

FIGURES | MELBOURNE FRINGE & SUBURBAN OFFICE | Q2 2024

Limited Upcoming Supply Should Aid Asset Fundamentals Over Upcoming Years.

▲ 4.5%

Victorian Unemployment Rate (June 2024)

▲ 17.96%

Prime Southbank Vacancy (+139bps h-o-h)

▲ 1.7%

Prime City Fringe NFR Growth q-o-q

▲ 128 bps

Prime City Fringe Yield Change y-o-y

Note: Arrows indicate change from previous quarter / year.

Key Points

- Leasing demand was negative across both Southbank and St Kilda Road over H1 2024 with both precincts recording 6-month absorption of -10,024sqm and -5,424sqm respectively.
- The office development pipeline remains empty for Southbank and St Kilda Road. Development activity in Melbourne’s City Fringe and Inner East remains modest, however is tapering off compared to levels experienced over 2020-2023.
- Vacancy for prime assets remains below secondary grade stock as of H1 2024 across both precincts. Total vacancy in St Kilda Road saw a mild decrease of -12bps over the last 6-months, attributed partly to negative net supply.
- Face rents across the fringe and suburban market saw mixed movements, with precincts experiencing stability or declines. Elevated incentives continue to put downward pressure on effective rents across most precincts.
- Investment activity in Melbourne’s Fringe and Metro markets remains subdued, with \$104m in fringe and suburban assets transacting over H1 2024. Despite subdued volumes, yields continue to see expansion as pricing adjusts to meet investor buyer-vendor expectations.

FIGURE 1: Summary of Prime Market Fundamentals

St Kilda Road	Q2 2024	Q1 2024	Q2 2023	Southbank	Q2 2024	Q1 2024	Q2 2023
Vacancy	27.4%	-	27.0%	Vacancy	18.6%	-	17.9%
NFR	\$462/sqm	\$462/sqm	\$468/sqm	NFR	\$630/sqm	\$641/sqm	\$641/sqm
Incentives	49.8%	48.8%	42.6%	Incentives	45.2%	43.8%	40.5%
NER	\$232/sqm	\$237/sqm	\$268/sqm	NER	\$345/sqm	\$361/sqm	\$382/sqm
Yield	8.10%	7.78%	6.88%	Yield	7.73%	7.31%	6.44%

Source: PCA, ABS, CBRE Research

Economic Overview

Economic growth remains positive, driven by elevated migration levels.

Economic growth conditions nationally remained positive over Q1 2024, growing by 0.1% on a nominal basis. This was the lowest recorded quarterly growth over the last 12-months. The June data release also signalled the fourth consecutive quarter of negative per capita GDP growth.

The Australian economy continues to be held up by elevated migration levels. Without the significant population increases associated with a liberal migration stance, Australia’s GDP is likely to have already turned negative over the last 12-months. Policy decision-makers are likely to take this information into account.

Future interest rate path showing heightened uncertainty amidst the May inflation read.

Australia’s cash rate remains at its recent peak of 4.35%, however heightened inflation conditions have created further doubt as to whether this will be the peak, or when the RBA will begin decreasing rates. These concerns were previously spurred by the May monthly CPI (inflation) indicator, which showed a year-on-year increase of 4.0%, higher than many official forecasts and expectations. However, the latest June read of inflation saw a year-on-year increase of 3.8%, in line with expectations, and seemingly subsiding expectations of a further rate hike.

Prior CBRE research in ‘Why Melbourne Office’ noted that throughout prior cash rate cycles from 2000, the longest duration rates have been at a relative peak is 12-months. Currently, Australia has been at its relative peak for 8-months. CBRE Research continues to have a house-view that Australia will see its first rate cuts before the end of 2024. This is supported by historical trends, and a view that declines in the cash rate will be necessary to spur future economic growth.

