

ST KILDA ROAD & SOUTHBANK

OFFICE MARKET BRIEF SEPTEMBER 2019

ST KILDA ROAD MARKET CONTINUES TO TIGHTEN

Key Findings

Vacancy in the **St Kilda Road** office market has fallen further in H1 2019, to now sit at **5.9%**

Prime net face rents in the **St Kilda Road** office market grew by 14.3% in the 12 months to July 2019

Office sales volume for St Kilda Road and Southbank are on pace to surpass sales volumes recorded in 2018 FY

Prime yields in the St Kilda Road and Southbank office markets **compressed by 75 basis points** in the 12 months to July 2019.



FINN TREMBATH
Associate Director

A lack of contiguous space being presented to the market, coupled with sustained tight CBD vacancy sees rents in the St Kilda Road and Southbank office markets continue to grow.

St Kilda Road vacancy reaches recent record low

A decade characterised by persistent low supply and office withdrawals for residential conversion has resulted in St Kilda Road office stock levels dwindling by 120,000 sq m between 2009 to 2019. Off the back of this, vacancy has halved with the current vacancy of 5.9% the lowest level recorded for close to 20 years. St Kilda Road's current vacancy is now comparable to the levels seen in some CBD precincts (Western Core 5.70%, Spencer 8.30%).

To ensure their properties meet the demands of the market and remain relevant in an increasingly competitive inner city office landscape, landlords along St Kilda Road are investing in the full spectrum of capital works ranging from sub-divisions with accompanying spec fit outs to adding/upgrading end-of-trip-facilities and ground floor foyers.

At 420 St Kilda Road, KKR and Vantage spent two years upgrading the building's foyer and lifts and adding EOTFs, the investment resulting in an upswing in rents,

reduced letting up periods and a marked decline in vacancy. In May the property sold for a reputed strong return (4.89% core market yield) on the initial \$68 million investment laid down just two years prior.

Southbank vacancy affected by 12 Riverside Quay

In direct contrast to St Kilda Road, vacancy in Southbank continues to rise. However, while the current vacancy level of 12.4% might be the highest recorded in almost 15 years, the overriding sentiment is the Southbank market is actually tightly held with much of the current vacancy being driven by one property – 12 Riverside Quay which is currently sitting dormant. Unlike St Kilda Road, supply has been plentiful at Southbank with 103,178 sq m of new supply added over the last decade, with 59,700 sq m of withdrawals.

In a deal brokered by Knight Frank, JB Hi-Fi's recent move to the landmark Southgate Towers owned by ARA Australia at 60 City Road is testament to the appeal of Southbank from an accessibility and amenity perspective, having previously been

located at two fringe locations.

Demand driven by Finance/ Insurance and Construction industries

Demand for St Kilda Road and Southbank office space in the first half of 2019 has been driven by the Finance/ Insurance (e.g. Leaseexpress, Loan Market) and Construction (e.g. Everland Global, 360 Built) sectors.

St Kilda Road renewals speaks volumes for the appeal of the precinct

Off the back of KBR, Broadspectrum and Newcrest electing to renew on St Kilda Road after initially considering alternative accommodation, transportation and logistics giant Toll also renewed at 380 St Kilda Road in H1 2019.

Large users are remaining on St Kilda Road due to the affordability and accessibility benefits presented by the leafy boulevard. The recent spate of renewals speaks volumes for the precinct's attraction within the broader central Melbourne office market. This will only be enhanced further with the opening of ANZAC Station in future years which will create a new dynamic for the St Kilda Road precinct.

Recent residential-office conversions set to continue

Australia's residential property slowdown has seen a number of recent residential developments in the CBD – 555 Collins Street, 383 La Trobe Street, 85 Spring Street – being aborted in favour of office developments. Softening buyer demand has resulted in slow off-the-plan sales making residential development plans unfeasible. At the same time record rental growth for office property has made

office the current best use of capital.

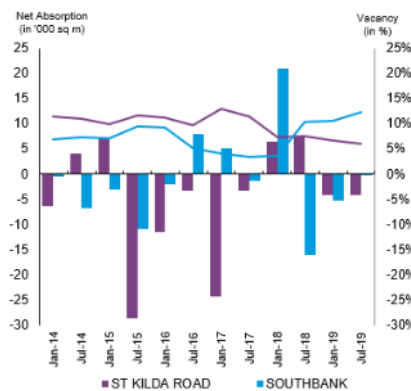
Traditionally an apartment rich precinct, the St Kilda Road office market has not been immune to the headwinds presented by the current residential downturn. In June 2019, 424 St Kilda Road was sold for \$70 million. Sitting on a 4,645 sq m site, 424 St Kilda Road is a 20,964 sq m commercial building that had plans to be developed into a \$360 million Bates Smart designed residential tower, however the property was sold to an offshore buyer who now plans to refurbish and re-market it as short term office accommodation.

