RESEARCH

MAY 2010

MELBOURNE METROPOLITAN

Office Market Overview

Knight Frank

HIGHLIGHTS

- After record levels of new supply delivered to the Melbourne metropolitan office market in 2009, only 32,100 sq m is forecast to be completed in 2010 – the lowest annual total in the past 10 years.

- Total vacancy within the metropolitan office market appears to have peaked in the short term, having fallen to 7.6% from 7.9% six months prior. All regions with the exception of the City Fringe recorded falls in vacancy.

- With the Victorian and national economies proving to be resilient, leasing demand in the suburbs has been robust with 47,600 sq m absorbed in the second half of 2009 as business confidence grew over the year. Tenant enquiry has picked up noticeably in Q1 2010, which bodes well for the market.

- Investment activity in Melbourne's metropolitan office market was significantly higher than 2008 levels with private investors dominating the purchaser profile however owner-occupiers have become active in the market again.

Melbourne Metropolitan Office Market

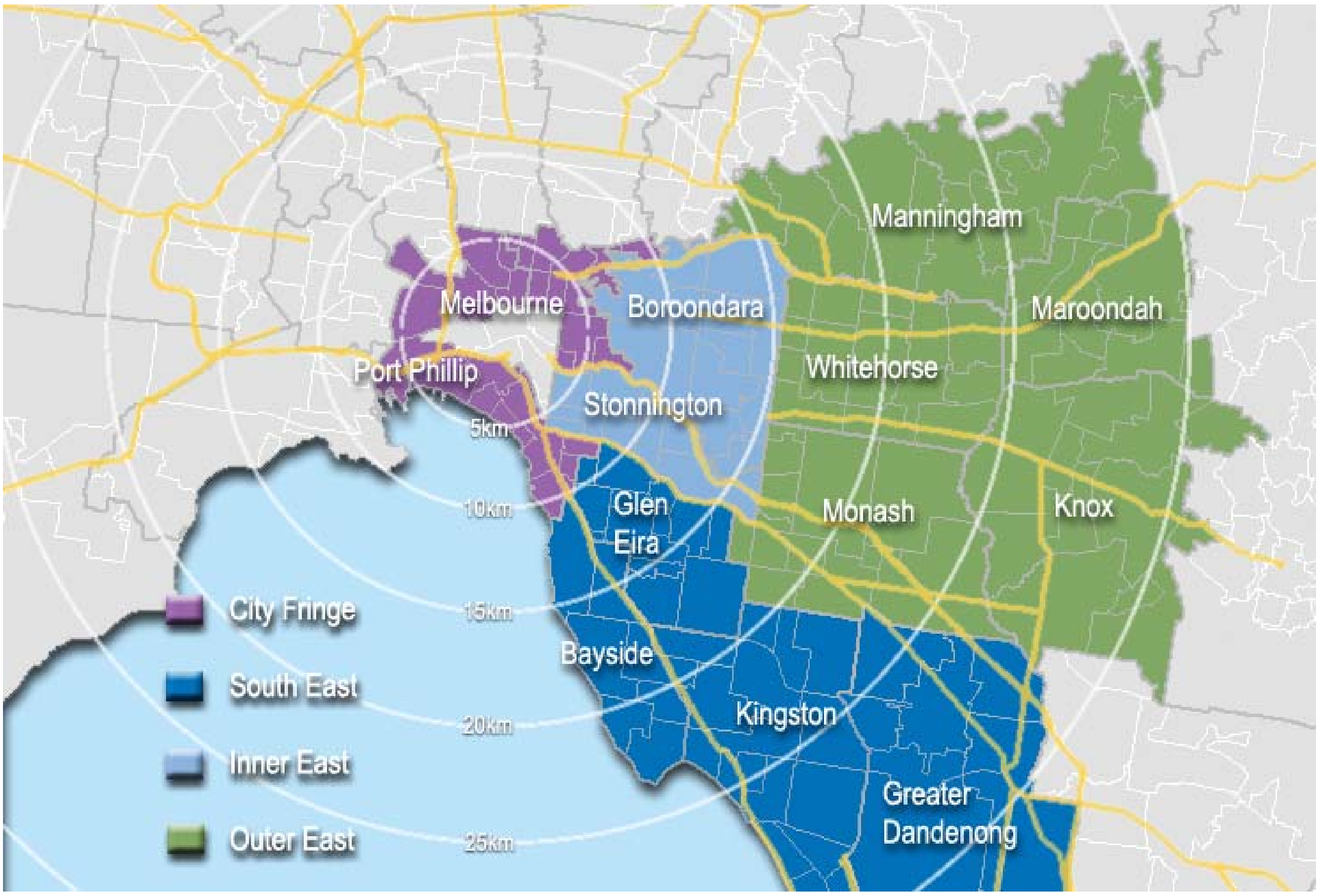
Table 1
Melbourne Metropolitan Office Market Indicators April 2010