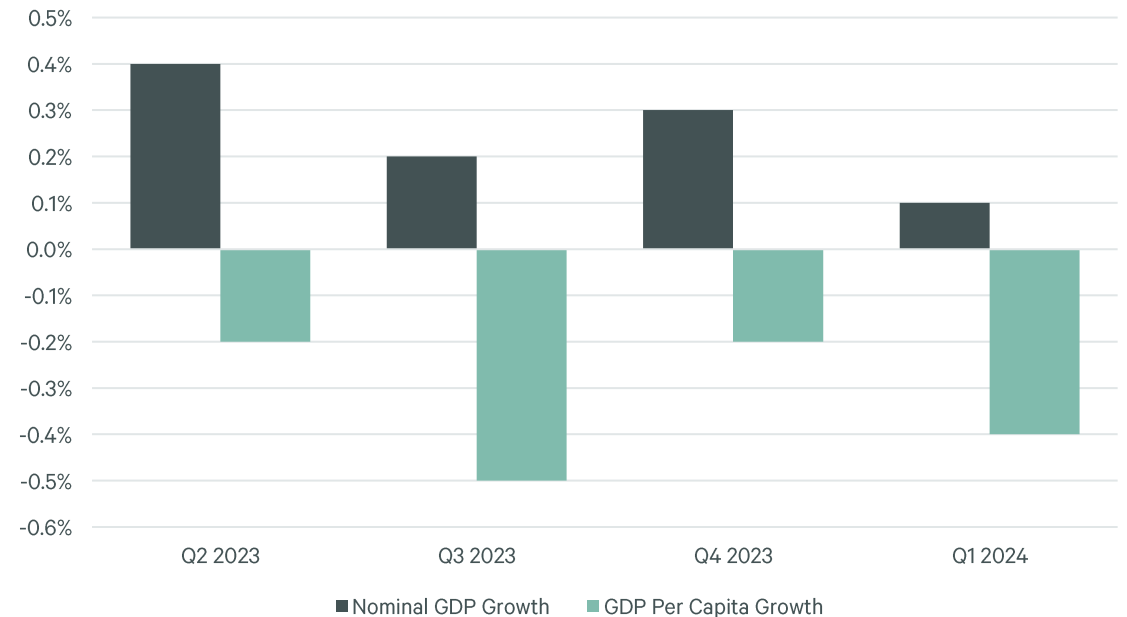
Unemployment rate loosening, both on a state and national level.

Labour market conditions continue to slacken across the country. Australia’s and Victoria’s unemployment rates grew by 10bps and 50bps to 4.0% and 4.5% respectively in the three-months to June 2024. A slackening labour market helps reduce inflationary pressures across the country and should further assist arguments supporting declines in the official cash rate.

Continued elevated migration set to aid office demand in the medium-term.

Given the current mixed, slightly bleak economic performance recorded in the past 12-months, we expect overseas migration levels to remain modestly high over the coming years. As aforementioned, this is driven by a belief that elevated migration will be necessary to maintain positive economic growth over the coming years. Office demand is set to benefit from this. As more individuals enter the state, we expect net absorption levels to increase as businesses adjust to an evolving workforce.

