Effective Rent Growth Remains as Incentives Continue to Normalise in Select Precincts.

▲718 AUD/sqm
Net Face Rent (+1.53% q-o-q)

▲47.2%
Prime Incentives (+36 bps q-o-q)

▲18.0%
CBD Office H1 2024 Vacancy (+313 bps y-o-y)

▲6.53%
Prime Yield (+48 bps q-o-q)

Note: Arrows indicate change from previous quarter / half / year.

Key Points

- Leasing demand in Melbourne's CBD improved moderately, however net absorption remains negative, with 6-month net absorption of -15,435sqm recorded. Negative net absorption was partially offset by strong positive demand for Premium grade office space (+2,116sqm).
- Supply completions over Q2 2024 included Melbourne Quarter Tower (69,000sqm), a Docklands asset which achieved a c.40% pre-commitment rate prior to practical completion.
- Melbourne CBD's overall vacancy rate ended H1 2024 at 18.0%. This figure represented an increase of 157bps from H2 2023. Vacancy continues to bifurcate across precincts as tenant preference becomes more pronounced.
- Prime net face rents continue to see growth across most precincts. Incentives in Q2 2024 continued to experience stability, resulting in positive prime effective rent growth this quarter.
- Melbourne CBD office sales remained subdued in Q2 2024, with $121m in CBD assets transacting. Yields expanded moderately across Melbourne due partly to recent deal evidence in the market.

FIGURE 1: Melbourne CBD Office | Summary of Prime Market Indicators

Melbourne CBD	2Q24	1Q24	2Q23	Q-o-Q Change	Y-o-Y Change
GFR	**AUD 929**	AUD 914	AUD 873	+1.67%	+6.38%
NFR	**AUD 718**	AUD 707	AUD 683	+1.53%	+5.09%
Incentives	**47.2%**	46.9%	42.9%	+36 bps	+433 bps
NER	**AUD 380**	AUD 377	AUD 391	0.93%	-2.70%
Yield	**6.53%**	6.05%	5.3%	+48 bps	+122 bps

Source: 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 it's 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 it's 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.

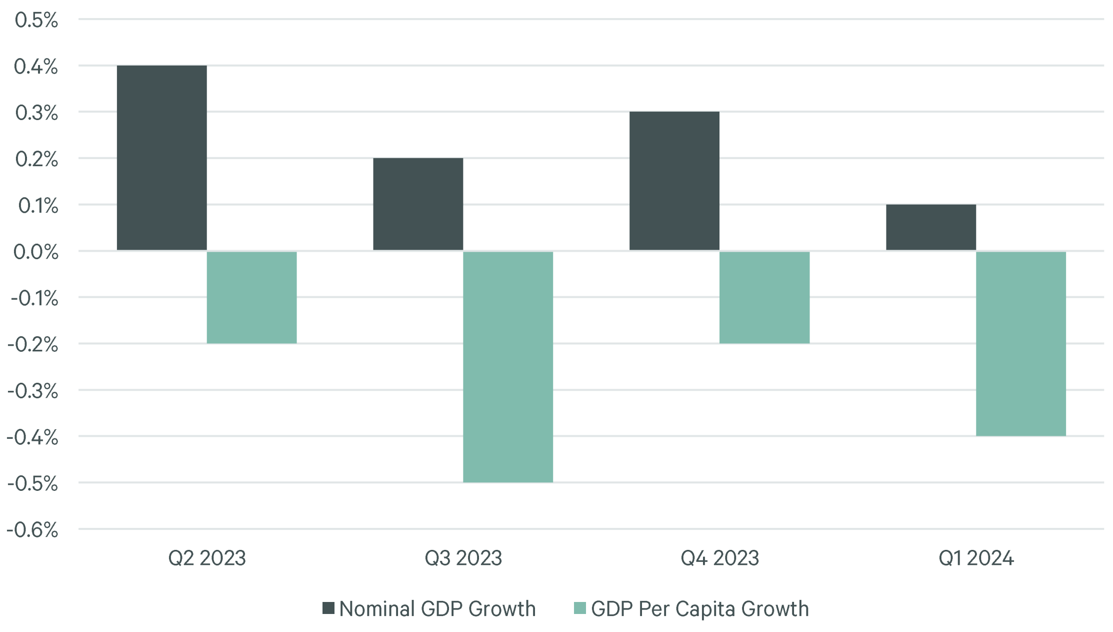
Unemployment rate loosening, both on a state and national level.

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 Per Capita GDP Growth Comparison by Quarter



Source: ABS, CBRE Research

Office Demand

Premium outperformance remains as further evidence of the flight-to-quality.

Melbourne CBD saw another period of overall negative absorption as office vacancy continues to adjust to fluctuations in tenant activity. As of H1 2024, trailing 6-month net absorption totalled -15,435sqm compared to -52,729qm on a trailing 12-month basis in Melbourne's CBD. These figures are further indication of occupier right-sizing. Notably, net absorption continues to trend in a positive direction. For the 2nd consecutive period, negative absorption has seen a significant improvement from the prior period.

