



ST KILDA ROAD & SOUTHBANK

OFFICE MARKET BRIEF SEPTEMBER 2015

Key Findings

There is currently 41,200m² under construction in Southbank, of which 91% is already pre-committed

Vacancy in St Kilda Road inflated with 10,500m² residing within offices being marketed for residential development

With prime vacancy at five-year highs, **rental growth is forecast to be subdued in the Southbank** office market

Investment sales activity muted in 2015 to date with offshore buyers and developers dominating purchases



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With 17,841m² withdrawn from the St Kilda Road office market, the amount of office space has fallen to its lowest level in 25 years, with a further 110,000m² identified for a change in use.

Development Activity

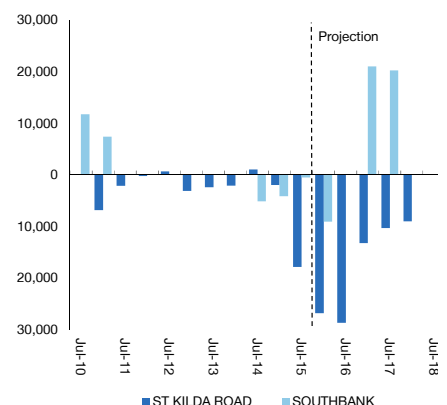
The first half of 2015 saw no new office space delivered in either the Southbank or St Kilda Road office markets. Looking ahead new office development in the fringe office markets remains focussed in the Southbank precinct with 41,200m² currently under construction.

Mirvac/ISPT's 21,000m² development at 2 Riverside Quay is scheduled for late 2016 having been pre-committed by PricewaterhouseCoopers (PwC). The A-grade 12-level office is 82% committed, however PwC has first right to additional office space, prior to practical completion. In addition, construction is well underway on the Australian Broadcasting Corporation's new 20,210m² headquarters at 102 Sturt Street. Scheduled to be completed in early 2017, the ABC's new office will aid the consolidation of all ABC Melbourne's metropolitan operations into Southbank.

In contrast, office space in the St Kilda Road precinct has shrunk to its lowest level in 25 years, with the last major development or refurbishment completed in 2003. In the six months to July 2015, 601 St Kilda Road

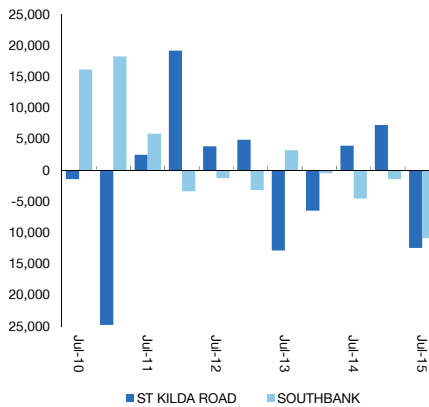
(10,241m²) and 14 Queens Road (9,600m²) were withdrawn with residential developments proposed for the sites. Office space is forecast to continue to decrease along St Kilda Road with 499 St Kilda Road (21,400m²) being marketed for residential conversion. Over the next five years, the St Kilda Road office market is forecast to decline by a further 110,000m².

FIGURE 1
St Kilda Rd & Southbank Net Supply
Per six month period (m²)



Source: Knight Frank Research/PCA

FIGURE 2
Net Absorption
Per six month period (m²)



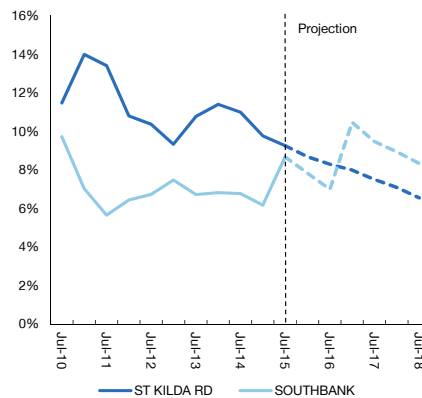
Source: Knight Frank Research/PCA

Net Absorption & Vacancy

Despite recording negative net absorption, the total office vacancy rate in the St Kilda Road office market fell from 9.8% in January to 9.3% as at July 2015. The decline in total vacancy resulted from the withdrawal of stock coupled with the expansion of a number of tenants who relocated within the office market. These tenants who expanded within St Kilda Road, typically relocated into A-grade accommodation, leading to the A-grade vacancy rate falling to 7.5% - its lowest level since January 2013. The total vacancy rate of the St Kilda Road office market is forecast to continue to decline with many of the offices identified for residential development currently incorporating some levels of vacant office space.

