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A tale of two precincts in the Melbourne fringe market

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The fortunes of the St Kilda Road and Southbank office precincts are rapidly diverging according to a new CB Richard Ellis report.

While both precincts started the year with a similar vacancy rate - St Kilda Road being 11.3% (84,997 square metres) and Southbank 11.1% (45,288 square metres) - CBRE's MarketView report highlights that the well known Melbourne fringe markets have become very much a "tale of two precincts".

CBRE Associate Director, Global Research and Consulting, Glenn Lampard said a series of new office towers in Southbank were drawing significant tenant commitments which were expected to reduce the precinct's vacancy rate in the short term.

"The new generation of buildings in Southbank are not only attracting tenants from St Kilda Road, but the likes of Kraft are also relocating from fringe areas such as Port Melbourne to locate in Southbank's South Wharf tower," Mr Lampard said.

"St Kilda Road remains attractive to certain tenants and may well attract occupiers from outside the precinct, however this is primarily at the smaller end of the market. Large vacancies resulting from single tenants vacating will take some time to back fill as a greater number of small tenants will be required to occupy the same amount of space."

As a result, Mr Lampard said that while the Southbank precinct was tipped to benefit from an immediate reduction in vacancy levels, St Kilda Road's vacancy might take some time to pull back as landlords in competing markets played on the perceived lack of amenity and building inefficiencies to "poach" St Kilda Road tenants.

"The St Kilda Road precinct has lost sizeable tenants such as Infosys and National Foods and this trend is expected to continue as other physically relocate out of the precinct such as ANL, AIG, CSC, Parsons

Brinkerhoff and Leaseplan, all to take up occupation in new projects in both Southbank and Docklands," Mr Lampard said.

CBRE's MarketView report highlights that supply additions in the St Kilda Road precinct have been restricted to refurbishments and strata office for more than a decade with the construction cycle restricted to residential.

In contrast, the Southbank precinct has had significant supply additions with the development of projects such as Twenty8 Freshwater (34,000 square metres) and the recently completed South Wharf office tower (21,450 square metres). These projects have swelled the stock of office space in Southbank to 407,908 square metres with the precinct now just over half the size of St Kilda Road at 752,892 square metres.

While both of Southbank's new office buildings have physical vacancy components, with the exception of approximately a floor and a half of Twenty8 Freshwater, both are effectively full based on existing lease contracts.

CBRE's MarketView report shows the diverging fortunes of St Kilda Road and Southbank have been reflected in office rents.

After hitting $260 a square metre net face in Q3 2008, rents for Grade A St Kilda Road stock have incrementally reduced to the current indicative level of $250 a square metre. The reduction in net effective rents has been even more noticeable given that incentive levels have increased from approximately 14% of net face rents to 20% over the same period.

By contrast, the new generation office buildings in Southbank have bumped up rentals in that precinct to a new benchmark of above $300 a square metre for Grade A stock.

However, CBRE Director, Office Services, Grant Tinker said the additional stock in the Southbank market had been speculatively built and while the net rents were higher incentives had been very aggressive particularly in the early stages to "win" leasing deals.

"Incentive levels of 30 to 35% were common place in the market during this stage," Mr Tinker said.

"The new, larger office buildings in Southbank with larger floor plates were attractive for some St Kilda Road tenants who had previously expanded over time to be sprawled over several smaller floors creating inefficiency. On the other hand St Kilda Road is not the basket case that some commentators might suggest."

Mr Tinker said there was a massive price differential between the CBD/ Southbank precinct compared to St Kilda Road and this was spurring some CBD and inner fringe tenants to consider St Kilda Road as a desired location.

"There has been solid demand for St Kilda Road opportunities in 2010 and with the expected upward pressure on rents in the CBD we expect St Kilda Road to come into it's own in the near future," Mr Tinker said, although he added that owners would need to pro-active in the current market.

CBRE's Victorian Director, Office Services, Hamish Sutherland said the Docklands precinct was another focal point for Melbourne tenants after a GFC related drop in commitments.

"Unlike Southbank there is no speculative development planned for Docklands which has assisted in keeping the rents and incentives balanced," Mr Sutherland said, adding that the recent announcement by NAB to commit to another 60,000sqm-plus office re-enforced that Docklands was the "financial heart" of Melbourne.

"ANZ, NAB, Bendigo Bank, AXA, AMP and others have their most senior executives based in Docklands and given the current interest I would expect to see another three to four major headquarter commitments in the Docklands area by the end of the year, with much of tenant interest focused on Walker/Kuok's Quattro development at 735 Collins Street."

Mr Sutherland said it was highly likely that the key Dockland sites around Collins and Bourke Street would be fully developed within the next three to five years, and while there was some interest from the St Kilda Road and South Melbourne areas the majority of the interest was coming from large established CBD based corporations.