FIGURE 2: Australian Nominal and Real Growth Comparison by Quarter



Source: ABS, CBRE Research

Office Demand

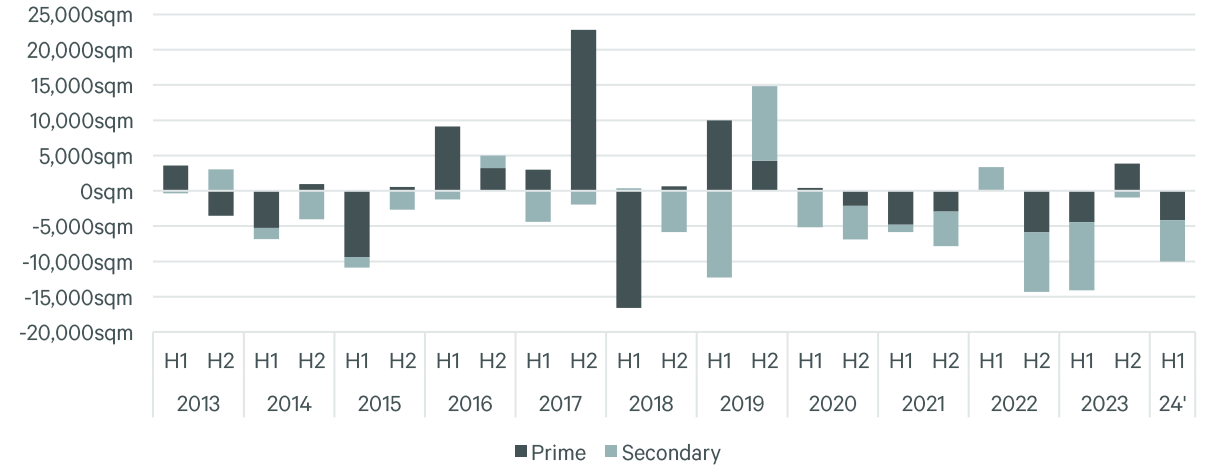
Demand levels remain subdued across Melbourne’s Fringe. Elevated incentives in CBD precincts lowering demand.

Melbourne’s fringe precincts continue to experience mixed performance. Over the last 6-months, negative total absorption was recorded in both Southbank and St Kilda Road, with total net absorption of -10,024sqm and -5,424sqm seen. This represents a mild improvement from H2 2023 for St Kilda Road, and a moderate worsening for Southbank.

The flight-to-quality trend evidenced across Melbourne’s CBD has shown occasional signs in Melbourne’s Fringe markets, however the impacts are more nuanced. Namely, elevated incentives in key CBD precincts is having a cannibalisation effect locally. Occupiers with generic requirements, looking for high-quality space in Melbourne’s Fringe precincts, have begun questioning the possibility of entering the CBD where incentives exceeding 50% are becoming more common. This is compared to the <40% incentives common across Melbourne’s metro.

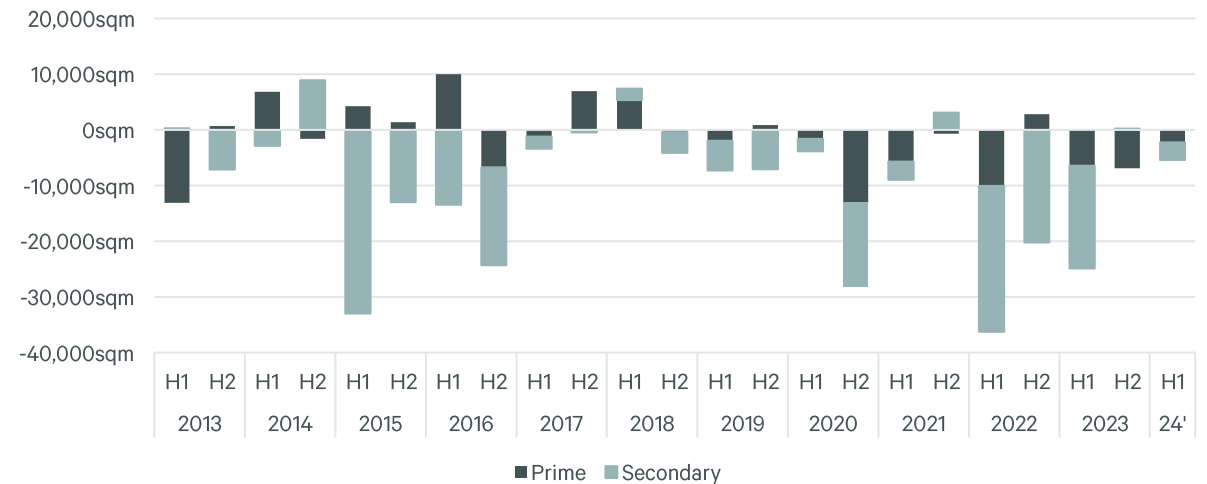
Pockets of positive demand remain present across Melbourne’s Fringe and Suburban precincts. Certain assets with key features, transport accessibility and amenity are still seeing strong demand levels with a select group of occupiers.