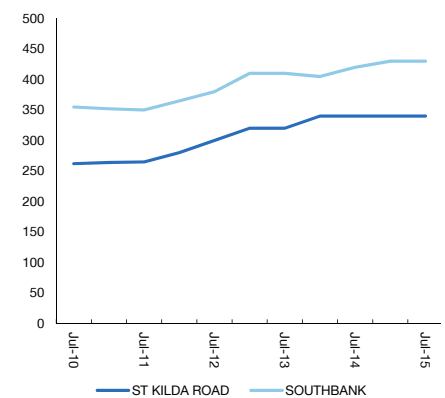
In contrast, the level of office vacancy within the Southbank office market increased to 8.7%, its highest level since July 2010. The Southbank office market was impacted by a number of tenants who relocated to other markets, namely ANZ and CrownBet into the CBD, collectively vacating 7,600m² in the process. As a result of the tenant relocations, the level of A-grade vacancy in the Southbank office market rose to 8.3%, also its highest level since July 2010. In fact, Southbank A-grade offices in the six months to July 2015, recorded net absorption of -9,396m² its lowest level of net absorption since July 1994. While leasing activity in Southbank has increased for 2015 to date, the majority involves existing Southbank tenants such as LinkedIn and Mondelez International. Southbank's total vacancy however is still forecast to decrease, aided by residential redevelopment much the same as the St Kilda Road office market.

FIGURE 3
St Kilda Rd & Southbank Vacancy
2010-2018 (%)



Source: Knight Frank Research/PCA

FIGURE 4
Average Prime Net Face Rents
St Kilda Rd & Southbank (\$/m²)



Source: Knight Frank Research

Rents

Whilst average net face rental levels in the St Kilda Road office market have remained steady over the past 12 months, the outlook for rental growth is promising. As at July 2015, prime net face rents average \$340/m². However, the decreasing available contiguous prime vacant options in the St Kilda Road office market and the reduction of total office stock in the precinct should lead to some upward pressure on rental levels, especially for A-grade accommodation. Despite the A-grade vacancy rate reaching a five-year high, the Southbank office market has recorded modest rental growth over the past 12 months. As at July 2015, prime net face rents average \$430/m², having increased by 2.4% over the year. The impending backfill resulting from the PwC and Mondelez relocations is likely to subdue any further rental growth for the short term.

TABLE 1
St Kilda Road & Southbank Office Market Indicators as at September 2015

Grade	Market	Total Stock (m ²)	Total Vacancy Rate (%)	Annual Net Absorption (m ²)	Annual Net Additions (m ²)	Average Net Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	St Kilda Road	245,325	7.5	2,612	0	330—350	25—30	7.00—7.50
	Southbank	248,819	8.3	-8,459	0	380—480	25—30	6.50—7.00
Secondary	St Kilda Road	472,310	10.2	-7,810	-19,841	260—290	25—35	7.25—7.75
	Southbank	168,851	9.2	-3,831	-4,683	260—300	25—35	7.50—8.00
Total Market	St Kilda Road	717,635	9.3	-5,198	-19,841			
	Southbank	417,670	8.7	-12,290	-4,683			

Source: Knight Frank Research/PCA

Investment Activity & Yields

After setting record levels of investment sales activity in 2014, investment activity within the Southbank and St Kilda Road office markets (above \$10 million) in 2015 to date has been relatively quiet with \$103.35 million transacted. In 2015 to date, only three sales over \$10 million have transacted with UEM Sunrise's purchase of 412 St Kilda Road for \$58.0 million the largest. Although current campaigns suggest that transaction levels in 2015 will surpass average annual levels, the heights set in 2014 are unlikely to be reached notwithstanding 50% of sales activity was transacted in the final quarter of that year.

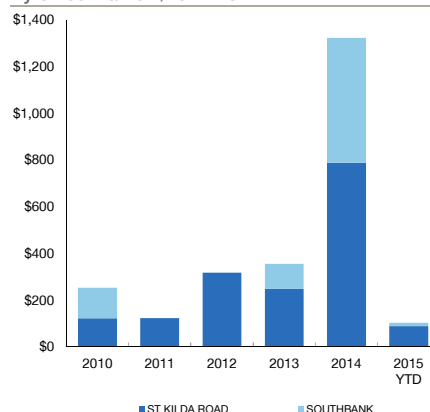
Over the past 12 months, average prime St Kilda Road office core market yields have compressed by 25 basis points to range between 7.00% and 7.50%, while

prime Southbank office core market yields have compressed by 50 basis points to range between 6.50% and 7.00%. With average prime St Kilda Road

and Southbank yields both now lower than 10-year averages, further yield compression is forecast to be modest in the short term.