Continuing the trend from H2 2023, Premium grade office space was the only grade that saw moderate positive net absorption. We continue to attribute this to tenant flight-to-quality, which is leading to further bifurcation between precincts and asset grades across Melbourne.

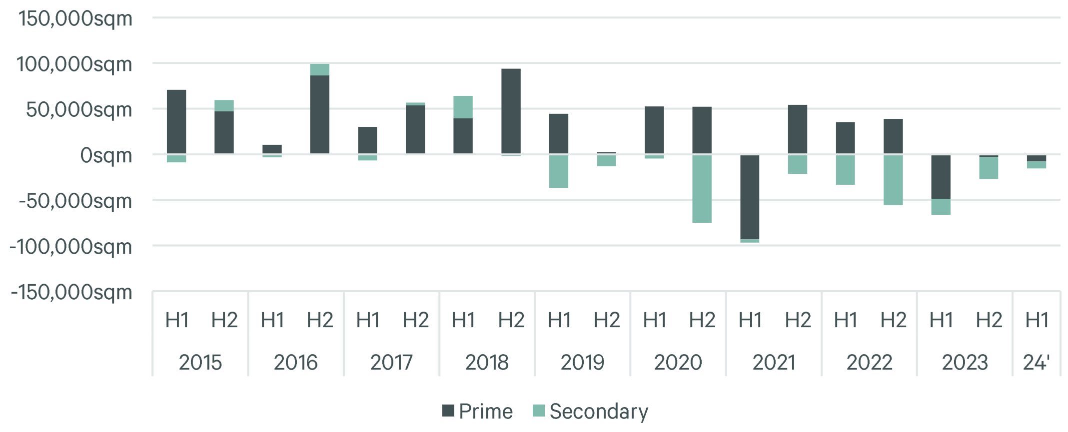
Precinct bifurcation remains as tenant preferences becoming increasingly selective.

On a precinct level, H1 2024 saw mixed results across precincts. This reaffirms our existing view of the bifurcation currently experienced across Melbourne. We continue to note the flight-to-quality trend remains, with tenant requirements for quality space, strong amenity and good accessibility being key factors driving decision making.

Affordability is another key factor driving the absorption performance recorded In H1 2024. Over H2 2023, we noted the key driver for Docklands positive absorption to be the elevated incentives it experienced, creating an attractive, affordable CBD option for Melbourne based tenants in the market.

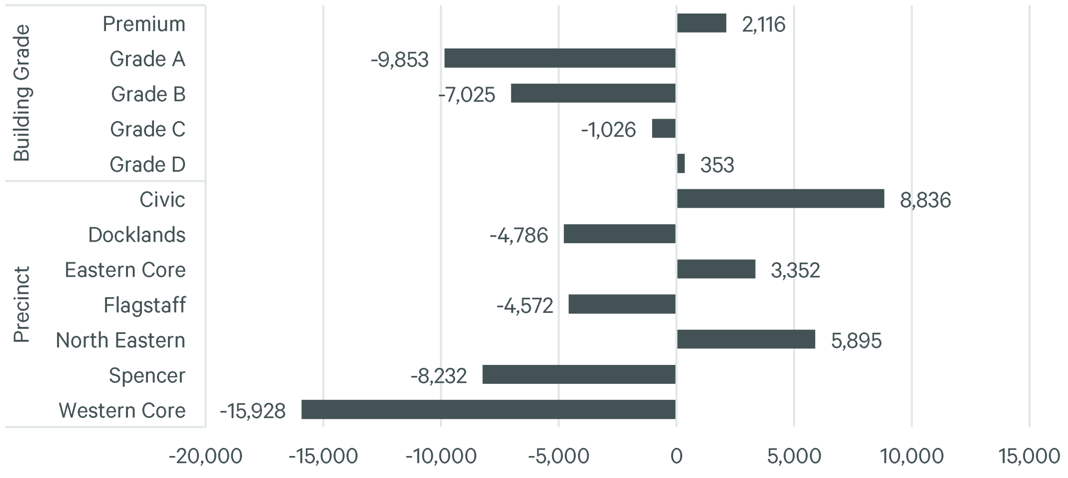
This trend remains prevalent in H1 2024, with Melbourne's North Eastern precinct, which has experienced a significant rise in incentives over the last 12-months (+1,000bps), comparable to the Docklands precinct. Deals in this precinct have become more attractive for both traditionally CBD based occupiers as well as historically fringe based tenants. This is the key reason we attribute to the positive net absorption experience in this precinct over H1 2024.

FIGURE 3: Melbourne CBD Office | 6-Month Net Absorption, by Building Grade



Source: PCA, CBRE Research

FIGURE 4: Melbourne CBD Office | 6-Month Net Absorption (sqm), by Building Grade & Precinct, H1 2024



Source: PCA, CBRE Research

Supply

Melbourne CBD office supply remains limited until 2026.

