe

Address	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Tenant	Date
449 Punt Road, Richmond	5,124	325n	8	carsales.com.au	Q3-11
Levels 2 & 3, 102 Albert Road, South Melbourne	2,183	240n	5	NLC	Q1-12
187 Todd Road, Port Melbourne	2,149	235n	5	Don KRC	Q4-11
31-49 Eastern Road, South Melbourne	1,567	319g	5	Carprice	Q2-11

Table 3
Major office sales › $5mill City Fringe

Address	Sale Date	Price ($ mill.)	Initial Yield (%)	NLA (m²)	Rate ($/m²)
17 Market Street, South Melbourne	Apr-11	8.95	8.90*	2,596	3,448
Building 5, 658 Church Street, Richmond	Apr-11	8.055	5.54^	2,245	3,588

* Core market Yield ^ Reflects vacancy at the time of sale g gross face rent n net face rent
Source: Knight Frank Research

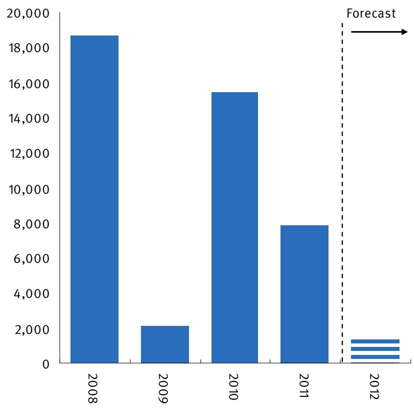
INNER EAST

The Inner Eastern region includes suburbs such as Camberwell, Hawthorn, Kew, Malvern and South Yarra. The Inner East forms 21% of the total suburban market.

Development Activity

Over the past two years, the Inner East office market has been the focal point for development within the suburban market, with 23,233m² of new office space delivered. The next phase of construction in the region has been muted by a combination of funding constraints on new projects and the change of use of a number of developments to residential. This lull in construction has meant just 1,600m² (Elizabeth St, Hawthorn) will be completed in 2012. Several office development sites in Hawthorn have recently seen proposals revisited; suggesting the announcement of further development in the sub-market could be imminent.

Figure 3
Inner East Major New Office Supply
2008-2012 (Space › 5000m²)



Source: Knight Frank Research

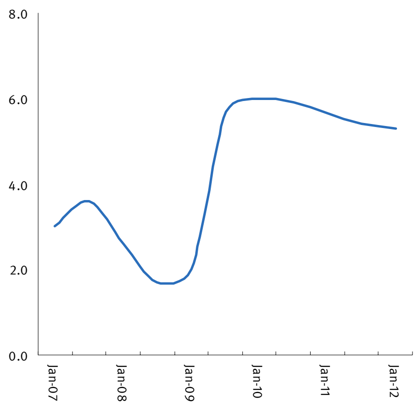
THE INNER EAST VACANCY RATE REMAINS TIGHT

Vacancy & Tenant Demand

Withdrawn stock had a modest impact on vacancy in the Inner East over 2011, as office buildings made way for new residential developments. Total office vacancy fell from 5.4% to 5.3% in the six months to January 2012. Hawthorn/Hawthorn East remain the largest office precincts in the Inner East market and maintain a low vacancy of 2.8%. Tight vacancy and dwindling options for larger tenants have driven face rental levels in the Inner East to experience an uplift of 3.2% for prime and 5.8% for secondary over 2011.

Despite a tempering in leasing activity across the suburban market in the second half of 2011; the Inner East experienced positive absorption of 9,656m² during 2011. There has been some relocation of operations to the Inner East by tenants that currently occupy buildings in the Outer East. The most notable of these were Skilled Group's take up of 5,661m² at 292 Burwood Rd, Hawthorn and API/Priceline will relocate from Bayswater to backfill 4,981m² of space at 250 Camberwell Rd, Camberwell upon Pearson's move to the Docklands this year. Similarly, Fusion Retail Brands (the new owner of the Colorado Group), secured 3,330m² of existing fitted space at 109 Burwood Rd, Hawthorn, backfilling the previous headquarters of carsales.com.au who have relocated their operations to the City Fringe. This deal also provides some indication of how highly sought after large fitted areas of office accommodation are in the Inner East.

Figure 4
Inner East Office Vacancy
2007-2012 (%)



Source: Knight Frank Research

Investment & Yields

Sales activity in the Inner East was consistent with the broader suburban market in 2011, recording just three major sales totalling $38.75mill. The largest transaction occurred at the recently developed 117 Camberwell Rd, Camberwell when owner occupiers (Victorian Teachers Credit Union) acquired the property for $26.0 million.