The residential-office conversion trend could well continue in the second half of 2019, with Malaysian developer UEM Sunrise recently putting 412 St Kilda Road on the market. Originally intended to be a 158 unit luxury apartment tower, the B-grade office tower – previously a police complex – is expected to sell for between \$80 - \$100 million in the second half of 2019.

Double digit rental growth along St Kilda Road

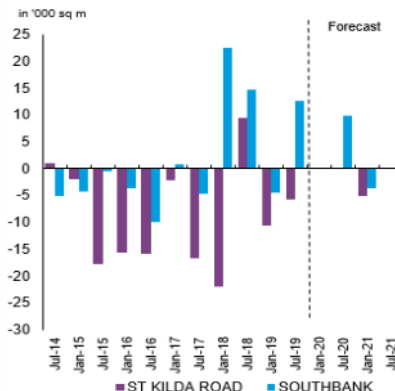
Tight office vacancy in central and fringe Melbourne, coupled with an increasing desire from tenants to be located centrally, has seen record rental growth being recorded along St Kilda Road with growth rates rivalling that witnessed in the CBD. St Kilda Road prime net face rents grew by 14.3% in the 12 months to July 2019 to average \$440/sq m, while secondary net face rents grew by 13.8% to average \$330/sq m. Prime rental growth in the St Kilda Road office market was comparable to that recorded for the CBD over the same period (16.2%).

FIGURE 1
Office Vacancy & Net Absorption
By Precincts: Semi-annually



Source: Knight Frank Research/PCA

FIGURE 2
Office Net Supply/ Withdrawals
By Precincts: Semi-annually



Source: Knight Frank Research

TABLE 1
St Kilda Road & Southbank Office Market Indicators as at July 2019

Grade	Market	Total Stock (sq m)*	Total Vacancy Rate (%)*	Annual Net Absorption (sq m)^	Annual Net Additions (sq m)^	Net Face Rents (\$/sq m)	Incentives (%)	Core Market Yield (%)
Prime	St Kilda Road	254,671	3.3	3,447	0	390–490	15–20	4.75–5.25
	Southbank	291,473	10.0	12,082	3,767	490–650	18–22	4.75–5.25
Secondary	St Kilda Road	380,168	7.6	-11,878	-19,809	300–360	15–22	5.00–5.50
	Southbank	154,224	16.8	-17,474	0	300–390	20–22	5.00–5.50
Total Market	St Kilda Road	634,839	5.9	-8,431	-19,809			
	Southbank	445,697	12.4	-5,392	3,767			

Source: Knight Frank Research/PCA

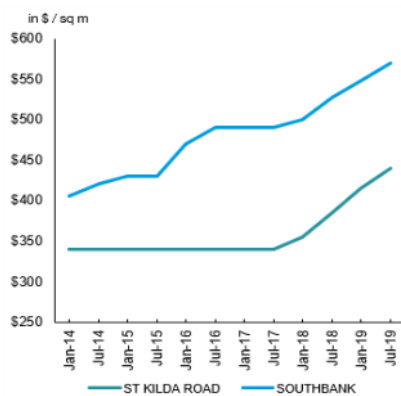
*As at 1st July 19

^12months to 1st July 19.

Strong rental growth was also achieved for the Southbank office market, where prime net face rents grew by 8.1% over the 2018/19 FY to average \$570/sq m, and secondary net face rents grew by 5.3% to average \$345/sq m.

Forecast continued rental growth for CBD office assets over the course of 2019/20 will underpin ongoing rental growth in the St Kilda Road and Southbank precinct as tenants look to the fringes in search of affordable accommodation options situated close

FIGURE 3
Prime Net Face Rents By Precincts
Average Office Rents



Source: Knight Frank Research

to the city.

Solid sales activity results in sustained yield compression

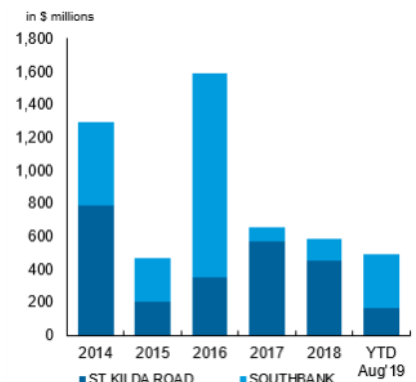
Over the first half of 2019, office sales volume in the St Kilda Road and Southbank office markets totalled \$494.5 million across 3 transactions. At this rate, and with a number of additional assets expected to hit the market in H2 2019, sales volume in 2019 CY is likely to eclipse the \$585.9 million recorded in 2018 CY as well as the ten year average of \$575.6 million. The most notable sale in 2019 to-date has been 2 Southbank Boulevard which sold to GPT Group in March. A 38 storey tower housing tenants such as CUB, Microsoft and Space&Co, 2 Southbank Boulevard sold for \$326.5 million (50% interest) at a core market yield of 5.00%.