Market	Total Stock (sq m)	Vacancy Rate (%)	Six Month 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	999,158	7.5	16,020	275 - 315	230 - 250	8.50 - 9.50	9.50 - 10.50
Inner East	514,381	5.9	530	280 - 320	200 - 240	8.25 - 9.25	9.50 - 10.50
Outer East	673,591	8.1	22,051	230 - 250	190 - 220	8.25 - 9.25	10.00 - 11.00
South East	242,093	10.1	9,098	200 - 230	160 - 200	9.00 - 10.25	10.50 - 11.50
Total Market / Average	**2,429,223**	**7.6**	**47,699**	**240 - 300**	**190- 225**	**8.50 - 9.75**	**9.75 - 10.75**

Source: Knight Frank Research

Definition: Grade: Prime includes office assets of A 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.

MELBOURNE METROPOLITAN OFFICE REGIONS



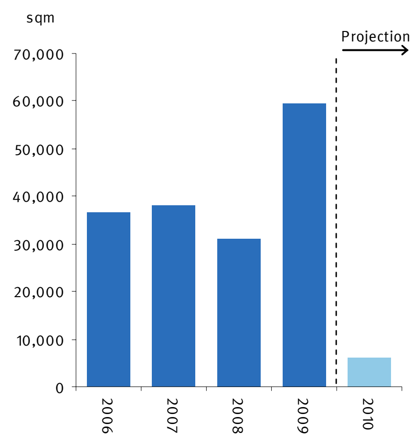
CITY FRINGE

The City Fringe region accounts for close to 40% of all Melbourne metropolitan office space. The City Fringe covers Collingwood, Port Melbourne and North Melbourne amongst other suburbs surrounding the CBD and is dominated by the office hubs of Richmond and East Melbourne.

Development Activity

Office space in the City Fringe region is quickly nearing one million square metres on the back of a surge in speculatively developed projects, making it larger than both the St Kilda Road and Southbank office precincts. Almost 60,000 sq m of new office space was completed within the City Fringe in 2009, the highest level delivered in the precinct in the past 10 years. As a result of tighter lending conditions, a mere 6,100 sq m is expected to be completed within the City Fringe in 2010 – its lowest level in nine years.

Figure 1
City Fringe New Office Supply
2006-2010



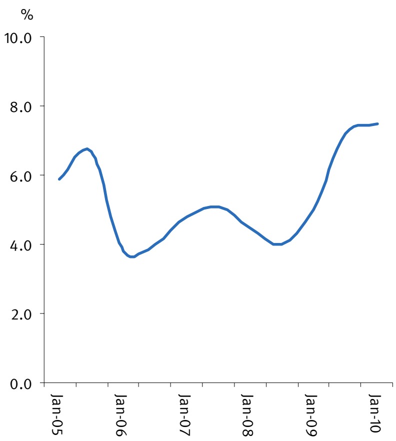
Source: Knight Frank Research

Recent completions in the region include Drapac's 7,500 sq m development at 200 Victoria Street, Carlton and the speculatively developed office building at 449 Punt Road, Cremorne/Richmond comprising 7,000 sq m. Projects expected to be completed this year include Grocon's new carbon neutral office building – Pixel, at The Brewery in Carlton and Mitchell Communications Group's headquarters at 101 York Street, South Melbourne.

Vacancy & Tenant Demand

As at January 2010, total office vacancy in the City Fringe office precinct continued its recent rise to 7.5% from 7.2% in July. This increase in vacancy largely resulted from the completion of several buildings in the final half of 2009. Although vacancy rose, it is expected to have peaked in the short term in the absence of any significant speculative development currently under construction.