FIGURE 3: Southbank 6-month Net Absorption



Source: PCA, CBRE Research

FIGURE 4: St Kilda Road 6-month Net Absorption



Source: PCA, CBRE Research

Supply

Majority of upcoming supply currently in ‘Development Application’ stage.

H1 2024 has seen the completion of multiple major office developments across the metro, accounting for c.61,000sqm of new office space, concentrated in Melbourne’s City Fringe. Total expected supply across Melbourne’s City Fringe and Inner East markets over 2024 is expected to reach c.90,000sqm, with no developments expected across Southbank and St Kilda Road.

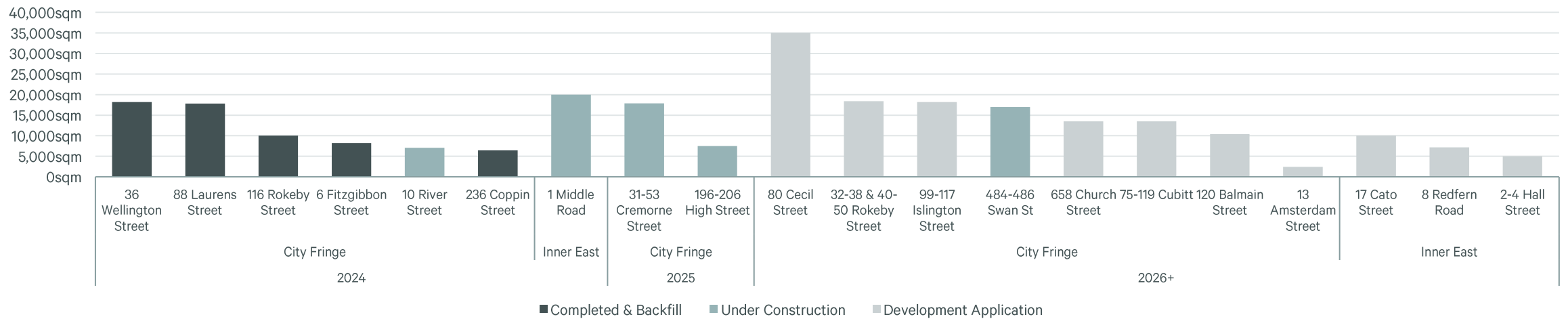
CBRE Research data suggests c.370,000sqm of new or majorly refurbished office space entered the City Fringe and Inner East markets over 2020-2023. Development activity is expected to remain modest with more than 130,000sqm of developments currently in the Development Application stage. Expectations are that despite short term pressures existing in the form of rising construction costs, elevated cost of debt and lender scrutiny increasing, most of these projects will reach completion due to their relative size and respective owner profiles.

FIGURE 5: Historical and Future Supply by Year and Precinct



Source: CBRE Research

FIGURE 5: Upcoming City Fringe and Inner East Developments by Development Stage



Source: CBRE Research

Vacancy

Vacancy continues to see mixed results in Melbourne’s Fringe markets.

Vacancy rates in Southbank over H1 2024 rose moderately and declined slightly in St Kilda Road. Over the 6-month period, Southbank recorded a 161bps increase to 18.64%, whilst St Kilda Road’s vacancy decreased slightly by 12bps to 27.38%. St Kilda Road continues to be the most impacted by the changing nature of tenant preferences across Melbourne.

