1 *Southbank and St Kilda Rd vacancy rise above 10%*

2 *No change recorded in net face rents in both precincts*

3 *Yields stable in both precincts despite COVID*

Knight Frank

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St Kilda Rd & Southbank Office Market

Research, April 2021

PRECINCTS SHOW RESILIENCE

Despite the COVID-19 pandemic affecting office leasing demand and sales activity, net face rents and yields within the Southbank and St Kilda Road office precincts have nonetheless held firm, which speaks volumes for the strength of these precincts.

Office vacancy rises above 10%.

Office vacancy in the Southbank precinct increased consistently throughout 2020 CY, rising from 9.7% in January to 10.5% in July and then to 12.3% in January 2021. The rise in vacancy coincides with negative net absorption of -12,196 sq m being recorded throughout 2020, with negative absorption recorded in both H1 (-5,309 sq m) and H2 2020 (-6,887 sq m). It is a similar story in the St Kilda Road precinct, where office vacancy increased from 8.7% in January 2020 to 9.3% in July and then to 12.9% in January 2021, with the rise in vacancy coinciding with negative net absorption of -32,079 sq m being recorded, with negative absorption recorded in both H1 (-3,861 sq m) and H2 2020 (-28,218 sq m).

COVID plays a role in the rise in sub-lease vacancy.

Similar to what we have observed with the CBD office market, since January 2021 office sub-lease vacancy has risen in both the Southbank and St Kilda Road precincts. The amount of sub-lease vacancy within Southbank (4,746 sq m) is the highest we have seen for 5 years while along St Kilda Road the amount of sub-lease vacancy has also risen over the last 6 months (8,956 sq m was previously 5,470 sq m).

The increase in the amount of sub-lease stock entering the market is a direct result of COVID-19, in particular in Southbank where a number of high profile tenants such as CUB, MMG and PWC have been forced to reconsider their office floorplate requirements in light of subdued business conditions brought upon by the pandemic.

However, in contrast to the CBD we have seen some recent evidence of sub-lease stock coming onto the St Kilda Road market and then being withdrawn. Knight Frank was initially marketing circa 4,400 sq m of sub-lease space on behalf of Downer at 549 St Kilda Road however some of the company's regional staff will now occupy this space. This is similar to what we have witnessed in the Cremorne market where the likes of MYOB, Seek and REA Group were marketing space during the COVID lockdown period but have since withdrawn this stock. The withdrawal of sub-lease space is a positive sign for these important office markets.

St Kilda Road & Southbank Office Market Indicators as at Jan 2021

GRADE		TOTAL STOCK SQM	VACANCY RATE %	ANNUAL NET ABSORPTION SQM	ANNUAL NET ADDITIONS SQM	AVERAGE NET FACE RENT $/SQM	AVERAGE INCENTIVE %	AVERAGE CORE MARKET YIELD %*
Prime	St Kilda Rd	251,505	9.9	-14,688	- -	400–500	18–35	4.75–5.25
	Southbank	294,410	10.7	-2,247	- -	490–660	20–35	4.75–5.25
Secondary	St Kilda Rd	387,382	14.9	-17,391	-5,270	310–380	18–28	5.20–5.70
	Southbank	151,430	15.3	-9,949	1,114	310–400	20–28	5.20–5.70
Total	St Kilda Rd	**638,887**	**12.9**	**-32,079**	**-5,270**			
	Southbank	**445,840**	**12.3**	**-12,196**	**1,114**			

Source: Knight Frank Research/PCA *assuming WALE 5.0 years

COVID-19 not the only driver of rising vacancy.

While COVID-19 has had the effect of softening tenant demand for office accommodation in many office markets worldwide, the recent rise in vacancy levels across the Southbank and St Kilda Road office precincts can't be attributed solely to the pandemic. Within the St Kilda Road precinct, two major vacancies unrelated to COVID-19 were due to enter the market at both 541 St Kilda Road and 380 St Kilda Road. With SEEK committing to their new headquarters at 60 Cremorne Street, Cremorne, circa 8,200 sqm will become available at 541 St Kilda Road in Q3 2021 and conversely with John Holland committing to the new Dexus development at 180 Flinders Street, further vacancy is available at 380 St Kilda Road. In one if the most significant refurbishments in St Kilda Road for many years, 16,000 sqm is available immediately at 412 St Kilda Road which was previously targeted for residential conversion.