Melbourne's CBD saw the practical completion of the Docklands development, Melbourne Quarter Tower (c.47,000sqm) in H1 2024, the first major new office completion in the year. Beyond Melbourne Quarter Tower, H2 2024 is expected to see the completion of two minor refurbishments in 85 Spring street and 299 Bourke street, bringing the total CY2024 supply to c.89,000sqm.

Major new office developments in Melbourne’s CBD are expected to be limited for the next 18-months, until 2026, which is expected to see c.215,000sqm of supply, modestly above the 5-year historical average of c.180,000sqm.

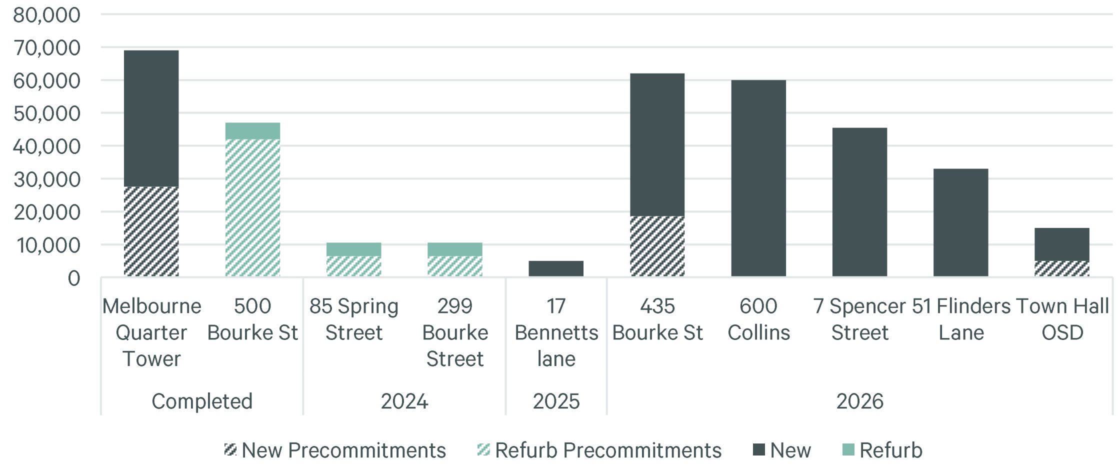
As noted in prior CBRE Research report ‘Why Melbourne Office’, the current and future supply pipeline is being pressured by the combination of elevated construction costs (35-40% higher than pre-covid) and feasibility concerns due to the current economic rents across the CBD (30%+ higher at pre-covid yield levels).

Project delays still possible dependent on short-term pre-commitment performance.

Limited pre-commitment activity has commenced in select developments slated for 2026 and beyond. Whilst some of these are anticipated to complete with no pre-commitments due to asset specific features and marketing decisions, this is not true for all assets within the pipeline.

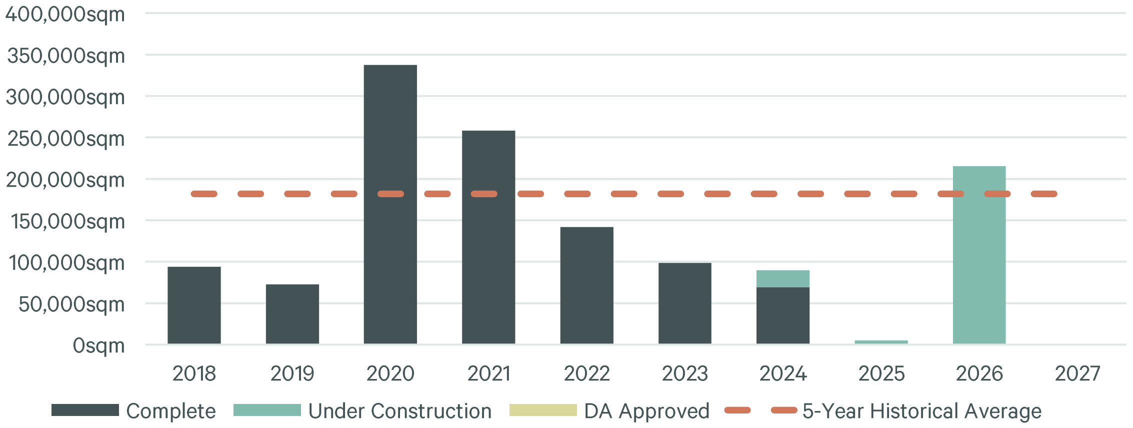
With an estimated c.330,000sqm in mooted developments in the CBD, Melbourne’s supply pipeline could easily change as developers continue to make evolving decisions in response to changes in market conditions.