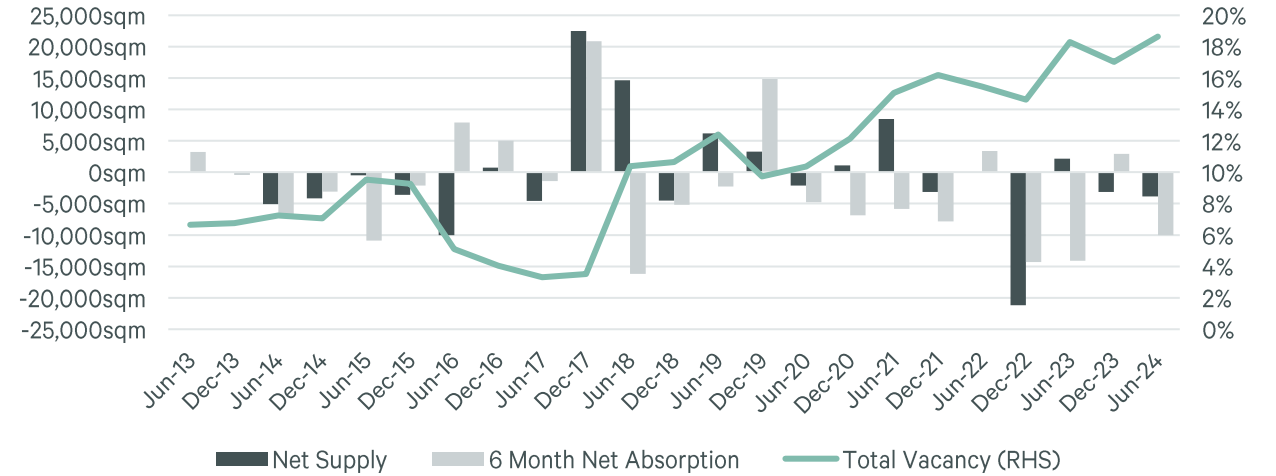
In Southbank, prime vacancy recorded slightly better performance over H1 2024, compared to its secondary counterpart, with increases of +139bps and +215bps seen respectively. On the contrary, secondary vacancy outperformed prime in Melbourne’s St Kilda Road, with secondary vacancy declining by 80bps compared to a prime increase of 83bps.

These mixed results indicate two key trends; Tenant demand continues to concentrate into select assets with unique and select offerings, and affordability for occupiers is seemingly becoming a more significant aspect of tenant decision-making.

For Southbank, whilst total vacancy has increased over the last 6-months, key assets continue to outperform and see strong leasing activity with moderate rental growth. The same can be said for St Kilda Road, outlier assets remain driven by key internal and external building offerings.

