



Research

# Melbourne Re-emerges

Property themes to look out for in 2021

January 2021



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# Hello

As we put an extraordinary year behind us, we are approaching 2021 with renewed enthusiasm.

Office workers have returned to the City and there is a real sense of newfound optimism in the air.

This optimism remains tempered and somewhat reliant on stable, predictable border policies, both domestic and international. Closed or restricted borders continue to have a profound impact on one of our largest exports, international tertiary education. Closed borders are also impacting our tourism industry, CBD retail and hotel sectors. However, our successfully revamped COVID contact tracing system has helped build trust that we can re-emerge with confidence.

As workers increasingly return to offices, Melbourne is slowly but surely rebounding into the diversified, vibrant, active and enticing city we love. The city which is consistently ranked as one of the most liveable and fastest growing in the world. One which will continue to attract a significant amount of local, national and international capital.

In this report, we have identified 13 property themes to watch out for as Melbourne commences its recovery journey.

So while many hurdles, and international risks remain, we are cautiously optimistic that our economy and trajectory is on the road to recovery.

**Craig Shute**

Managing Director, Victoria





# Melbourne Momentum

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*Few other places in the world have tamed a second wave as well as Melbourne. London had similar daily case numbers per day in July 2020 (~550) but now in early 2021, has a stretched health system and 40,000 to 50,000 cases per day. Countries that managed the first wave well, such as Japan and South Korea are now facing a third wave.*

Approximately 74% of the 230,000 jobs lost in Victoria as a result of pandemic have been recovered since the trough in September. On a national basis the trough was in May and 89% of jobs lost have now been recovered <sup>1</sup>. Confidence is rebounding, The second lock down has had a pronounced negative impact on confidence in Victoria, but the November Roy Morgan Confidence index was 100 in four states, NSW, QLD WA and SA and higher on a national basis than the September 2019 reading.

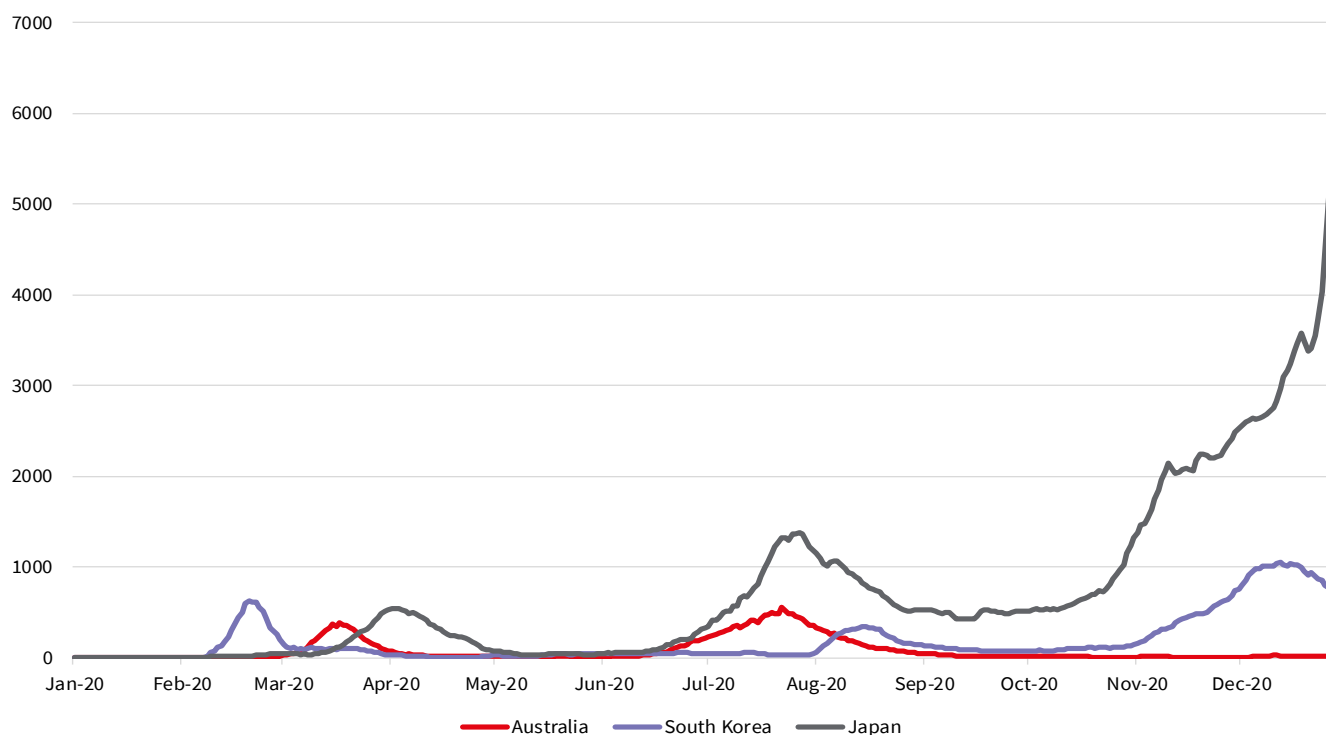
Successful management of the second wave of the virus , and strong responses to recent outbreaks, bodes well for Victoria as restrictions are eased in coming months. Political goodwill at both federal and state level, an orderly approach to releasing restrictions across the country and likely roll out of a vaccine before next winter are supporting confidence.