FIGURE 5: Melbourne CBD Office | Upcoming Major Development Projects



Note: Mooted projects not shown
Source: CBRE Research

FIGURE 6: Melbourne CBD Office | Historical & Forecast Supply



Note: Mooted Projects not shown.
Source: CBRE Research

Vacancy

Total vacancy continues to rise, driven largely by supply-based factors.

Melbourne's CBD overall vacancy increased 155 bps to 18.0% in H1 2024. Vacancy across the CBD continues to experience consecutive increases since H1 2020. Underperformance in H1 2024 can be partly attributed to 69,000sqm of net supply brought to market with the recent completion of Melbourne Quarter Tower (MQT), which was unable to be fully absorbed by the market prior to completion.

Total vacancy across all asset grades saw increases in H1 2024, except for D grade office space, which saw a 53bps decline to 7.19%. The largest increase in vacancy was observed in Melbourne's Premium grade stock, which experienced a 490bps increase to 16.06% in H1 2024. In contrast, a milder increase of 78bps to 18.05% was observed in Melbourne's A grade stock.

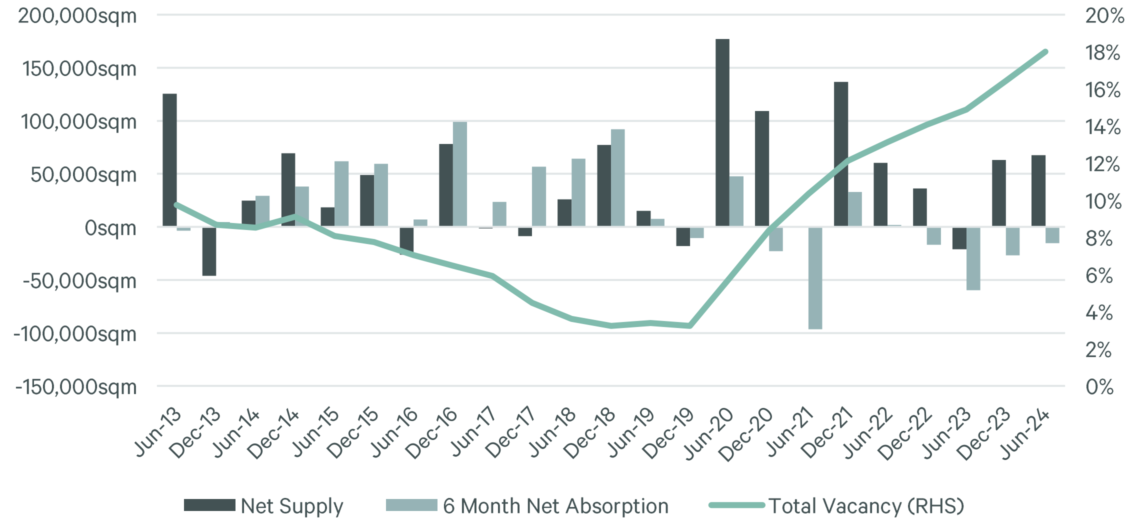
Whilst these figures, specifically the movement in premium vacancy, seemingly contradict evidence of the 'flight-to-quality' across Melbourne, we believe this is only half the story. Premium grade assets specifically, experienced mild positive absorption of 2,116sqm over H1 2024, thus, MQT's completion in Docklands is the key factor causing the abnormal spike in vacancy this period. To note, the subdued period of supply expected over the next 18-months should support declining vacancy in the short term.

Outliers remain in Melbourne's sublease vacancy market, with strong leasing activity continue to be recorded which should aid future volume reductions.

CBRE Research's sublease vacancy data suggests the emergence of two key precinct outliers in the sublease market. Notably, 2/3rds (67%) of sublease space available in the market is across 4 assets as of Q2 2024.

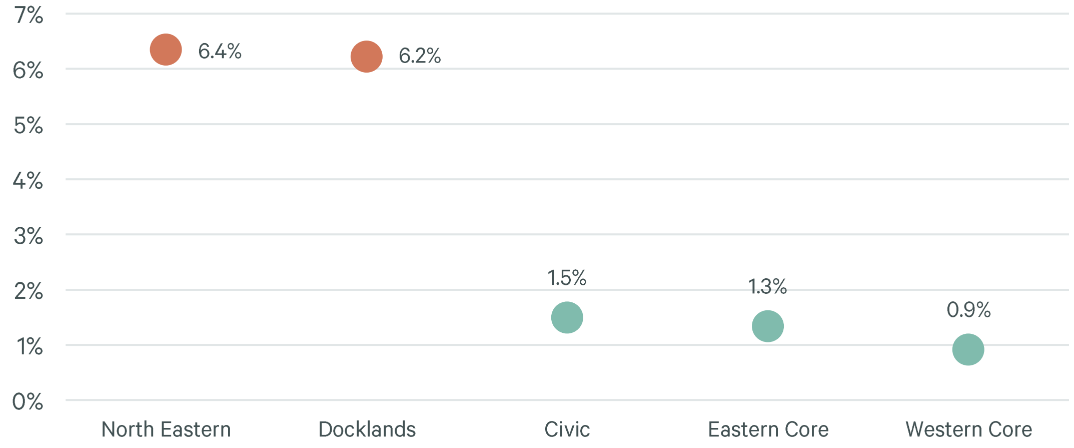
We continue to expect a gradual decline in sublease volumes over H2 2024, due to the attractive lease terms on offer in these availabilities, causing demand for these spaces remains moderately high.