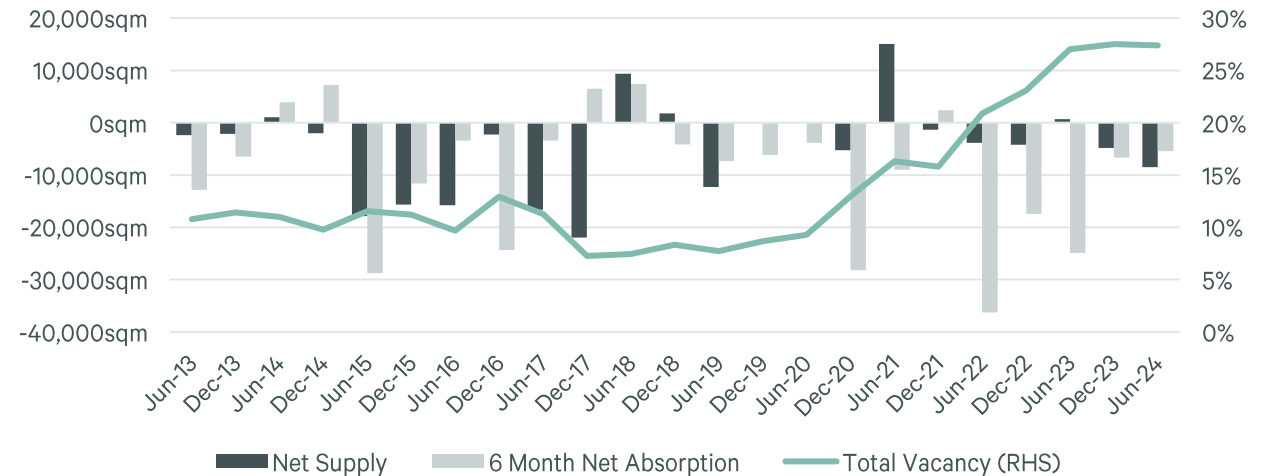
Source: PCA, CBRE Research

FIGURE 6: Southbank Office Market Balance



Source: PCA, CBRE Research

FIGURE 7: St Kilda Road Office Market Balance



Source: PCA, CBRE Research

Rental Performance

Mixed rental rate performance over H1 2024, with strong performing assets continuing to demonstrate high growth levels.

Prime face rents across Melbourne’s fringe and suburban markets experienced further bifurcation over Q2 2024. Negative year-on-year growth face rent growth was experienced by Southbank and St Kilda respectively, with -1.83% and -1.28% growth recorded to Q2 2024. In contrast, all suburban precincts have experienced positive year-on-year performance over the last 12-months.

This can be attributed to increasing competition between fringe and CBD assets. Notably, recent developments in Melbourne CBD’s office market has created an environment with elevated incentives in under-performing precincts which is detracting leasing demand in fringe assets.

Suburban precincts are less impacted by this trend. Tenant composition in these precincts are typically drawn to the unique characteristics on offer within the non-central suburbs. As a result, rental growth in these locations has remained relatively resilient over the same period, as tenants are less inclined to lease space in CBD locations.

However, prime incentives continue to rise across fringe and suburban precincts, increasing by 900bps on average across the 12-months to Q2 2024. Demand has continued to weaken across all precincts over the last 12-months, and landlords in these precincts are raising incentives aggressively to attract tenants in the current environment.

Important to note is that key assets in all precincts are experiencing strong rental growth and resilient incentives. Melbourne’s office market, including the fringe and suburban precincts are experiencing continued bifurcation which is driving lease fundamentals.

FIGURE 9: Prime Net Face Rent Growth from Base Period (Q2 2021) by Precinct.



Source: CBRE Research

FIGURE 10: Prime Incentive Movement (bps) from Base Period (Q2 2021) by Precinct



Source: CBRE Research

Investment Market

Investment activity in Melbourne’s Fringe and Suburban markets remains subdued as at H1 2024.

Sales across Melbourne remain at historically low levels as at H1 2024. As at Q2 2024, \$369m in office transactions have taken place across the state, with \$104m taking place in suburban locations. Major transactions across the suburban market over H1 2024 include Botanicca Seven & Botanicca Nine for c.\$38.5m and c.\$41.5m respectively.