Figure 2
City Fringe Office Vacancy
2005-2010



Source: Knight Frank Research

In line with improving economic conditions and growing business confidence – tenant demand gained momentum in the final half of 2009. In the final six months of 2009, the City Fringe recorded 16,020 sq m net absorption, driven by tenants moving into recently completed stock. Net absorption is expected to continue to rise back to historical levels over the next 12 months with business investment forecast to increase. Major leasing activity in the region includes Golder Associates' commitment to 582 Swan Street, Richmond and Delaware North's commitment to 630 Church Street, Richmond. In addition, GlaxoSmithKline, Ingram Micro and Mercy Health are all expected to relocate into the City Fringe office precinct over the next six months. Rental levels eased marginally in the City Fringe as landlords of speculatively developed stock competitively attempt to secure tenants. As at April 2010, prime net face rents in the City Fringe range between $275/sq m and $315/sq mwith incentives ranging between 14% and 18%.

Sales Activity

Investment sales activity (above $2 million) within the City Fringe office market over 2009 more than doubled 2008 levels as investor confidence rose. Office sales over $2 million totalled $196.35 million from 12 transactions with owner occupiers accounting for 29% of all purchases. Major sales concluded over 2009 included: 395-405 Royal Parade, Parkville ($57.6 million), 100 Leicester Street, Carlton ($29.8 million) and 289 Wellington Parade South, East Melbourne ($27 million). As at April 2010, recent transactions indicate that average core market yields for City Fringe prime offices have stabilised since mid 2009 and range between 8.50% and 9.50%. Secondary yields for office stock in the City Fringe range between 9.50% and 10.50%.

289 Wellington Parade South, East Melbourne sold for $27.0 million on a core market yield of 8.17%.

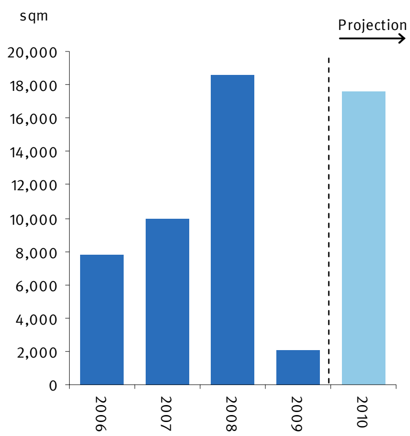
INNER EAST

The Inner Eastern region includes such suburbs as Camberwell, Hawthorn, Kew, Malvern and South Yarra.

Development Activity

After a record year of new supply completed in the Inner East in 2008, last year witnessed the completion of only one development in the precinct and its lowest annual level in terms of new supply in the past 10 years. Yet in 2010, more than 17,600 sq m is forecast to be completed across four new developments. Major office projects already completed in 2010 include; 115-133 Cotham Road, Kew (6,300 sq m), 108 Power Street, Hawthorn East (4,500 sq m) and 21 Shierlaw Avenue in Canterbury (1,500 sq m).

Figure 3
Inner East New Office Supply
2006-2010



Source: Knight Frank Research

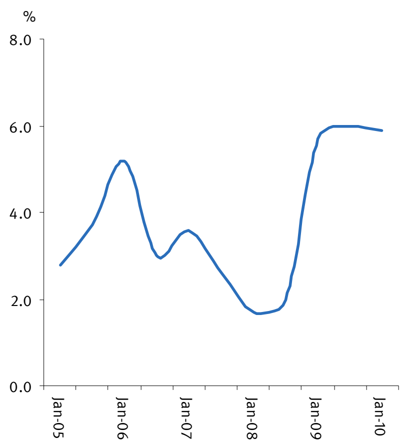
A further 9,000 sq m is currently under construction scheduled for completion in 2011. Beyond the projects underway, the deterioration in the lending environment coupled with an easing of yields led to a number of scheduled developments in the Inner East being shelved. The next building cycle is unlikely to begin prior to 2012 or until strong rental growth filters through.

Vacancy & Tenant Demand

As at January 2010, total office vacancy within the Inner Eastern precinct was 5.9% down slightly from 6.0% in July 2009. Although minimal supply came on line in 2009, total vacancy within the Inner East did not fall largely as a result of backfill space created following the relocations of Golder Associates and OAMPS into the City Fringe. With demand picking up, evidenced by a number of deals being signed at the new 108 Power Street development, vacancy in the Inner East is anticipated to only briefly remain higher than its 10-year average of 4.5%. Despite several tenant relocations into the City Fringe, the Inner East remains a much sought after location for tenants with amenity such as prestigious schools, prime retail strips and strong public transport supporting the area.

