

Research insight

October 2007

Central City Offices: State of the Market Update

Melbourne's Central City office market is made up of the CBD, St Kilda Road, Southbank, East Melbourne and Docklands. The total office market contains almost 5 million sq.m. (NLA) of floor space. Seventy per-cent of this space is located within the CBD whilst the adjoining commercial precincts of St Kilda Road and Southbank account for smaller shares of this market at 16% and 8% respectively. The adjoining Docklands precinct contains 160,000 sq.m. of "A" grade office space.

With the completion of 8 Exhibition Street (Ernst & Young), 50 Lonsdale Street (The Urban Workshop) and 121 Exhibition Street (SX1) in early 2006, the CBD office market will have grown by 15% represented in 18 new and refurbished buildings since 2002. While there will be limited new supply coming into the market during 2007, an additional 332,790 sq.m. currently under construction in the CBD and Docklands is expected to be completed by late 2009.

Completions in Docklands to date include 700 Collins Street at Batman's Hill, the National Australia Bank's world headquarters at Victoria Harbour, the first stage of Digital Harbour @ Comtech Port's Innovation Building and Bendigo Bank located at Victoria Point. The new corporate headquarters of ANZ, AXA, Lend Lease and Ericsson are all under construction.

Structural composition of the market, according to the quality of accommodation, has been changing over recent years with prime grade accommodation taking an increasing share of the total market. This has occurred due to the high pre-commitment market while older stock continues to be withdrawn.

Over 1.93 million sq.m. of "A" grade office accommodation exists in the Central City which constitutes 39% of the total market. The CBD contains the majority of "A" grade space (1.26 million sq.m.) which accounts for 36% of its total stock. St Kilda Road and Southbank both contain lesser amounts of "A" grade accommodation but it is noted that this accommodation represents 52% of Southbank's total stock.

The volume of "B" grade office space accounts for 1.45 million sq.m. whilst lower quality "C"/"D" grade space is a significant sector (0.95 million sq.m.) as it continues to witness the withdrawal of obsolete stock from supply. The smallest segment of the office market is "Premium" grade (0.61 million sq.m.) which is restricted to the CBD. Interestingly, all of the upcoming new supply in the current construction cycle is considered to be "A" grade.

Since late 2000, there have been a number of active major lessees in the market seeking new accommodation. A common factor in many of the development briefs is the underlying objective of altering the corporate culture via the built form, so as to make workplaces more pleasant environments. A second significant theme is containing corporate real estate costs via building operational efficiencies.

Major tenants that have committed to new office area by way of pre-commitment include ANZ, AXA, BHP Billiton, nab, PricewaterhouseCoopers, State Government, Ernst & Young, William Mercer, Sensis, AWB, Bureau of Meteorology, Lend Lease, Ericsson and Medibank.

Table 1: Central City Office Markets: Stock Composition (sq.m.) – July 2007

Office Market	"Premium"	"A" Grade	"B" Grade	"C"/"D" Grade	Total
CBD (Less Docklands)	605,050	1,258,367	936,905	668,434	3,468,756
St Kilda Road	-	250,835	332,771	178,325	761,931
Southbank	-	192,521	100,900	75,484	368,905
East Melbourne	-	63,272	82,702	26,945	172,919
Docklands	-	160,594	-	-	160,594
Total	605,050	1,925,589	1,453,278	949,188	4,933,105

Source: Property Council of Australia / Charter Keck Cramer

Table 2: Central City Office Markets: Vacancy (%) – July 2007

Office Market	“Premium”	“A” Grade	“B” Grade	“C”/“D” Grade	Total
CBD (Less Docklands)	2.5%	7.1%	5.6%	71.4%	5.9%
St Kilda Road	-	9.5%	8.1%	69.2%	8.6%
Southbank	-	1.6%	4.8%	65.0%	4.4%
East Melbourne*	-	0.2%	11.0%	69.2%	5.5%
Docklands	-	9.6%	-	-	9.6%
Total	2.5%	6.6%	6.4%	7.6%	6.2%

Source: Property Council of Australia / Charter Keck Cramer

As at July 2007, it is estimated that there is a total of over 307,000 sq.m. of vacant space across the Central City office market. Within the CBD, around 127,000 sq.m. is vacant “Prime” grade stock. Along St Kilda Road, “A” grade space represents 36% and in Southbank 18%. The Central City office market’s vacancy rate stands at 6.2%, a fall from 7.9% 12 months prior.

New completions have placed pressure on vacancy of prime quality stock. The withdrawal of secondary buildings has continued to reduce “B” and “C” grade vacancy rates. History reveals that the demand profile of tenants tends to dictate the outcome of a vacancy recovery.

In the CBD and Southbank, historically high vacancy rates were experienced in the 1990s and since then have moved downwards. In recent years they have generally been well under 10%. Declining vacancy rates have also been observed in the St Kilda Road precinct although not to the same degree as the CBD and Southbank. As at July 2007, the effects of increased leasing activity of office space is being felt as vacancy rates have moderated overall in each precinct.

It is estimated that there is over 600,000 sq.m. of space in major new and refurbished buildings that may be completed in the Central City region over the next three years. To date, the completions of Freshwater Place in Southbank (53,800 sq.m.) and in the CBD, 501 Bourke Street (RACV Centre, 14,000 sq.m.), 121 Exhibition Street (SX1, 77,800 sq.m.), 50 Lonsdale Street (Urban Workshop, 62,000 sq.m.) and Ernst & Young Plaza (43,700 sq.m.) have dominated building activity more recently. The City of Melbourne’s Council House 2 at 218-242 Little Collins Street was officially opened in early 2007. Of the upcoming space in new buildings, more than 80% has been pre-committed to.

Current forecasts suggest that the total vacancy rate will peak in mid-to-late 2008 at around 8%. This assumes that tenant demand remains at positive levels and business expansion continues, underpinned by a sound economic environment.

It is envisaged that demand should moderate in 2007, as large-scale requirements are filled and a general slowing in both the local and international economies.

Net effective rents are expected to moderate as incentives remain around current levels and face rental growth records minor increases. Stronger than expected gross absorption over 2006 has resulted in the leasing of several new buildings in the CBD lessening pressure on incentives to remain at record high levels. The short term outlook is for a softening in absorption rates.

The CBD has continued to attract traditional city fringe tenants due to favourable leasing terms. Average yields will remain under pressure to firm as quality assets with long residual lease terms will continue to be favoured by cashed up funds and syndicates.

Frank Sorgiovanni
Senior Property Analyst – Commercial
Strategic Research

Charter Keck Cramer offers detailed and customised briefings by engagement.

To find out more about the firm’s full range of services including Corporate Real Estate, Strategic Research, Valuations, Quantity Surveying / Tax Depreciation and Development & Project Management contact:

Melbourne – Telephone 03 9642 5000 Level 4, 473 Bourke Street Melbourne VIC 3000 frank.sorgiovanni@charterkc.com.au

Visit the Charter Keck Cramer web site @ www.charterkc.com.au for further information.

This report has been carefully prepared by Charter Keck Cramer – Melbourne. This report is not intended to be comprehensive or render advice and neither Charter Keck Cramer nor any persons involved in the preparation of this report accepts any form of liability for its contents. The information contained herein should not be relied upon to replace professional advice on specific matters. This report is Copyright and cannot be reproduced without written permission of Charter Keck Cramer.