

The Melbourne CBD is currently in the middle stages of a major construction cycle which is substantially increasing the amount of prime (Premium and A Grade) office space in the market. Notwithstanding considerable stock additions, the vacancy rate for prime office buildings declined over 2004, a result of very strong demand driven by large increases in white collar employment and a pronounced flight to quality accommodation by tenants.

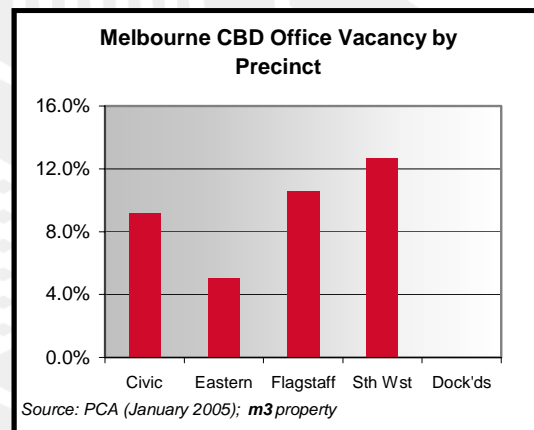
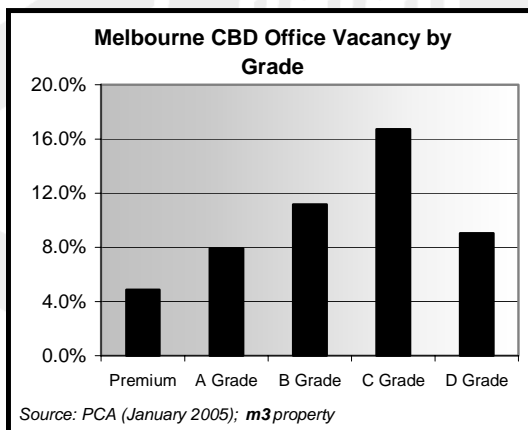
In 2004 more than 156,000 square metres of new and refurbished stock was completed across the Melbourne CBD (including Docklands). Total office stock within the Melbourne CBD as at January 2005 stands at 3,363,282 square metres. Slightly more than half (52.3%) is prime office space, increasing from a 50.5% share just one year earlier.

Despite this increase, tenant 'trading up' from secondary to prime quality accommodation has caused the prime vacancy rate to fall from 11.0% to 6.9% over the past 12 months. At the same time, the secondary vacancy level has increased from 8.3% to 12.9%.

Melbourne CBD Office Stock - January 2005						
	Stock		Vacancy		Historical Vacancy	
	(m2)	Share	(m2)	Rate	Jul-04	Jan-04
Prime	1,758,840	52.3%	121,238	6.9%	8.9%	11.0%
Secondary	1,604,442	47.7%	207,662	12.9%	11.6%	8.3%
Total	3,363,282	100.0%	328,900	9.8%	10.2%	9.7%

Melbourne CBD including Docklands
Source: PCA, Office Market Report, January 2005; m3property

The 'flight to quality' is also evident when considering vacancy by precinct. Areas with the highest proportions of prime stock recorded the lowest vacancy factors. However, in the case of the Eastern precinct the vacancy level is expected to come under pressure over the next 18 months, due to some movement out of the area, uncommitted space in new developments yet to be completed and movements within the area creating significant amounts of backfill space.



A further 253,350 square metres of new and refurbished office accommodation will be completed within the CBD core between 2005 and 2006. At Docklands, another 59,015 square metres will be added between 2005 and 2007, including two recently announced buildings, the AXA headquarters at Batman's Hill and the Podium building at Digital Harbour. In addition, Freshwater Place will add 53,814 square metres of office space by mid 2005 at Southbank.

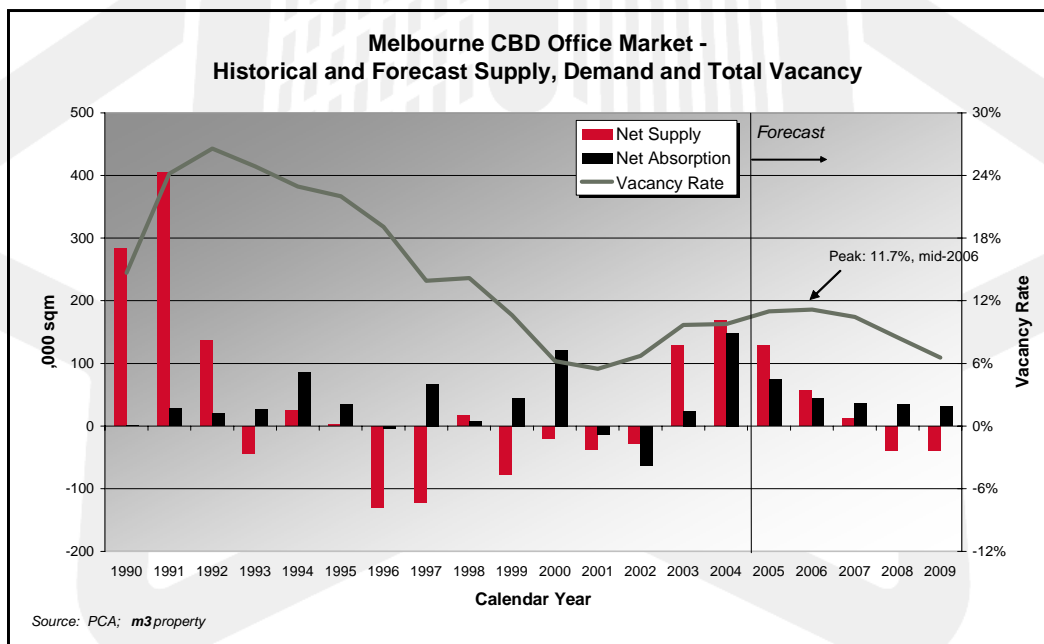
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New Supply		2005	2006	2007	Total
Precinct	Type of Development				
CBD Core	New Construction	152,132	75,918	0	
	Refurbishment	5,300	20,000	0	
	CBD Core Sub-Total	157,432	95,918	0	253,350
Docklands	New Construction	8,015	0	51,000	59,015
Southbank (Freshwater Place*)	New Construction	53,814	0	0	53,814
Grand Totals		219,261	95,918	51,000	366,179

