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investment strategy

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The Melbourne Central Office Market and the Prospect of \$1,000 Rents



Key Points

- The Melbourne central office market currently offers tenants a substantial rental discount to many other Australian capital cities.
- Whilst an abundance of commercial development sites is often cited as the reason for the discount, we believe there is scope for more rental growth.
- In March 2009, Savills asked over 2,000 industry participants a series of questions regarding the possibility of Melbourne office rents reaching \$1,000 gross face per square metre for a minimum suite size of 200 square metres.
- Whilst respondents believed overwhelmingly the Melbourne office market would achieve this level of rent in the next four years, they were divided on whether it would be an existing or new building. However, most agreed it would most likely be in the Paris End of the CBD.
- In order to reach \$1,000 gross face per square metre, rents would need to grow by 33% from where they are now. This implies substantial rental growth of between 8% and 16% per annum at the top end of the market.
- Reaching rents of \$1000 per square metre for office space in Melbourne's CBD results in higher quality buildings, services and amenities.

Introduction

The Melbourne central office market has seen substantial rental growth in recent years. Whilst this rental growth has been impressive statistics from the first quarter of 2009 show a decrease in national face rents in CBD locations around Australia. On a national level, Melbourne and Adelaide currently have very low rents.

CBD Office Gross Face Rents – March 2009

	Premium Grade Office		A Grade Office	
	Low	High	Low	High
Adelaide	400	510	320	380
Brisbane	725	755	590	700
Melbourne	555	750	450	605
Perth	900	1080	720	890
Sydney	845	1270	655	965

Source: Savills Research

The reason for the discrepancy in rents is often put down to the availability of commercial development sites in Melbourne, and the ability to supply the office market with new stock quite easily. However, the global financial crisis has impacted new office development in three ways. Firstly, business confidence has been hit to the point where buyers are reluctant to precommit to a new building. Secondly, developers are finding it extremely difficult to obtain finance. Thirdly, it is extremely difficult to find somebody to buy the finished product.

Savills' Melbourne office undertook primary research in March 2009 with industry participants with knowledge and interest in the Melbourne office market. The research consisted of the following six questions:

1. What year will Melbourne achieve a rent of \$1,000/sqm gross face (includes incentives) for a deal of at least 200 sq.m.?
2. What quarter in that year?
3. Existing or new development?
4. Which precinct?
5. Is the Existing or New Development being marketed?
6. What is its address?

Melbourne Office & \$1,000 Rents

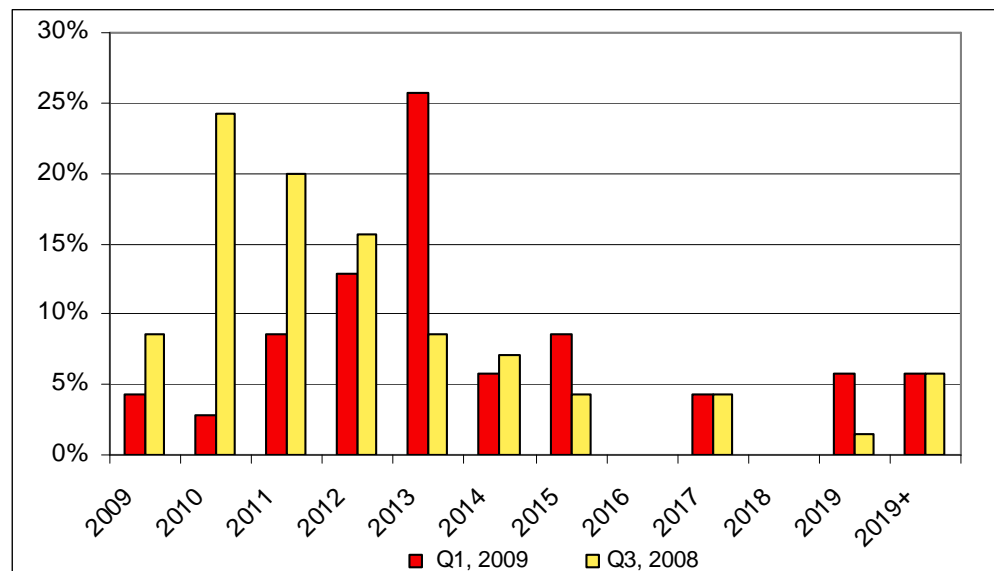
Respondents were given the following range of options:

1. Any year from now through to 2019 or beyond.
2. 1st, 2nd, 3rd or 4th quarter.
3. Existing building or new development.
4. Eastern CBD North of Bourke St, Eastern CBD from Bourke St South, Western CBD North of Bourke St, Western CBD from Bourke St South, Southbank, Docklands or Carlton.
5. Yes or No.
6. Respondents could nominate a building or site or leave it blank.

What follows in this document is a brief analysis of the survey results.

Question 1: What year will Melbourne achieve \$1,000 in Gross Face rent?

Respondents overwhelmingly believed the Melbourne market could achieve \$1,000 gross face rent not only in the next decade but almost certainly in the next four years with almost 80% of respondents favouring the period 2009-2013. Most respondents chose 2013 as the designated year.

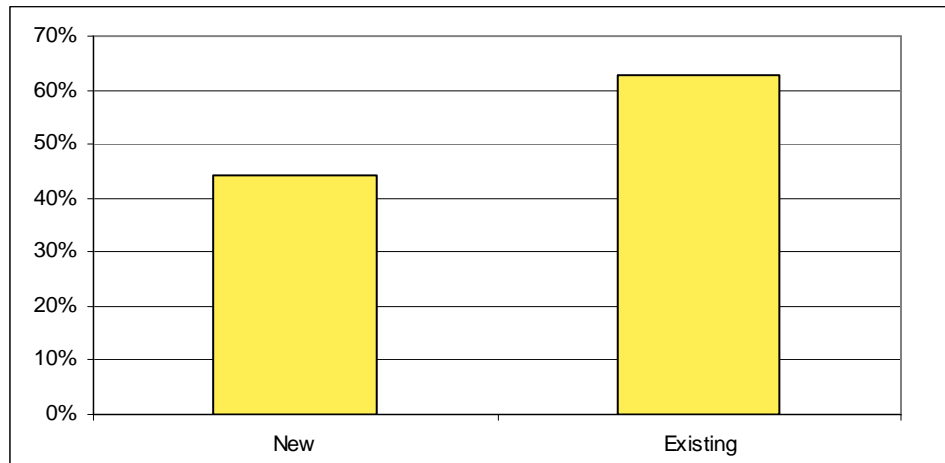


The level of participant optimism decreased from last year, where the period most likely to reach \$1,000 gross face rent was in 2010. In order to reach \$1,000/sq.m., gross face rents would need to grow by 33% from where they are now. This implies 16% per annum growth if it is to be achieved in the next two years, 11% annual growth over three years or 8% annual growth over four years. The responses indicate that those surveyed are aware of Melbourne's low level rents and the ability for

movement in the market in coming years.

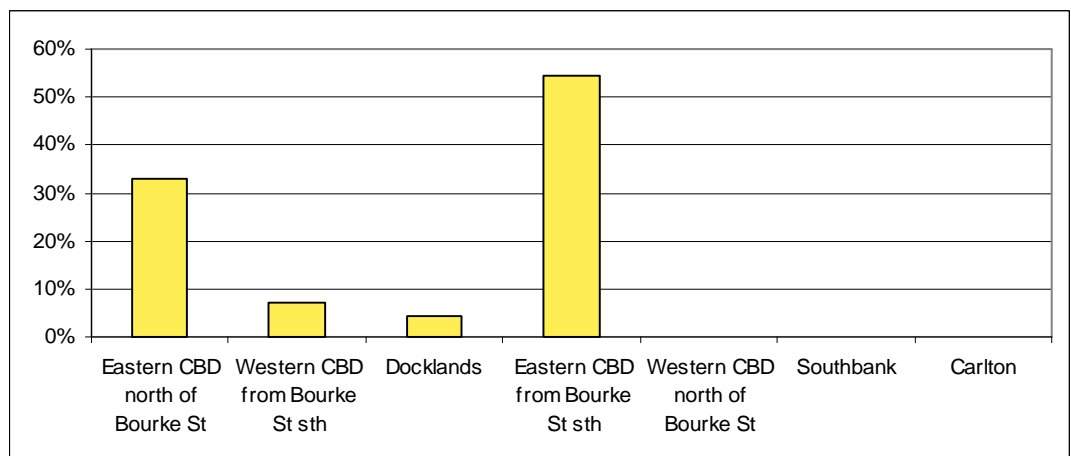
Question 2: Existing Building or New Development?