FIGURE 7: Melbourne CBD Office | Market Balance



Source: PCA, CBRE Research

FIGURE 8: Melbourne CBD Office | Sublease Vacancy Rate by Precinct



Source: CBRE Research Sublease Barometer

Rental Performance

Premium outperformance remains as tenant preferences continue to be fragmented.

Face rents across Melbourne's CBD saw modest quarterly growth or stability in all precincts over Q2 2024. A similar trend was observed on a year-on-year basis, with all precincts experiencing non-negative growth.

Melbourne's occupiers continue to demonstrate a clear preference for key premium assets in core locations, driving elevated rental growth. This is observed through the widening spread between year-on-year premium and grade A rental growth. As of Q2 2024, this spread has increased to 400bps, as year-on-year premium growth has increased to 6.9% compared to grade A stock of 2.9%.

This trend is more pronounced in select precincts, such as the Eastern Core, which has recorded a spread of 1100bps, as premium net face rents in this precinct have grown 13.0%, compared to 2.0% in grade A stock.

Effective rents see signs of growth as incentives continue to stabilise in most precincts.

Over Q2 2024, most Melbourne precincts recorded positive or stable quarterly effective rental growth. Whilst year-on-year effective rent growth remains negative in all precincts except for the Eastern Core, performance in the Civic, Flagstaff and Western Core precincts is gradually trending towards positive year-on-year growth. Notably, this trend is driven by stabilising or declining incentives in these precincts.

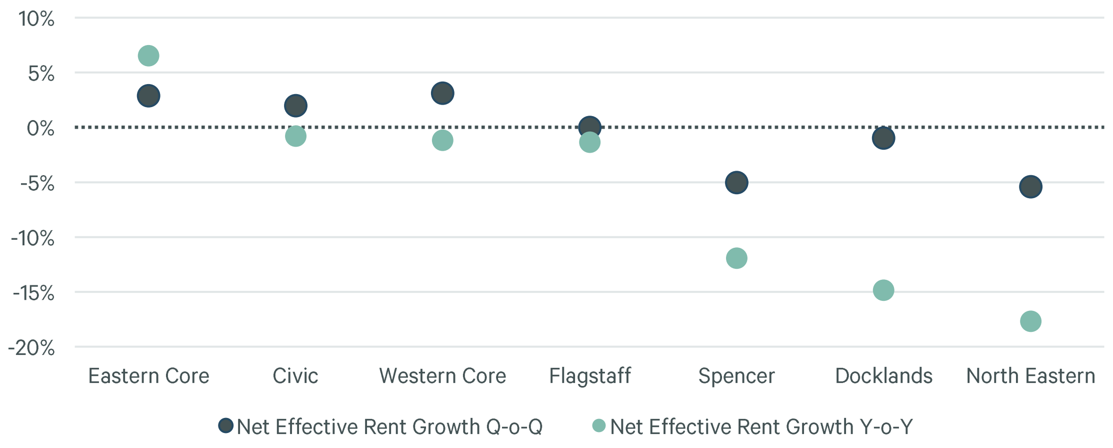
Recent incentive developments in Melbourne CBD's Prime office market is evidence of demand levels normalising in most precincts. Landlords in high performing assets are beginning to hold firm with respect to incentives as vacancy levels in these assets begins to decline. Expectations are that incentives will continue to bifurcate over H2 2024, with overall stability anticipated from 2025 onwards.

FIGURE 9: Melbourne CBD Office | Prime Rental Indicators, by Precinct

Melbourne CBD Precinct	Prime NFR (AUD/sqm)			Prime NER (AUD/sqm)			Prime Incentives (%)		
	2Q24	Q-o-Q Change	Y-o-Y Change	**2Q24**	Q-o-Q Change	Y-o-Y Change	**2Q24**	Q-o-Q Change	Y-o-Y Change
Civic	**703**	2.0%	5.2%	**377**	2.0%	-0.8%	**46.4%**	Stable	325 bps
Docklands	**552**	2.0%	2.2%	**234**	-0.9%	-14.8%	**57.5%**	125 bps	850 bps
Eastern Core	**858**	2.5%	7.9%	**521**	2.9%	6.5%	**39.8%**	Stable	120 bps
Flagstaff	**568**	Stable	4.4%	**295**	Stable	-1.3%	**48.0%**	Stable	300 bps
North Eastern	**612**	Stable	Stable	**285**	-5.4%	-17.6%	**53.3%**	267 bps	1,000 bps
Spencer	**673**	2.3%	3.9%	**319**	-5.0%	-11.9%	**52.5%**	250 bps	850 bps
Western Core	**755**	1.0%	4.0%	**405**	3.1%	-1.2%	**46.3%**	-113 bps	275 bps

Source: CBRE Research

FIGURE 10: Melbourne CBD Office | Prime Net Effective Rent Growth Rates by Precinct



Source: CBRE Research

Investment Market

Transaction volumes remain modest with buyer-vendor expectations narrowing.