The solid sales activity on witness within the St Kilda Road and Southbank precinct has resulted in prime office yields in both markets compressing by 75 basis points in the 12 months to July 2019 to average 5.00%. These are the lowest yields recorded for these two precincts since 2003. Within the Southbank precinct, yields tend to be tighter in the front end (waterfront side) of

Southbank, compared to the back end of the precinct.

With supply tight both in the CBD and in neighbouring inner fringe areas, and yields in the CBD tipped to continue to compress, the current climate of low bond rates and rising rents should translate to sustained demand for assets situated close to the CBD, in turn placing further downward pressure on yields within the St Kilda Road and Southbank precincts.

FIGURE 4
Transactions By Precincts
Office \$10mln+ Sales- YTD Aug'19



Source: Knight Frank Research

TABLE 2
Recent Leasing Activity St Kilda Road & Southbank

Address	NLA (sq m)	Term (yrs)	Lease Type	Tenant	Sector	Start Date
111 Cecil Street, Melbourne	3,788	10	New	Creative Cubes	Co-working	Nov-19
180 St Kilda Road, Melbourne	3,000	10	New	Victory Offices	Co-working	Sep-19
30 Convention Centre Place, Southbank	2,633	7	New	Database Consultants Australia	Tech	Dec-19
417 St Kilda Road, Melbourne	586.8	10	New	Hewison & Associates	Finance	Jul-19
71 Queens Road, Melbourne	839	5	New	Synchronised Business Services	Finance	Sep-19

Source: Knight Frank Research U/D undisclosed

TABLE 3
Recent Sales Activity St Kilda Road & Southbank

Address	Price (\$ mil)	Core Market Yield (%)	NLA (sq m)	\$/sq m NLA	Vendor	Purchaser	Sale Date
2 Southbank Boulevard, Southbank	326.5^	5.00	54,870	5,950	Frasers Property	GPT Group	Mar-19
420 St Kilda Road, Melbourne	98.0	4.89	10,452	9,376	KKR/ Vantage Property	Private Investor	May-19
424 St Kilda Road, Melbourne	70.0	VP	20,964	3,339	Woodlink	Private Investor	Jun-19
541 St Kilda Road, Melbourne	64.0	4.96	8,246	7,761	Bayley Stuart	Marprop Development & GLL RE Partners#	Dec-18

Source: Knight Frank Research ^price reflective of a 50% interest # joint venture

RESEARCH & CONSULTING

Finn Trømbath

Associate Director, Victoria
+61 3 9604 4608
Finn.Trombath@au.knightfrank.com

Kanwal Singh

Research Analyst, Victoria
+61 3 9604 4627
Kanwal.singh@au.knightfrank.com

Ben Burston

Partner, Chief Economist
+61 2 9036 6756
Ben.Burston@au.knightfrank.com

CAPITAL MARKETS

Guy Bennett

Partner, Head of Institutional Sales,
VIC & SA
+61 8 8233 5204
Guy.Bennett@au.knightfrank.com

Danny Clark

Partner, Head of Commercial Sales, VIC
+61 3 9604 4686
Danny.Clark@au.knightfrank.com

Jazmyn Walkin

Associate Director, Capital Markets, VIC
+61 8 9604 4638
Jazmyn.Walkin@au.knightfrank.com

OFFICE LEASING

Hamish Sutherland

Partner, Head of Office Leasing
+61 3 9604 4734
Hamish.Sutherland@au.knightfrank.com

Adam Jones

Director, Office Leasing
+61 3 9604 4647
Adam.Jones@au.knightfrank.com

OCCUPIER SERVICES

Gordon Wyllie

Partner, Occupier Services
+61 3 9604 4666
Gordon.Wyllie@au.knightfrank.com

VALUATION & ADVISORY

Michael Schuh

Partner, Joint Managing Director
+61 3 9604 4726
Mschuh@vic.knightfrankval.com.au

VICTORIA

James Templeton

Partner, Managing Director
+61 3 9604 4724
James.Templeton@au.knightfrank.com

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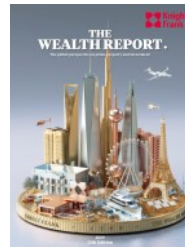
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