Table 4
Major office leasing activity Inner East

Address	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Tenant	Date
250 Camberwell Road, Camberwell	4,981	335n	10	API (Priceline)	Q4-12#
292 Burwood Road, Hawthorn	5,661	310n	10	Skilled Group	Q4-11
Level 3, 293 Camberwell Road, Camberwell	2,000	300n	7.2	Wright Express	Q3-11

Table 5
Major office sales › $5mill Inner East

Address	Sale Date	Price ($ mill.)	Initial Yield (%)	NLA (m²)	Rate ($/m²)
117 Camberwell Rd, Camberwell	Aug-11	26.00	VP	5,265	4,938
15-17 Shierlaw Ave, Canterbury	Mar-11	8.00	8.50*	2,361	3,388

* Core market Yield VP Vacant Possession n net face rent # committed to the ex Pearson space
Source: Knight Frank Research

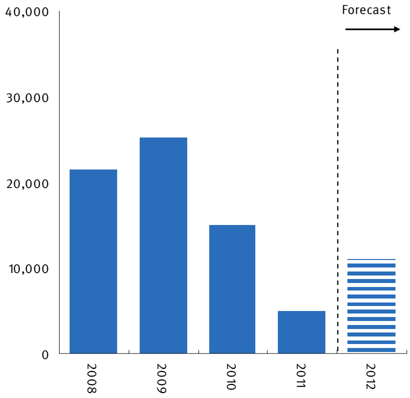
OUTER EAST

The Outer Eastern region forms 29% of all Suburban office stock and includes suburbs such as Box Hill, Mt Waverley and Mulgrave.

Development Activity

The Outer East remains the most affordable destination within relative proximity to the CBD in the entire metropolitan office market. Therefore pre-committing to a new office development presents an attractive prospect for tenants with lease expiries or consolidation plans; particularly given the lack of large contiguous floor space.

Figure 5
Outer East Major New Office Supply
2008-2012 (Space › 5000m²)



Source: Knight Frank Research

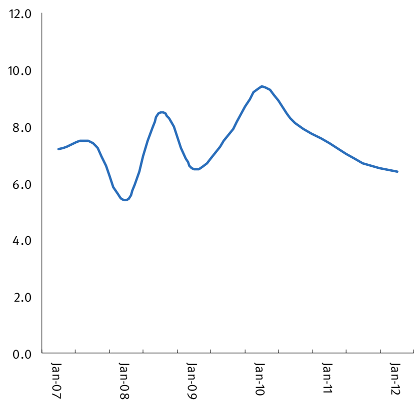
Unsurprisingly, pre-lease levels were significantly up in 2011 when compared to the previous year with five new developments securing leasing commitments, with two of these having commenced construction and will deliver 11,000m² of new A-grade office space over 2012. Both buildings will be located in Salta's Nexus Corporate Park and already have been 71% pre-leased (Carlisle Homes & Bristol Myers Squibb). Beyond 2012, other pre-lease deals include; Schneider Electric and Olympus have pre committed to new buildings at Goodman's Ferntree Business Park, Notting Hill, ADP will move to Nexus Park, whilst early this year, Grocon announced that the ATO would relocate to their 19000m² Box Hill development at 913 Whitehorse Road by around mid/late 2014.

Vacancy & Tenant Demand

With little new supply and a modest level of take up, office vacancy in the Outer East sub-market has been contracting since its peak in H2 2009. Over the six months to January 2012 this tightening moderated, resulting in a current vacancy rate of 6.4%, down from 6.7% recorded at the mid point of 2011. Demand for office space has been driven by tenants with lease expiries who are typically choosing to accommodate a small level of expansion space or consolidate operations in new premises through pre-lease arrangements. Though a significant amount of the markets active requirements were fulfilled over 2011, there are still several tenants such as Tru Energy (6,000m²) and Greencap (1,500m²) seeking office space.

The prelease market in the Outer East has placed upward pressure on the prime net face rent levels, however existing space has only seen a marginal increase of 0.9% over 2011. Secondary net face rents rose 1.1%.

Figure 6
Outer East Office Vacancy
2007-2012 (%)



Source: Knight Frank Research

Investment & Yields

With seven sales totalling $45.2 million, the Outer East had the greatest number of transactions in 2011; however this remains subdued when compared historically.