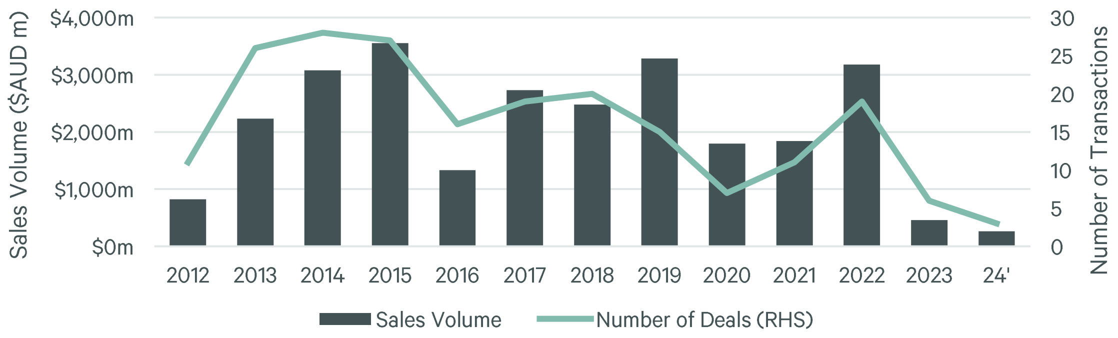
Sales volumes in Melbourne's CBD over Q2 2024 reached $121m, a mild decline from Q1 2024 (c.$144m)[1]. Activity recorded over H1 2024 remains subdued compared to prior years.

Recent sales evidence across Melbourne is indication of improving confidence in the sector, at the correct pricing. Whilst buyer-vendor expectations have been mismatched over the last 18-months, we believe this gap to be narrowing. Multiple assets in the >$100m price range have begun to see sales activity in the last 6-months. Whilst the only confirmed sale of this size as of Q2 2024 is 628 Bourke Street, CBRE research acknowledges multiple deals are currently pending which should result in total sales volume above levels seen in 2023.

Yields see sharp expansion as first signs of major deal evidence are recorded.

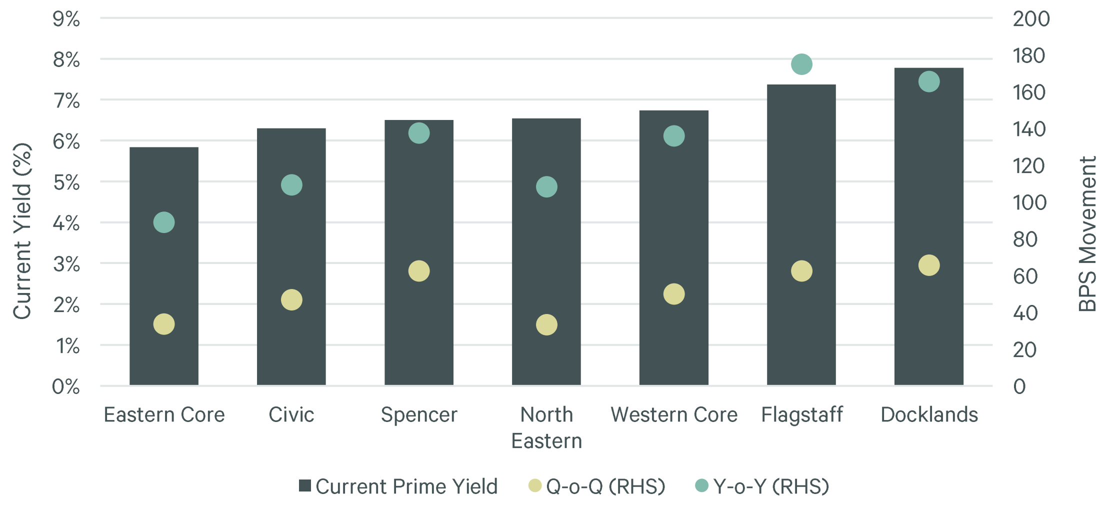
Average CBD prime yields expanded 48bps to 6.53% in Q2 2024, a moderate increase from the 16bps increase seen in Q1 2024. We attribute the elevated increase in yields to recent evidence recorded in the market, providing guidance as to current market pricing conditions in Melbourne.