* Freshwater Place not included in CBD definition
Source: m3property

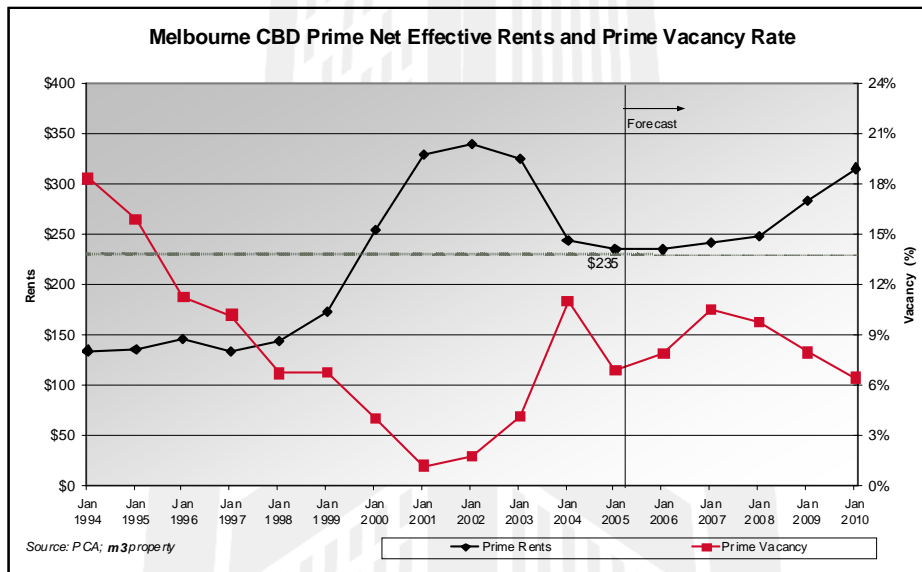
On the demand-side, in the 2004 calendar year net absorption was recorded at 148,740 square metres, the strongest result in two decades. Due to the trading-up by tenants, net absorption in prime buildings totalled 199,460 square metres, compared with negative 50,720 square metres in the secondary market. While it is expected to ease slightly from its recent record highs, total net absorption is likely to remain above recent historical averages in 2005 and 2006.

Notwithstanding the forecast of strong demand for office accommodation, the Melbourne CBD office market will be most significantly influenced by the continued delivery of new supply over the next three years. Combining our supply and demand projections, we forecast total vacancies increasing to a peak of 11.7% in the middle of 2006. Following this, vacancies are unlikely to fall below 10% until 2008, with the next construction cycle expected to bring new office stock onto the market by 2011. Due to the continued trading up by tenants over the current construction cycle, the vacancy level within prime buildings is likely to peak at a lower level, forecast at 10.6% in mid 2006.



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Due to the strong influence Freshwater Place will have on the CBD market, being a premium quality building located closer to the CBD core than Docklands, and the implication of CBD backfill space, we have also considered the vacancy level with Freshwater Place included in the CBD definition. This sensitivity analysis shows that the vacancy level peaks at 12.4% in mid-2006 (due to the current commitment level in Freshwater Place being lower, at 44%). Conversely, due to the high level of pre-commitment at Docklands, we have also conducted a sensitivity analysis considering the CBD core (that is, without Docklands). In this scenario, the vacancy level peaks at 12.2% in mid-2006.



Considering rents, the market's knowledge of pending supply pressures has created an extremely competitive leasing environment. Although the projected peak in vacancies is still at least one year away, effective rents have declined considerably over the past three years, but have stabilised over the past twelve months. Lease incentives have become commonplace, currently as high as 20% to 25% of face rents and, in some cases, as much as 30%.

Based upon our forecasts for the prime market, we believe that net effective rents have reached their trough and will remain stable over the next 18 months, before returning to growth by mid 2006 with particularly strong growth expected in the latter part of this decade. The outlook for secondary rents is not as strong, due to the continuing impact of tenants moving into newly completed projects and backfill prime space. The trading up effect will see prime stock outperform secondary over the next five years.

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