By quality grade, A-grade and B-grade office vacancies fell to 6.2% and 6.3% respectively, while C-grade office vacancy rose to 6.1% as at January 2010. Within the Inner East, Camberwell's vacancy remains tight at 2.2% while Hawthorn East's vacancy fell to 6.4%.

Figure 4
Inner East Office Vacancy
2005-2010



Source: Knight Frank Research

In the six months to January 2010 net absorption for the Inner East was a mere 530 sq m, compared to its historical half year average of around 10,000 sq. Although there has only been a handful of leasing deals above 1,000 sq m in the past 12 months, contiguous options for tenants remain scarce which has placed a cap on net absorption levels. Prime net face rents in the Inner East have risen marginally over 2009 and now range between $280/sq m and $320/sq m. Incentives range between 14% and 18%, but are likely to have peaked in the short term.

Sales Activity

Investment sales activity (above $2 million) within the Inner East office market over the course of 2009 totalled $44.78 million, a vast increase on the mere $10.6 transacted the previous year with no transaction greater than $5 million. Private investors acquired 92% of sales by value, followed by developers. The largest transaction within the region in 2009 was the sale of 16-18 Cato Street, Hawthorn East for $16.73 million bought by a private investor, however a more recent sale was 50 Burwood Road, Hawthorn, which changed hands for $17.10 million in March 2010. The building was partially vacant and has planning for a further two floors to be added. As investor appetite has improved in line with an improving economy, prime core market yields appear to have stabilised over the past six months and currently range between 8.25% and 9.25% with secondary properties ranging between 9.50% and 10.50%.

1318-1326 Malvern Road, Malvern sold for $7.9 million on a core market yield of 7.14%.

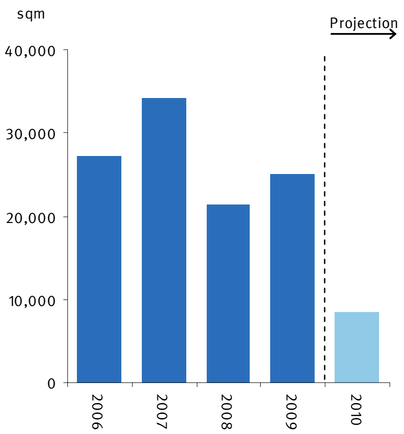
OUTER EAST

The Outer Eastern market comprises more than 670,000 sq m of office stock and is the second largest suburban office region, representing 25% of Melbourne's metropolitan office stock. The Outer Eastern region includes Box Hill, Mt Waverley, Mulgrave and Burwood amongst others.

Development Activity

New supply levels in the Outer East are forecast to fall to their lowest level since 2004 with only 8,500 sq m forecast to be completed over 2010 via just one project. Beyond the speculatively developed 28 & 29 Redland Drive, Mitcham (8,500 sq m) there are other commercial projects currently under construction in the precinct. It is extremely unlikely that speculative developments will proceed in the near future with projects likely to progress requiring substantial pre-commitment to meet lending requirements and will have to achieve rental premiums in order to launch projects.

Figure 5
Outer East New Office Supply
2006-2010



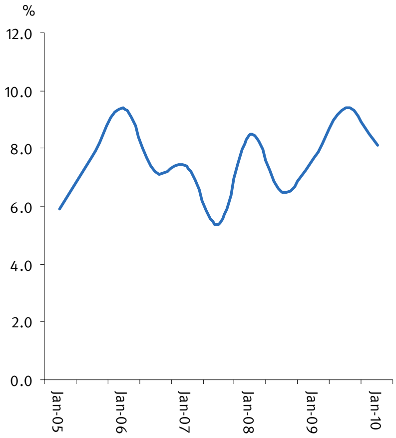
Source: Knight Frank Research

Vacancy & Tenant Demand

Following a rise over the past year, total vacancy within the Outer East decreased 130 basis points to 8.1% in the six months to January 2010, close to its 10-year historical average. As a result of available contiguous options and tenants keen to lower occupancy costs, the Outer East recorded 22,051 sq m of net absorption in the six months to January 2010 – accounting for 46% of all absorption within the metropolitan office market.