FIGURE 11: Melbourne CBD Office | Sales Activity[1]



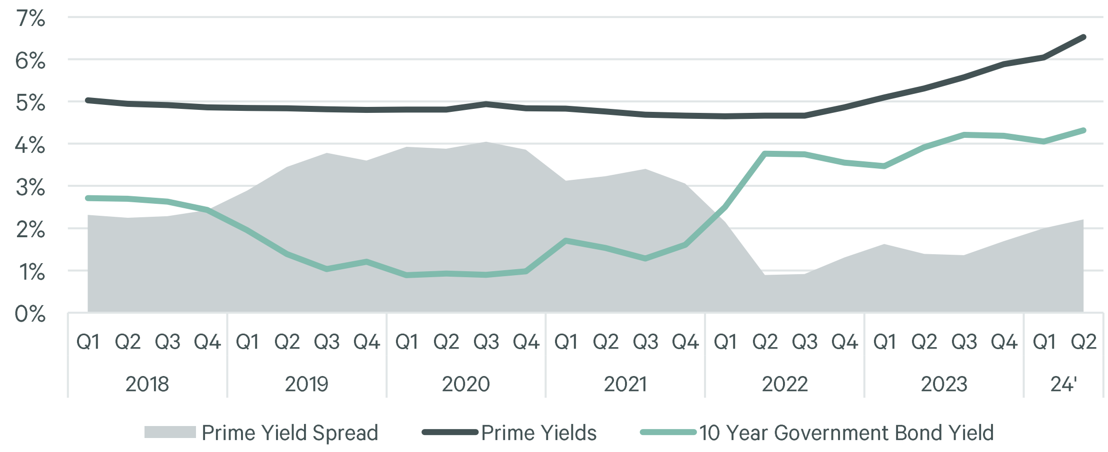
Source: CBRE Research
[1]Includes sales above >$20m AUD.

FIGURE 12: Melbourne CBD Office | Current Prime Yield and Prime Yield Change by Precinct



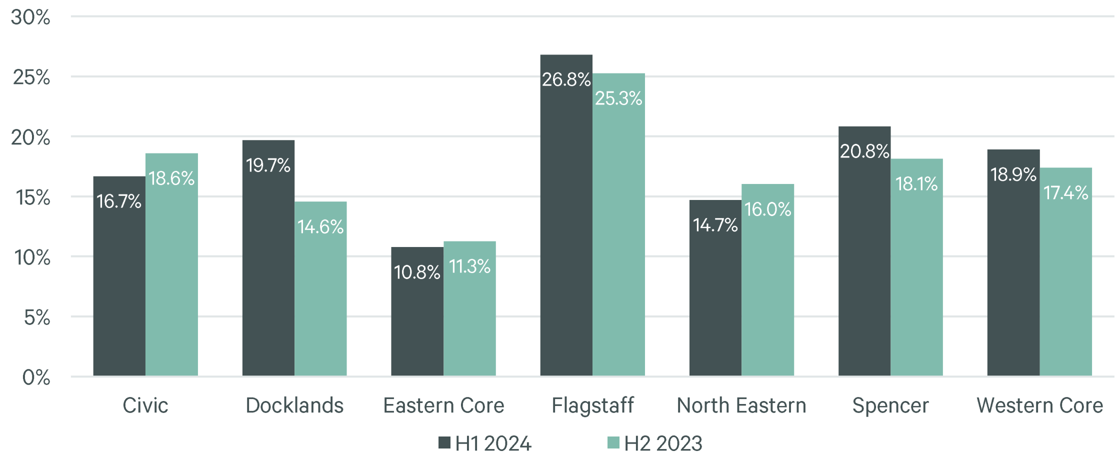
Source: CBRE Research

FIGURE 13: Melbourne CBD Prime Office Indicative Yields vs Commonwealth Government 10-yr Bond Yields