Table 6
Major office leasing activity Outer East

Address	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Tenant	Date
310 Ferntree Gully Rd, Notting Hill~	5,865	298n	10	Schneider Electric~	Q2-13
310 Ferntree Gully Rd, Notting Hill~	4,000	295n	10	Olympus~	Q2-13
1 Nexus Court, Mulgrave~	4,200	295n	10	Carlisle Homes~	Q3-12
35 & 37 Dunlop Road, Mulgrave	3,613	270n	10	Adidas	Q1-13
3 Nexus Court, Mulgrave~	3,600	295n	10	Bristol Myers Squibb~	Q3-12
5 Nexus Court, Mulgrave~	5,000	295n	10	ADP~	Q2-13
31-41 Joseph Street, Blackburn	3,000	155n	10	Arlec Australia	Q3-11
382 Wellington Road, Mulgrave	2,100	195n	10	John Sands Australia	Q3-11
13-15 Compark Circuit, Mulgrave	1,500	200n	7	PZ Cussons	Q3-11

Table 7
Major office sales › $5mill Outer East

Address	Sale Date	Price ($ mill.)	Initial Yield (%)	NLA (m²)	Rate ($/m²)
601 Doncaster Road, Doncaster	Oct-11	5.80	8.19	1,695	3,422
22-28 Compark Circuit, Mulgrave	Jul-11	6.40	4.17^	1,997	3,205
18-20 Prospect Street, Box Hill	Jun-11	8.10	8.30*	2,426	3,339
599 Doncaster Road, Doncaster	May-11	5.55	8.60*	1,663	3,339

*Core market Yield ^ Reflects vacancy in the building – sold to owner occupier who will partly occupy
~ Pre-lease n net face rent
Source: Knight Frank Research

SOUTH EAST

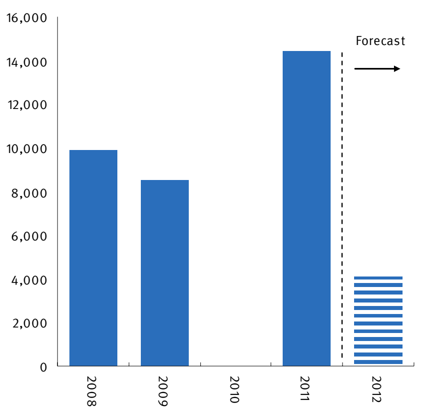
The South Eastern region comprises 265,067m² of office stock and accounts for approximately 10% of Melbourne's Suburban office stock. The South East includes the suburbs of Cheltenham, Moorabbin and Dandenong amongst others.

Development Activity

With the completion of Grocon's new Government Services building in Dandenong, the South Eastern region added a total of 14,000m² in 2011. This is the largest stock addition within any sub market and provides some indication of what has been driving new development in the South East.

Major new office development has been focused on the commercial hub within the re-emerging Dandenong precinct; an area that has been a focus for the State Government as part of the continued "Revitalisation of Dandenong" project. An additional two sites offered by Places Victoria nearby to Grocon's new development will support the expansion of the office component of this project.

Figure 7
South East Office Vacancy
2008-2012 (%)



Source: Knight Frank Research

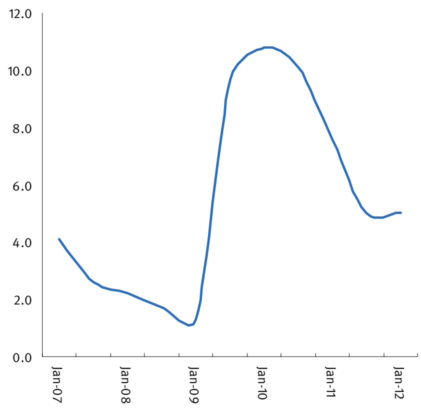
Vacancy & Tenant Demand

Despite adding the most significant amount of new stock of any suburban sub-market in 2011, the vacancy rate in the South East remained flat at 5.0% over the six months to January 2012.

A small level of tenant demand exists within the region; however a lack of large contiguous floor space has pushed some prospective tenants towards the Outer East, where a broader range of accommodation is more readily available. South East Water, the regions largest active tenant is seeking 10,000m² of office space, however there are currently no existing premises that can accommodate such a requirement, suggesting that a pre-lease to a new building is the most likely outcome.

With low levels of leasing activity in the South East, net face rents in the region were relatively stable over 2011. The pre-lease of Grocon's development in Dandenong to the State Government established a second rental tier in prime rents when $350/m² was achieved. Typically, prime rents are in the range of $205-$250/m², which represents no growth over the course of 2011. This is partly a result of a lack of leasing evidence to suggest any notable uplift took place over the period. Secondary rents lifted 5.0% over the year and now range between $160-$230/m². With very few prime options, secondary office stock has provided tenants with the greater choice when seeking new accommodation. Incentives have been static throughout 2011.

Figure 8
South East Office Vacancy
2007-2012 (%)



Source: Knight Frank Research

Investment & Yields

There has been a major lack of investment opportunities in the South East over the past year, resulting in just one transaction of $14.0 million when Forza Capital acquired 294 Bay Rd, Cheltenham. With little transactional evidence it hasn't been possible to ascertain whether any movement in yields has occurred over 2011. Currently prime yields average between 8.50 – 9.00% while secondary average between 9.50 – 10.50%.