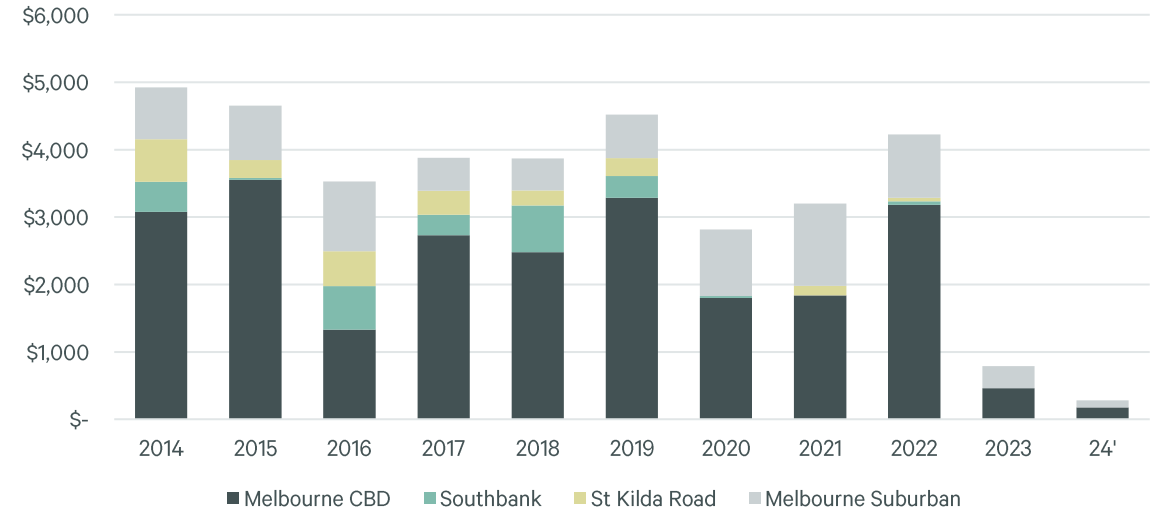
Investor activity remains relatively cautious despite significant repricing already taking place over the last 24-months. In the short term, multiple standalone and mixed-use office assets are currently on the market heading into H2 2024. Expectations are that heightened activity will emerge as investor expectations become more aligned in an environment of elevated stability.

Aggressive yield expansion remains, however certain assets remain resilient in current office environment.

Yield expansion continued across all precincts in Q2 2024. Valuations continue to adjust to reflect changing market conditions and expectations. As at Q2 2024, prime yields across fringe and suburban precincts rose 37bps on average q-o-q and 115bps y-o-y.

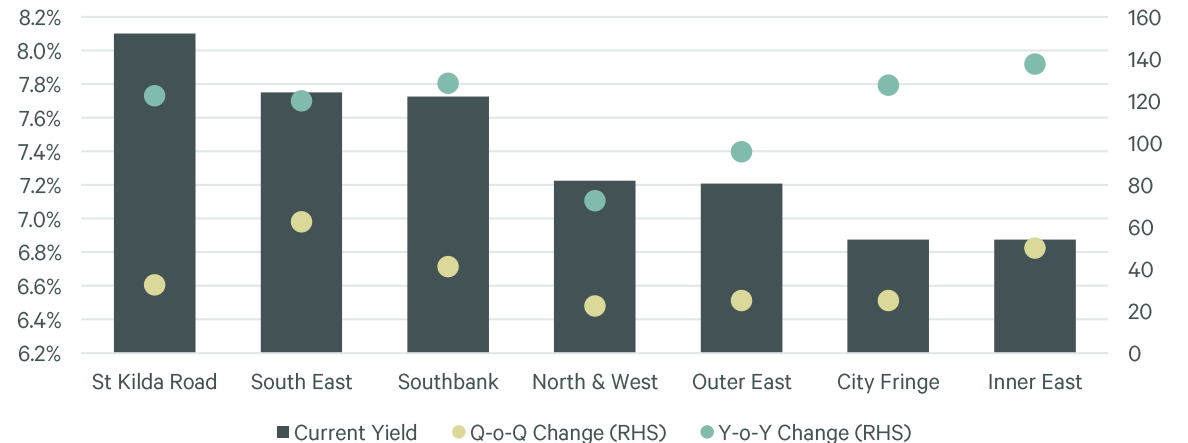
Currently, prime yields across all precincts are above 6%, with some underperforming precincts reaching levels between 7.5-8.5%. Important to note is that key assets in both resilient and unperforming precincts are experiencing resilient yield movement. Investor preference remains strong for high quality locations assets in key locations across the fringe and suburban markets, and this continues to drive yield movements and investment activity locally.

FIGURE 11: Melbourne Office Sales (greater than AUD 20 million)



Source: CBRE Research

FIGURE 12: Melbourne Metro Current Yields and Yield Movements by Precinct



Source: CBRE Research

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