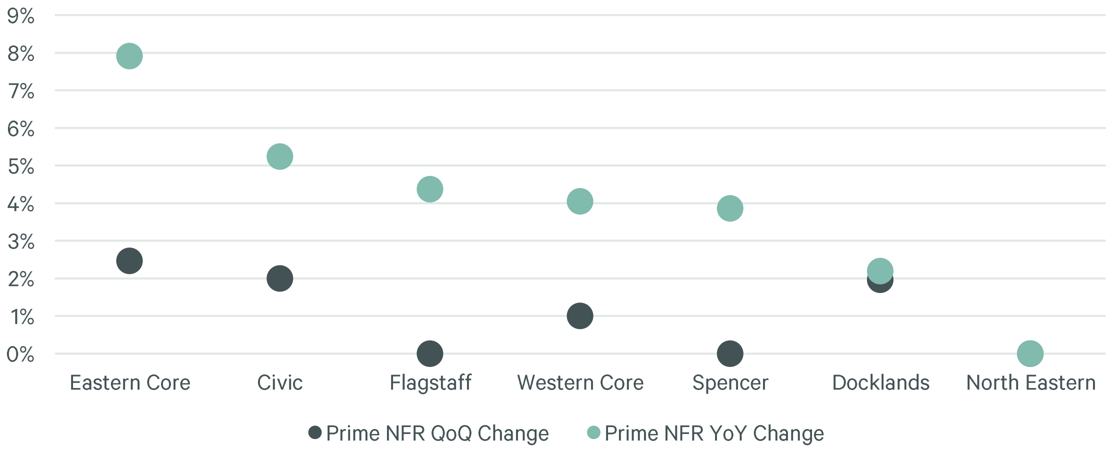
Source: RBA, CBRE Research

FIGURE 14: Melbourne CBD Office | Total Vacancy Rate by Precinct



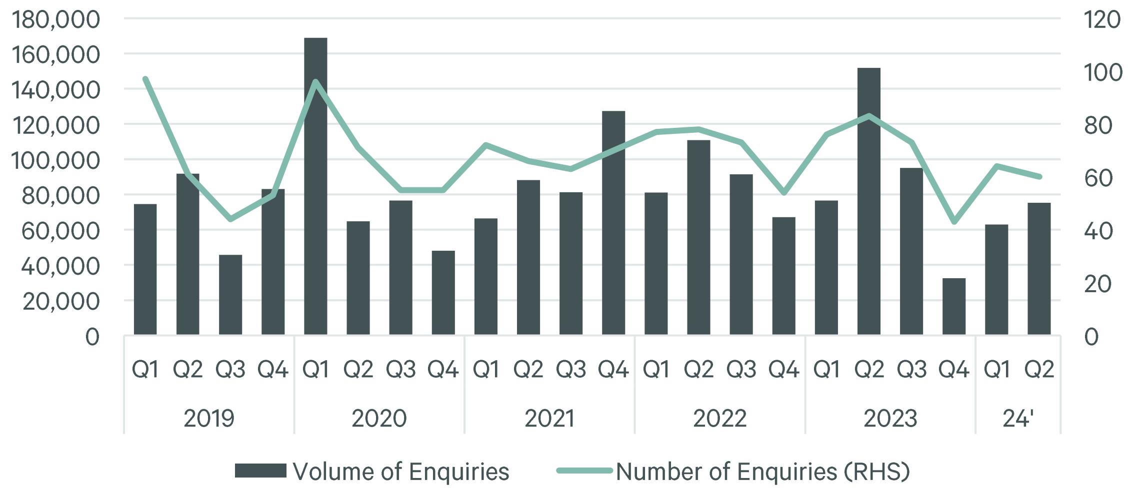
Source: PCA, CBRE Research

FIGURE 16: Melbourne CBD Office | Net Face Rental Rates Growth Rates by Grade



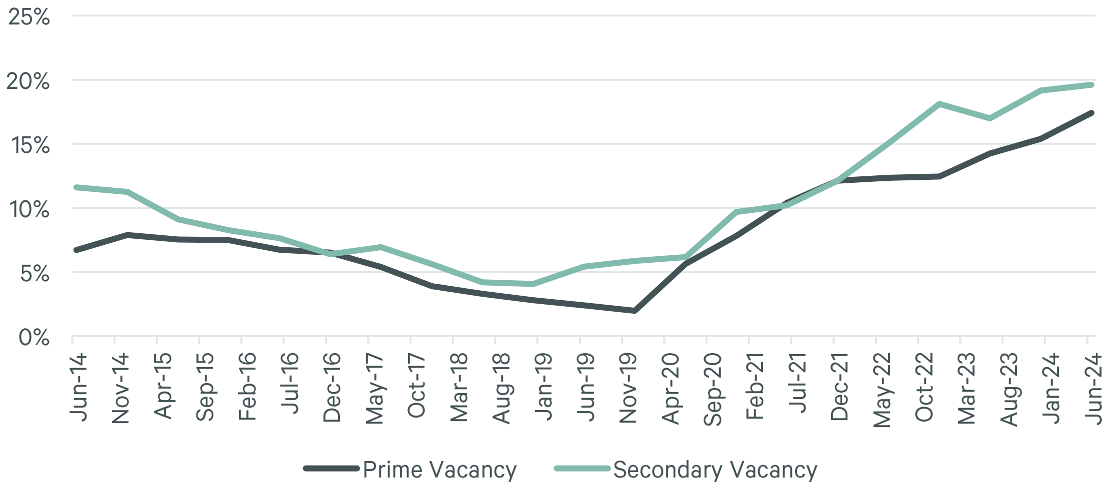
Source: CBRE Research

FIGURE 15: Melbourne CBD Office | Tenant Enquiry Levels



Source: CBRE Research

FIGURE 17: Melbourne CBD Office | Vacancy Rates, by Grade



Source: PCA, CBRE Research

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Office Submarket & Precinct Maps

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