Table 8
Major office leasing activity South East

Address	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Tenant	Date
51 Princes Highway, Dandenong	1,116	220n	3	Connections Uniting Care	Q4-11
Cnr Thomas & Walker Street, Dandenong	14,399	350n	20	State Government	Q4-11
311 Lonsdale Street, Dandenong	1,626	250n	3	Chisholm TAFE	Q3-11

Table 9
Major office sales › $5mill South East

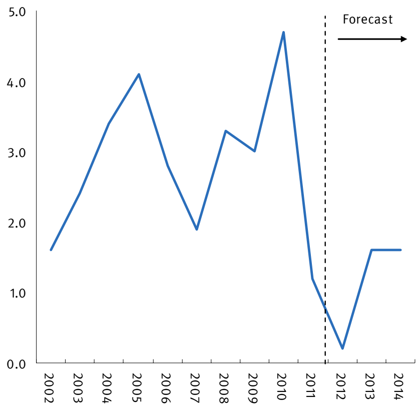
Address	Sale Date	Price ($ mill.)	Initial Yield (%)	NLA (m²)	Rate ($/m²)
294 Bay Road, Cheltenham	Jan-11	14.00	8.82*	4,772	3,015

* Core market Yield n net face rent
Source: Knight Frank Research

OUTLOOK

Market conditions softened in the second half of 2011 as sentiment waned in the face of persisting uncertainty brought about by sovereign debt issues out of Europe, resulting in white collar employment growth stalling through H2 2011. However, in what seems to be counter-intuitive, there has been a significant increase in larger deals (particularly in the Outer East) which involved corporate groups consolidating, taking on expansion space and/or premises upgrade which was counter to the broadly more cautious/negative business sentiment. Looking ahead, Deloitte Access Economics forecasts white collar employment in Suburban Melbourne to experience relatively flat growth in 2012, before rebounding to 1.4% in 2013, driven by the construction and wholesale trade sectors.

Figure 9
Suburban White Collar Employment
2002-2014 (%)



Source: Deloitte Access Economics

This will undoubtedly have a negative impact on the demand side of the equilibrium equation. However, what may balance the market is the lack of new supply; brought about by scarcity in funding. New office supply in the suburban market has been in decline for the last three years and 2012 should see this trend continue with just 26,434m² of office space forecast to be completed. Over the next two years, the Outer East will have the lion's share of new developments with over 25,600m² confirmed through pre-lease deals done across five new buildings within both Goodman Group's, Ferntree Business Park and Salta's Nexus Corporate Park. The Inner East and City Fringe will contribute just 1,600m² and 9,300m² respectively to the stock base in 2012; however Knight Frank is tracking approximately 75,600m² across both sub regions that could advance to market over the coming two years. The South East has just 4,121m² slated for completion over the coming twelve months, while an additional 15,000m² could be delivered in 2014/15 should the ATO move forward with their current requirement that is in the market, with Grocon and Cbus front runners to secure a pre-commitment.

Despite a dampened demand environment, vacancy should continue to steadily decline as absorption remains positive in 2012; albeit at greatly reduced levels. Throughout 2011, a significant number of the active requirements that were present in the market were absorbed. Remaining requirements such as South East Water (10,000m²), TRUenergy (6,000m²), Cardno (4,000m), Navitas (2,500m²) and Greencap (1,500m²) will drive a moderate level of demand across the suburban market in 2012; supporting the view that a stable vacancy rate is likely.

There is strong tenant demand for quality fitted space that is often pursued vigorously. It is anticipated that tenant renewals will be common in the tightly held Inner East and City Fringe, while office consolidation and pre-leases will remain prevalent in the Outer East as developers attract tenants to new buildings with competitive rents. The South East is expected to feel the greatest impact of ongoing market cautiousness, with small businesses not expected to grow significantly in the short term. Lack of large quality accommodation for major tenants may see some demand transference to other regions.

Average net face rents across the entire suburban market should continue to see a marginal uplift in face rents, while incentives remain relatively static in the Outer and South East markets. A lack of stock is likely to see incentives tighten within the Inner East and City Fringe. Pre lease deals; particularly in the Outer East should create upward pressure on the prime face rental range.

117 Camberwell Road, Camberwell was sold to an owner occupier (VTCU) for $26.0 million. This was the only sale › $20.0 mill in 2011

Investor activity across the entire suburban market was notably subdued over 2011 with just $120.9 million exchanged on fourteen properties. Investment demand going forward is expected to be swayed somewhat by market caution; however there are some expectations for a greater number of buying opportunities, as owners who have previously been under little pressure to sell from financial institutions re-consider offloading assets. Yields should remain relatively stable over the coming year.

Schneider Electrics commitment (5,865m²) to Goodman's Ferntree Business Park is one of five pre lease deals (totalling 25,600m²) confirmed in the Outer East during 2011.

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