Beyond this, it is worth noting that vacancy in Southbank was 12.4% in July 2019, while in St Kilda Road vacancy was 12.9% in January 2017, so it is not unusual for these precincts to record vacancy levels over 10%. Furthermore, while COVID has resulted in a lack of leasing transaction activity with companies assessing their space and staff needs, the pandemic is not felt to be pushing many tenants out of the Southbank and St Kilda Road precincts. If anything, moving forward it is possible we will see some price driven and downsizing CBD tenants look towards Southbank and St Kilda Road as these precincts offer a good value proposition with close proximity to the CBD.

Victorian economy already rebounding.

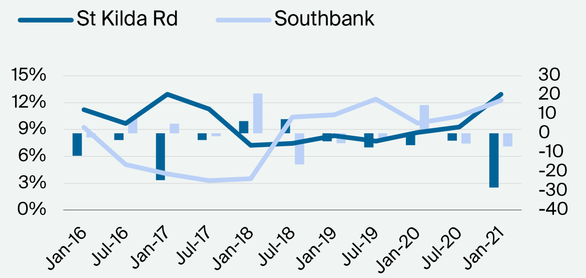
While office vacancy in the Southbank and St Kilda Road precincts could potentially rise further in 2021, we do not anticipate vacancy will rise to the levels seen in the 1990s when an oversupply of stock caused Southbank vacancy to peak at 28.8% in 1994 and St Kilda Road vacancy to peak at 22.4% in July 1992. Indeed, the Victorian economy has already begun to rebound, and the state's economy is expected to recover more strongly than other states and territories. Between 2022-2025, the state's GDP is forecast to grow by over 3.0% each year, which is above the forecasts for the other regions nationally.

Transformation of Southbank Boulevard.

The last six months has seen significant progress made on the Transforming Southbank Boulevard project with the Civic space to the front of the ABC Southbank Centre finished. With the tram track, roadway works and Arts Gateway also complete, construction has now shifted to two neighbourhood parks on the open space between Moore Street and Kavanagh Streets and Fawkner Street and City Road. This will create an additional 2,730 sq m of open space on Southbank Boulevard. These open spaces will feature new public lighting, hardstand areas with seating, lawn, garden beds and ground cover planting, numerous trees and a boardwalk in the open space between Fawkner Street and City Road.

Southbank/St Kilda Rd Office Vacancy

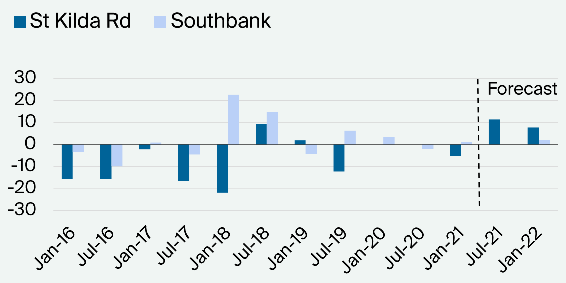
'000 sqm absorption (RHS); % vacancy



Source: Knight Frank Research

Southbank/St Kilda Rd Office Net Supply

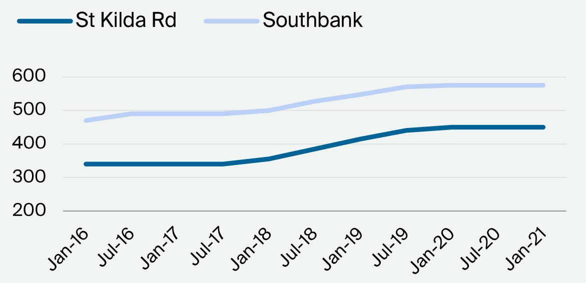
'000 sqm



Source: Knight Frank Research

Southbank/St Kilda Rd Office Rents

$/ sqm prime net face



Source: Knight Frank Research

Asking rents stable despite COVID-19.