Respondents were fairly evenly divided on this point with 44% of respondents favouring a new building and the slender majority believing an existing building would be first to the post.



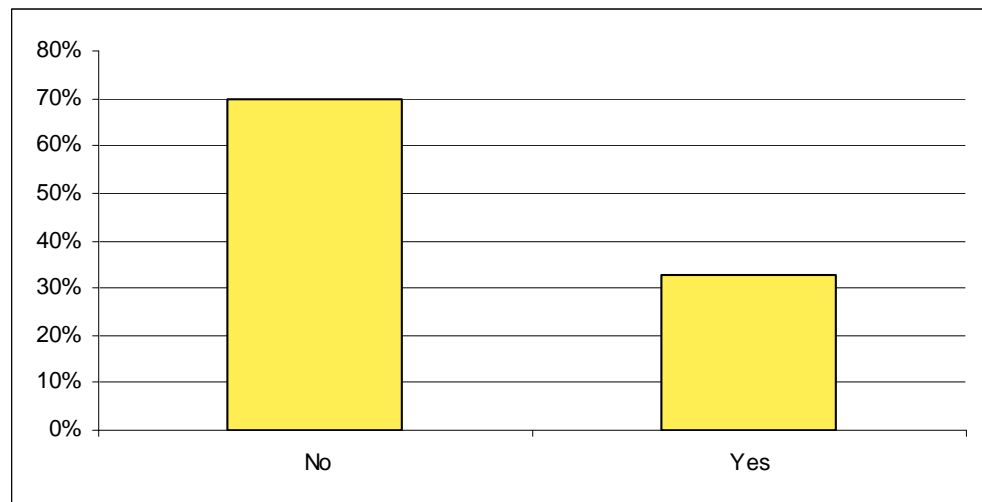
Question 3: Which precinct?

Respondents were given four CBD locations, Southbank, Docklands and Carlton. Not one respondent believed Carlton, Southbank or the “Legal Precinct” would be the first location to achieve \$1000/sq.m rents. The CBD grid itself accounted for around 90% of respondent’s preferences, with the South-East or “Paris End” being the most favoured location (54%) to achieve a Gross Face rent of \$1,000 per square metre.



Question 4: Is the building currently being marketed for lease?

The vast majority of respondents believed the building was not currently being marketed for lease. 33% of participants believe that the building to reach this level of rent currently exists and is already being marketed for lease. Given respondents expected the rent to be achieved in the next four years – if it is a new building – the developer had best get started marketing it soon!



Conclusion

- Perth and Sydney have already achieved rents of \$1000/sqm. Gross rents of \$750/sqm have already been achieved in Melbourne, which reinforce the fact that \$1,000/sq.m. is within reach and that Melbourne rents are very cheap on a national level.
- The occurrence of the global economic crisis has meant that confidence levels have decreased since the last survey was taken, resulting in the expectation of reaching \$1,000/sq.m. extended by three years.
- Most believe the building to achieve \$1,000/sq.m. is existing, as opposed to under development or a proposed development. Given it will likely be a Premium grade building that achieves this rental benchmark, this response suggests that the broader market is not expecting a Premium grade development to be built in the medium term.

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