FIGURE 5
St Kilda Rd & Southbank Sales

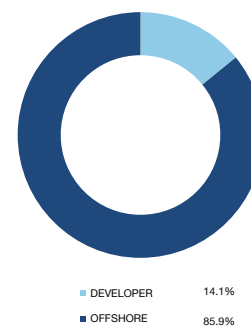
By office market \$10 million+



Source: Knight Frank Research

FIGURE 6
St Kilda Rd & Southbank Sales

By purchaser by type \$10 million+ 2015YTD



Source: Knight Frank Research

TABLE 2

Recent Leasing Activity St Kilda Road & Southbank

Address	NLA (m ²)	Net Face Rental (\$/m ²)	Term (yrs)	Lease Type	Tenant	Date
2 Riverside Quay, Southbank	17,200	U/D	12	Pre-com	PwC	Q4-16
60 City Rd, Southbank	1,000	U/D	5	New	LinkedIn	Q1-16
60 City Rd, Southbank	882	U/D	5	New	Interactive Data	Q4-15
75 Dorcas St, South Melbourne	4,600	U/D	10	New	Mondelez International	Q4-15
509 St Kilda Rd, Melbourne	1,649	320	10	New	Fair Work Building & Construction	Q3-15
417 St Kilda Rd, Melbourne	1,350	U/D	5	New	St John of God Health Care	Q2-15
228-230 Albert Rd, South Melbourne	1,456	335	15	New	Nido Early School	Q2-15
468 St Kilda Rd, Melbourne	979	290	7	New	EGA	Q2-15

TABLE 3

Recent Sales Activity St Kilda Road & Southbank

Address	Price (\$ mil)	Core Mkt Yield (%)	NLA (m ²)	\$/m ² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
412 St Kilda Rd [^]	58.00	N/A	16,285	3,562	1.0	IGR Property Group	UEM Sunrise Berhad	Jul-15
71-75 City Rd [^]	14.60	N/A	1,845	7,913	N/A	Private Investor	Central Equity	May-15
10-16 Dorcas St	30.75	7.08	7,567	4,064	4.0	Cromwell Property	Crescent Wealth	Mar-15
81-87 City Rd [^]	18.00	N/A	1,152	15,625	N/A	Private Investor	Central Equity	Dec-14
499 St Kilda Rd [^]	80.00	N/A	21,377	3,742	N/A	Offshore Investor	Qualitas / Les Smith	Dec-14
600 St Kilda Rd	83.10	7.47	16,914	4,913	4.8	Arena Office Fund	Offshore Investor	Dec-14
432 St Kilda Rd	41.60	7.00	9,217	4,513	2.2	Private Investor	Standard Life	Dec-14
85 Coventry St [^]	15.20	4.77*	2,006	7,577	N/A	Private Investor	Offshore Investor	Dec-14
2 Riverside Quay	106.00 [#]	6.12	21,000	10,095	N/A	Mirvac	ISPT	Dec-14

Source: Knight Frank Research * initial yield U/D undisclosed # 50% share
[^] bought for potential residential redevelopment



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Outlook

After recording little employment growth since 2012, looking forward, white collar employment growth within the St Kilda Road office market is forecast to continue to recover. Deloitte Access Economics is forecasting white collar employment growth of 1.1% in 2015, following a contraction of -0.1% in 2014. Within the Southbank precinct, white collar employment is also forecast to grow, boosted by the pre-committed developments currently under construction.

Having reduced by 17,800m² in the six months to July 2015, office stock in the St Kilda Road office market is projected to continue to decrease. In the short term a further 110,000m² of St Kilda Road office space has been identified to be withdrawn with the majority of the withdrawn space within B-grade stock. Despite some residential redevelopment taking place in the Southbank office market, total office stock in the precinct will continue to grow with two major developments currently under construction.

While both office markets recorded negative net absorption over the first half of 2015, total vacancy in both precincts are forecast to fall over the next three years. Whilst the office vacancy level in the Southbank office market will be briefly elevated by PwC's relocation in 2016; by July 2018, the total vacancy rate in the precinct is projected to sit below its current rate of 8.7%.

The lack of contiguous prime space for lease within St Kilda Road coupled with the continued reduction of office stock is expected to encourage rental growth in the prime market. Whereas, the elevated level of prime vacant space in the Southbank office market together with the impending backfill space following PwC's relocation is likely to maintain current rental levels in the precinct.

With prime CBD office investment opportunities becoming increasingly scarce, fringe office assets offering higher returns or assets with potential for residential development is likely to maintain investor appetite in both St Kilda Road and Southbank office markets.

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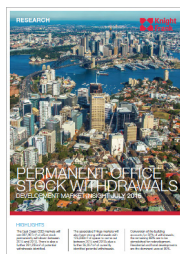
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