

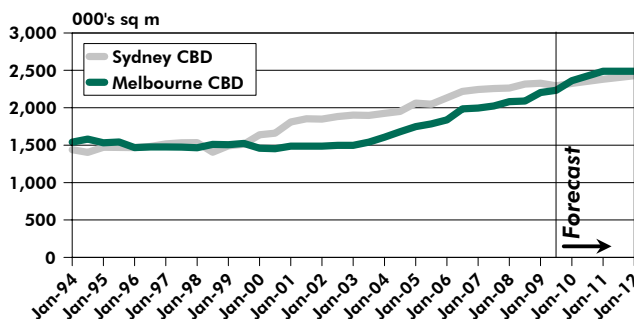


MELBOURNE'S PRIME OFFICE SPACE OUTGROWS SYDNEY

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SUMMARY Australia's two largest cities, Sydney and Melbourne have long been rivals; from attracting sporting events, to developing cultural facilities and stimulating population growth. As a business destination, Melbourne was hit hard in the 1990's as it struggled out of recession. At the same time, Sydney emerged as a clear finance and business centre of national and international significance. But now, the tide is turning as more and more evidence emerges of the rise of Melbourne, including the ability of commercial areas to grow and provide quality office space for corporations to occupy.

Chart 1: Prime CBD office stock, Melbourne & Sydney



Source : Property Council of Australia & CB Richard Ellis (July 2009)

Melbourne is about to overtake Sydney as the city with the most prime CBD office space in Australia. This is despite Melbourne having half a million fewer people than Sydney.

It's not that Sydney hasn't grown; it's just been outgrown by Melbourne, especially over the last 5 years.

Prime office space is the highest quality available and the type most likely to attract and maintain large corporations. (Using real estate definitions, Prime is the sum of Premium and Grade A office space, as defined by the Property Council of Australia.) It's also an important indicator of the business attractiveness and potential of a city.

There are a number of reasons behind the phenomenon. The first is the availability of land to develop.

Six years ago, the construction of prime office buildings in Melbourne started to take off at a much higher rate than Sydney. As shown in Chart 1, by the end of this year, there will be more prime office space in the southern capital than in the harbour city.

In the 1990's Melbourne added the Docklands to its city grid and this area has attracted many expanding and/or consolidating corporations, especially finance groups, from the traditional CBD and beyond. Over the last 5 years, companies such as NAB, AXA, Bendigo Bank, Ericsson and National Foods, to name a few, have moved into new office buildings in the Docklands. The Age, Myer and the ANZ will also be moving to the precinct over the next 6-12 months.

The latest trend in prime office building design has also played right into the hands of Melbourne developers. Contemporary office building design now requires the provision of large floorplates with as few columns as possible or even column-free. This allows for flexible, efficient workspaces which can adapt to the changing demands of corporations over time, without the need to relocate.

But large floorplates demand larger parcels of land and these are difficult to find or create in traditional CBD grids. This is where Docklands has been able to perfectly match contemporary corporate demand with buildings designed to the detailed specifications of individual companies.

The new ANZ office building in Docklands, scheduled for completion late this year is the finest example of this. The building will be just 10 levels high, yet will contain as much office space as the Rialto building, which is 66 storeys high and was built in 1986.

In contrast, Sydney has witnessed only a small recent extension to the CBD in the King Street Wharf development. Other than this, creating and facilitating major new office buildings in the tightly developed city remains a challenging and drawn-out process.

To date, Docklands has added 323,000 square metres of prime grade office space to the Melbourne CBD and more development sites exist. In contrast, Sydney's King Street Wharf development includes just 76,000 square metres and is now built out. The much larger, adjoining Barangaroo development site could deliver as much as 350,000 square metres of office space, but the timing for this complex and controversial project remains unclear.

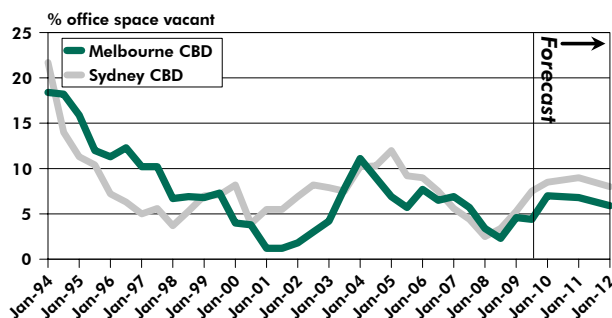
The other key driver has been affordability.

Melbourne prime office rents are still almost 30% below the equivalent in Sydney, despite Sydney Gross Effective Prime rents falling 20.0% in the last 12 months (Melbourne's have fallen 9.0% in this recent cycle). This means it's more affordable to lease more office space in Melbourne compared to Sydney.

But ultimately, it's been higher employment growth in Melbourne rather than Sydney which has created the opportunity to expand the prime office base. The rate of expansion in Melbourne employment and business over the last five years has been well above national average.

This all sets Melbourne up nicely for the short to medium term. Given as much as 75% of all the new office space in Melbourne has been pre-committed to tenants before construction completes, the vacancy rates have remained very low. Vacancy is now starting to rise slightly in Melbourne, like office markets in the rest of the country, yet as shown in Chart 2, the peak is forecast to be just 7.0% by the end of this year, compared to Sydney's 9.0% by the end of 2010.

Chart 2: Prime CBD office vacancy, Melbourne & Sydney



Source : Property Council of Australia & CB Richard Ellis (July 2009)

Lower vacancy means a greater chance of rental growth and Melbourne looks more much more likely to experience this in the short term than Sydney, while keeping overall occupancy costs low by national and international standards. This is also likely to make Melbourne more attractive for commercial property investors, especially as rents there grow off a lower base and show a higher percentage increase and therefore, return.

The rivalry has always been there between Australia's two largest cities. But it appears Melbourne is now out-growing Sydney in many important areas, including it's ability to retain, expand and potentially attract, high calibre corporations to more, new and high quality office space than can be offered in Sydney.

Now, it's Melbourne's turn to shine.

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