Mirroring what we have seen in the CBD office market, despite demand for office accommodation in Southbank and St Kilda Road having softened in response to the COVID pandemic, Landlords have not as yet adjusted their asking rents with deals completed during lockdown being made at similar rates as what was recorded pre-COVID. Prime net face rents have remained static in the Southbank and St Kilda Road office precincts over 2020. In Southbank, average net face rents sit at $575/sq m and along St Kilda Road rents are currently $450/sq m. Prior to COVID, rents had risen by 5.0% and 8.4% respectively over the course of 2019.

The impact of the pandemic, however can be seen in incentives and in turn effective rents. While prime net face rents have not changed in the 12 months to January 2021, incentives have risen notably, with prime incentives in Southbank now ranging between 20% to 35% and along St Kilda Road prime incentives now range between 18% to 35%. The rise in incentives has resulted in net effective rents declining. In Southbank, net effective rents now average $429/sq m which is down on the $515/sq m recorded in January 2020. In St Kilda Road, net effective rents now average $327/sq m which is down on the $365/sq m recorded in January 2020.

Sales volume down however office yields hold.

Office sales volume in the St Kilda Road and Southbank office markets in 2020 totalled $122.5 million across 4 transactions. The level of sales was well below the long-term average ($476.2 million) and the levels recorded over 2019 ($704.3 million). The lacklustre sales activity within the St Kilda Road and Southbank precincts can be linked to the COVID pandemic causing a shortage of office assets being presented to the market in 2020.

However, Melbourne's broader economic recovery is well under way and with white collar workers gradually returning to the office, pent up demand should drive renewed interest among investors for office assets in 2021. Moreover, while there were no sales transactions in the second half of 2020, deals recorded in the nearby fringe markets suggest office yields within the St Kilda Road and Southbank precincts have likely held stable over 2020. Prime office yields in both the St Kilda Road and Southbank office markets range between 4.8% to 5.3% to average 5.00% and these remain the lowest yield levels recorded since 2003.

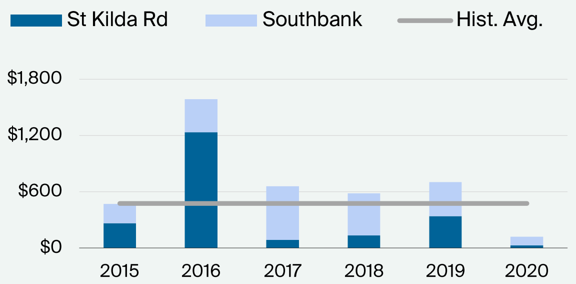
Flex space and tech emerge as future trends.

Moving forwards, we expect demand for flexible workspaces within existing office towers to increase as tenants react to business challenges and growth uncertainty brought upon by COVID. Indeed, already we are seeing virtually all new office developments contain a flex space element as part of their standard offer.

And the aftermath of the COVID pandemic will also accelerate the growth of PropTech, with Landlords likely to increasingly embrace technology as a means of future proofing their buildings. PropTech has become a focal point for Landlords as they review innovative manners to which assets operate in order to return a level of trust to building users as they return to occupation post the recent lockdown periods. Such technology which is currently being considered or deployed include biometric, robotic and frictionless automation.

Southbank/St Kilda Rd Office Sales

'000; CY sales



Source: Knight Frank Research

Recent significant tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	TERM YRS	STRUCK DATE
Beulah International	55 Southbank Boulevard	Southbank	1,264	5	Q4 2019
Healthcare Australia	324 St Kilda Road	St Kilda Road	918	1	Q1 2021
Hansen Yuncken	412 St Kilda Road	St Kilda Road	750	5	Q4 2020
Consultel Cloud	390 St Kilda Road	St Kilda Road	746	5	Q2 2020
Hitachi	5 Queens Rd	St Kilda Road	601	5	Q1 2021

Contact leasing team for further information on these deals.

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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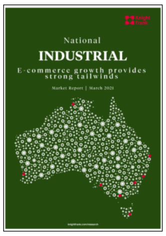

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