Tenants who have recently taken space within the Outer East include: Leadtech (Burwood East), RYOBI (Doncaster), Godfreys (Glen Waverley) and Life Technologies (Mulgrave). In the six months to January 2010, vacancy rates fell in most of the significant office hubs within the Outer East. Vacancy remains tight in Box Hill at 2.2%, Mt Waverley at 2.3% and Notting Hill at 4.8% while despite solid tenant demand: vacancies in Burwood East, Mulgrave and Glen Waverley remain in double digits.

Figure 6
Outer East Office Vacancy
2005-2010



Source: Knight Frank Research

With vacancy coming off relatively high levels, net face rents within the Outer East remained stable in the six months to January 2010. With total vacancy anticipated to trend down over the next 12 months, downward Pressure is building on incentives for both sitting and incoming tenants. As at January 2010, prime net face rents range from $230/sq m to $250/sq m and secondary stock from $190/sqm to $220/sq m.

Sales Activity

Investment sales activity within the Outer East accounted for 29% of all metropolitan office transactions (above $2 million) from 10 sales. Sales activity in the Outer East over 2009 totalled $135.08 million increasing by 16% on the previous year as investor sentiment continued to climb. Private investors continued to dominate purchases, acquiring 87% of all transactions with listed trusts and wholesale funds accounting for the vast majority of vendors. The largest sale transacted within the Outer East in 2009 occurred in August 2009, with ING's sale of 990 Whitehorse Road, Box Hill for $43.8 million. The sale reflected a relatively high core market yield of 11.4%, accounting for the potential risk of ATO vacating the building in 2014 rather than the average market yield.

Other significant sales transacted in the Outer East over 2009 included two assets in Doncaster at 591-609 Doncaster Road ($17.29 million) and 660 Doncaster Road ($9.85 million) and 883 Whitehorse Road, Box Hill ($24.3 million). Yield stabilisation has begun to occur in late 2009 with average prime grade yields now ranging from 8.25% to 9.25% and secondary stock between 10.00% and 11.00%.

883 Whitehorse Road, Box Hill sold for $24.3 million on a core market yield of 8.1%.

SOUTH EAST

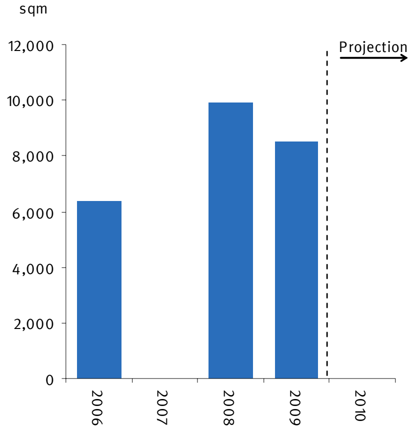
The South Eastern region comprises 242,000 sq m of office stock and accounts for approximately 10% of Melbourne's metropolitan office stock. The South Eastern region includes the suburbs of Cheltenham, Moorabbin and Dandenong amongst others.

Development Activity

Only one building was completed in the South East region in 2009 which was Deal Corporation's 8,500 sq m Arkana project in Dandenong. Completed in November 2009, the building had pre-commitment from the State Trustees, Child Support Agency and Workcover. The mixed use development incorporated three levels of office, retail and apartments and was part of the State Government's building program to re-vitalise the Dandenong CBD. While there are no further projects currently under construction or scheduled for completion by the end of 2010, Grocon is developing a new 14,399 sq m, A-grade office building scheduled for completion in the second half of 2011. The new project is pre-committed by four State Government departments: Human Services, Justice, Planning & Community Development and Education & Early Child Development

Grocon's new development on the corner of Thomas & Walker Street, Dandenong due for completion in H2 2011.

Figure 7
South East New Office Supply
2006-2010



Source: Knight Frank Research

Although unlikely in the short term, there is future development potential in the Bayside area with commercial development being encouraged in order to gentrify former industrial zoning to higher uses.

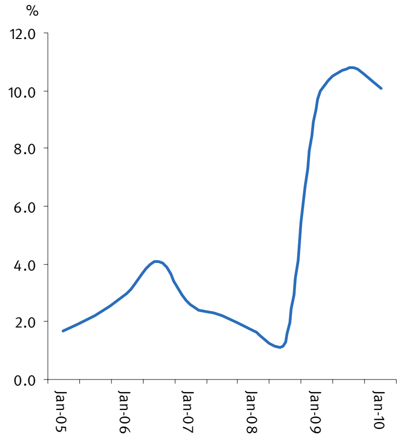
Vacancy & Tenant Demand

Vacancy within the South East as at January 2010 fell slightly to 10.1% from 10.8% six months prior. The South East office market still records the highest total vacancy of Melbourne's metropolitan office regions, but given its small size is prone to fluctuations of vacancy. While A grade vacancy in the South East rose as a result of Fujitsu's departure from 1230 Nepean Highway, Cheltenham, B grade and C grade vacancy fell in the six months to January 2010.

