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Tortoise Melbourne will outlast the rest

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MELBOURNE'S office market will outperform those of other Australian cities in the 2009-10 financial year as strong medium-term prospects for rental growth attract overseas investors, syndicates and superannuation funds.

Since the peak of the market at the end of 2007, Melbourne has performed similarly to other office markets across Australia. But agents and property analysts expect a growing chasm between Melbourne and the overheated markets in Sydney, Brisbane and Perth, where demand has been driven by the now-flailing mining and finance industries.

From peak to trough, Melbourne and Sydney's prime capital values have dropped by about 18 per cent, according to Jones Lang LaSalle figures. Values have fallen 17 per cent in Perth and 26.5 per cent in Brisbane.

Rents in Melbourne have fallen less than in most capital cities, down 14.3 per cent, compared with 25.2 per cent in Sydney and 18 per cent in Brisbane. Perth has fallen 8.6 per cent since peaking late last year, but a severe correction is expected.

Jones Lang LaSalle researcher Andrew Ballantyne says that because Melbourne's rents did not grow to an unsustainable level in the boom, they will suffer less in the next 12 months.

"The correction in Perth and Brisbane rents will continue through 2010 and the first part of 2011. Sydney will have further to fall in 2009, while Melbourne rents appear to be stabilising," he said.

Tony Crabb, director of investment strategy at Savills, agreed that the outlook for Melbourne was strong.

"Melbourne has probably been the best office market in the country," he said. "Office enquiry is as good as it was last year, particularly thanks to sectors such as health care, education and utilities.

"Demand is holding up ... While the cash flow of companies is down, it's not as though they're being hit with high interest rates or high debt charges. Office workers are shifting from full-time towards part-time jobs or nine-day fortnights rather than sackings. If these businesses hold together, with that there will be rental growth."

While other agencies are predicting rents will stabilise or decline slightly, Mr Crabb is more optimistic, expecting a boost of about 10 per cent this year, from an average of about \$360 per square metre to between \$390 and \$400.

He says this is because Melbourne rents are still considerably cheaper than in other cities, vacancy is low and supply is almost non-existent.

"While we've had sub-lease space hit the market, lots of pre-committed tenants have had their buildings cancelled and need to stay or find new space. We've gone from having 180 full floors for lease this time last year to 120 available today."

Development doldrums

THE only big office development coming out of the ground in Melbourne is 717 Bourke Street, and agencies are not counting on new development for three to four years, apart from one-off specific requirements.

Lack of development is likely to be exacerbated by the failure of the Rudd Government's Australian Business Investment Partnership bill to pass the Senate.

The scheme had been designed to plug the gap if overseas lenders pulled out of major projects, using as initial collateral \$2 billion from the four major banks and \$2 billion from the Government.

Developers and proponents of the scheme regarded it as a safety net, while detractors saw it as a means to prop up unfeasible projects.

The bill is likely to return for a second hearing when Parliament returns from recess, but insiders give it little hope of passing.

Developers now say they will struggle to secure financing from syndicated lenders because of the threat, however minor, of overseas banks pulling out.

Australian banks will not be able to fill the breach, as they are believed to have reached their maximum level of exposure to commercial property, as advised by APRA.

"I would have thought that the end outcome of this is that businesses are going to have to take this on themselves," Mr Crabb said. "Government will have to build its own buildings, and companies will become owner-occupiers — as ANZ has with its Docklands building."

Space short, sales to soar

THE upside of a severe supply shortage is that the premium on space is increasing. Mr Crabb said there was 240,000 square metres of vacant space, and tenants were absorbing about 100,000 sq m annually. "There is no way that is going to last us five years," he said.

This bodes well for rental growth and has probably been a factor in about \$1 billion of sales this past year in Melbourne, double that achieved by this time last year.

Jones Lang LaSalle said office transactions had more than doubled in the final quarter of the year, compared with the previous corresponding quarter.

There were 11 sales worth \$424 million between April and June 2009, compared with nine sales worth \$171 million in the same months last year.

Jones Lang LaSalle Victorian managing director Andrew Wood said that buyers and sellers were closer now to agreement on value.

"We just had this falling market and the longer the purchasers waited, the better it got for them," Mr Wood said. "They were also nervous about buying into a falling market ... 'Catching a falling knife' was the analogy of last year."

By contrast, buyers at the start of this past year seemed more assured.

"Buyers both locally, nationally and internationally see Melbourne as a good market to invest into ... we've seen a number of private buyers make a commitment and make a call that they don't think it is going to get worse."

Trusts stable, privates pouncing

MEANWHILE, listed property trusts have not been as desperate to sell as was first expected when the market crashed in about September 2008.

Property stocks have fallen about 30 per cent in the past 12 months. The share prices of major listed office owners such as GPT, Macquarie Office, Goodman and ING Office are worth less than half their value this time last year.

But Australian corporations have managed to raise an estimated \$90 billion on the equity markets, with the banking and property sectors taking the lion's share.

Property trusts are in no rush to offload properties, but they are not buying properties either. Instead, private investors, syndicates and overseas buyers are keeping transaction volumes healthy, with the bulk occurring in the market under about \$100 million.

Major deals have included the Laidlaw family's purchase of Geelong's TAC building for \$75 million, Alan Finkel's purchase of 461 Bourke Street for \$34 million and the Roth family buying a half stake in 1 Spring Street for \$65 million.

Overseas funds have signalled confidence with Credit Suisse buying 505 Little Collins Street late last year for \$83 million on a 6 per cent yield.

Yields have likely softened since then — with German pension fund Deka buying 15 William Street last month for \$167 million on an 8.75 per cent yield.

But Jones Lang LaSalle's Mr Wood said Deka had a mandate to buy anywhere in the world, and the fact it chose to buy in Melbourne at the same time it bought a property in Vancouver showed its confidence in the stability and rental prospects.

Time to buy

A SURVEY by Colliers International has found that most property owners believe the window for buying office property is the next six months.

Colliers managing director John Marasco said the survey of 200 owners, half of whom had portfolios worth more than \$1 billion, tallied

with a growing recovery in transaction volumes and prices.

"Whether the bottom of the market is in the next six months or early next year, certainly the opportunity to buy is now.

"The only problem is there really isn't a lot of property on the market, so it's a bit of a Catch 22, where we've got quite a bit of buying interest, but not a lot to buy.

"But I think that will change, like it normally does. Spring's always a very busy time, not only for residential but for commercial and industrial. I just know from the amount of submissions we're doing there's going to be a lot more property on the market in the next three to six months."

Mr Marasco also expected more interest from overseas buyers.

Tony Crabb said his pick for the bottom of the investment market was "next year some time", depending on the timing of the economic indicators. But he also regarded the next six months as a window for buyers.

"Even if the market falls another couple of per cent, you're still getting far better value than a year ago. It's now a case of saying it's more important to get the funds invested than it is to get cute on price."

This story was found at: <http://www.theage.com.au/business/tortoise-melbourne-will-outlast-the-rest-20090630-d3v1.html>