Within the South East, the vacancy within office precincts of Moorabbin, Cheltenham and Dandenong remain in double digits, but tenant demand is showing signs of improving. Total vacancy within the South East is expected to tighten significantly over 2010 as tenants begin to occupy recent commitments.

In the six months to January 2010, the South East region recorded net absorption of 9,098 sq m, its highest level in the past five years.

Figure 8
South East Office Vacancy
2005-2010



Source: Knight Frank Research

Sales Activity

Sales activity remains scarce within the South East with no office sales above $2 million transacted during 2009 and only one transaction the previous year. More recently in February 2010, Leighton Properties' sold 294 Bay Road, Cheltenham for approximately $20 million to an owner occupier which will assist in driving vacancy down in the region. As at April 2010, despite limited actual transactions, anecdotally prime yields range between 9.00% and 10.25% with secondary stock ranging between 10.50% and 11.50%.

294 Bay Road, Cheltenham sold for a reported $20 million to an owner occupier.

OUTLOOK

Australian business confidence and overall business investment has been remarkably resilient over the past year which has led to a more positive demand outlook. White collar employment growth within the Melbourne metropolitan office market is expected to pick up over the next few years, with Access Economics forecasting solid average white collar employment growth of 3% per annum over the next three years.

Demand for space in the metropolitan office market rose significantly in the final half of 2009, with net absorption of 47,600 sq m recorded for the six month period, its highest level since the first half of 2006. Current enquiry suggests that robust demand will continue for the remainder of 2010, with circa 60,000 sqm of active enquiry. Several major tenants looking for office space in the suburbs include the Department of Veteran Affairs, Honeywell, Hertz, Transfield, Kodak, Crazy John's and Coomes Consulting.

With rents on the rise in the CBD due to a looming shortage of available stock, rental differentials between the CBD and the suburbs will widen significantly making suburban stock more cost effective, following a major migration into the CBD over the past two years. The suburban office vacancy rate is likely to have peaked in the short term but will remain steady for 2010 due to the new projects finished to meet growing demand, before trending down from 2011, with demand outstripping supply. Due to increased activity from owner occupiers, an upswing in tenant demand and the benign supply outlook, we expect the vacancy rate will fall to around 5-6 per cent by the end of 2011.

Rents are anticipated to remain stable for the rest of 2010, however, as the economy gains momentum and tenants continue to absorb the existing stock on offer over the next 12 months -driven by a solid rebound in white collar employment growth - the subsequent reduction in the vacancy rate will see rentals start to move. The upswing in demand should lead to rental growth picking up from 2011 and building strongly in 2012 as vacant stock is absorbed, which may encourage developers to launch the next round of construction from late 2011 and into 2012 as development becomes viable again. Although construction costs have levelled off recently, they are unlikely to ease significantly as labour shortages will remain evident due to the pick up in residential construction and the stimulus driven construction in schools, however as the government stimulus programs are wound back, there is the potential for some smaller private developers becoming more aggressive to win jobs later this year.

Downward pressure on incentives is building as tenant demand picks up and the CBD tightens. However, owners of existing space, especially in the Outer East and Fringe where there are some pockets of vacancy, may need to remain aggressive to move space for the remainder of 2010. Hence above average incentives should be a consideration, particularly for space that has been hard to move, to avoid the potential of sitting with an empty building for an extended period.

With growing investor confidence, recent sales evidence indicates that metropolitan office yields have stabilised, particularly for prime stock. Owner occupiers have also become more prevalent over the past six months and we expect this trend to continue as SME's and established local businesses continue to gain confidence in their future growth trajectory. We will see many of them opt out of the tenancy market and target vacant or short WALE assets while prices are at the low point in the cycle capitalising on the price reductions from the late 2007 peak.

Table 2
Selected Major Investment Sales Melbourne Metropolitan Office

Address	Sale Date	Price ($ mill.)	Initial Yield (%)	NLA (sq m)	Rate ($/sq m)
465 Auburn Road, Hawthorn East	Apr-10	11.20	7.85	2,780	4,029
50 Burwood Road, Hawthorn	Mar-10	17.10	n/a	5,247	3,259
294 Bay Road, Cheltenham	Feb-10	-20.00	n/a	4,850	4,124
289 Wellington Pde Sth, East Melb	Jan-10	27.00	8.17^	5,607	4,815
1318-1326 Malvern Road, Malvern	Dec-09	7.90	7.14^	1,701	4,644
677 The Esplanade, Eaglemont	Nov-09	11.35	8.34	3,216	3,529
660 Doncaster Road, Doncaster	Nov-09	9.85	9.09	3,134	3,143
883 Whitehorse Road, Box Hill	Oct-09	24.30	8.10^	7,237	3,358
30-32 Compark Circuit, Mulgrave	Sep-09	7.20	9.60	2,539	2,834
990 Whitehorse Road, Box Hill	Aug-09	43.80	11.40^	20,650	2,121

Source: Knight Frank Research ^ Core Market Yield

Table 3
Selected Recent Leasing Activity Melbourne Metropolitan Office

Address	Region	Area (sq m)	Face Rent ($/ sq m)	Tenant
351 Burwood Hwy, Burwood East	Outer East	4,700	190n	Jemena
43 Elizabeth St, Richmond	City Fringe	4,400	310n	Dept of Justice
436 Johnson St, Abbotsford	City Fringe	4,168	275n	Glaxo Smith Kline
15 Dalmore Drive, Scoresby	Outer East	2,200	140n	AGFA
1341 Dandenong Road, Chadstone	Outer East	2,000	265n	Funtastic
436 Johnson St, Abbotsford	City Fringe	1,800	275n	Ingram Micro
5 Lakeside Dr, Burwood East	Outer East	1,225	220n	Leadtech
540 Springvale Rd, Glen Waverley	Outer East	1,150	220n	Godfreys
540 Springvale Rd, Glen Waverley	Outer East	1,100	220n	IMED
108 Power St, Hawthorn	Inner East	1,200	305n	MSI Ragg Weir
295 Springvale Rd, Glen Waverley	Outer East	980	250n	Super Concepts P/L
18-20 Compark Circuit, Mulgrave	Outer East	920	175n	Vision Stream
108 Power St, Hawthorn	Inner East	820	385g	Galvin Constructs

Source: Knight Frank Research g gross n net

RESEARCH

Americas
USA
Bermuda
Brazil
Caribbean
Chile

Australasia
Australia
New Zealand

Europe
UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Russia
Spain
The Netherlands
Ukraine

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
Thailand
Vietnam

The Gulf
Bahrain

Knight Frank Newmark Global

Knight Frank Research

Matt Whitby
National Director – Research
+61 2 9036 6616
matt.whitby@au.knightfrank.com

Jennelle Wilson
Associate Director – Research QLD
+61 7 3246 8830
jennelle.wilson@au.knightfrank.com

Valuation Contacts

David Way
Joint Managing Director – Victorian Valuations
+61 3 9604 4704
dway@vic.knightfrankval.com.au

Joe Perillo
Joint Managing Director – Victorian Valuations
+ 61 3 9604 4617
jperillo@vic.knightfrankval.com.au

Commercial Agency Contacts

Paul Henley
National Director – Commercial
+61 3 9604 4760
paul.henley@au.knightfrank.com

Ken Smirk
Director – Commercial Sales & Leasing
+61 3 8545 8622
ken.smirk@au.knightfrank.com

Simon D'Arcy
Associate Director – Commercial Sales & Leasing
+61 3 9604 4668
simon.darcy@au.knightfrank.com

Marcus Quinn
Manager – Commercial Sales & Leasing
+61 3 9604 4638
marcus.quinn@au.knightfrank.com

John Nunan
Manager – Commercial Sales & Leasing
+61 3 8545 8620
john.nunan@au.knightfrank.com

Paul Burns
Managing Director – VIC
+ 61 3 9604 4610
paul.burns@au.knightfrank.com

Knight Frank Research provide strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, financial and corporate institutions. All recognise the need for the provision of expert independent advice customised to their specific needs.

Knight Frank Research reports are also available at www.knightfrank.com.