<sup>1</sup> Source: ABS, November 2020



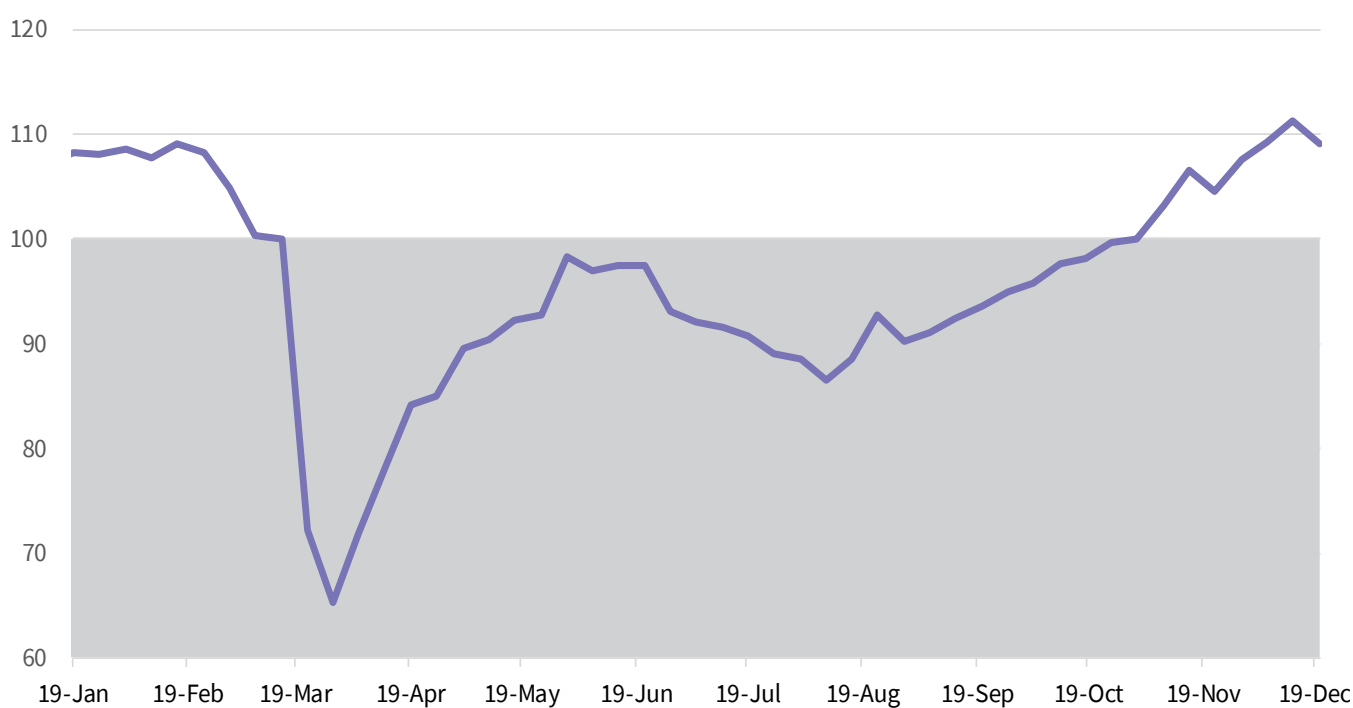


**FIGURE 1: Daily Confirmed COVID Cases, January 2020 to January 2021**



Source: JLL Research, University of Oxford

**FIGURE 2: ANZ Roy Morgan Australian Consumer Confidence, January 2020 to January 2021**



Source: JLL Research, ANZ Roy Morgan Australian Consumer Confidence

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*Though Melbourne had one of the toughest COVID lockdowns of anywhere in the world in 2020, with easing restrictions, consumer and business confidence is bouncing back strongly.*

*However, as we consider our forecasts for 2021 and beyond it is within the context of volatility and uncertainty. Business confidence needs to translate into business decisions for a sustained recovery. We expect office market vacancy will peak in 2021. The retail capital value correction still has some way to go and substantial challenges remain for some of our alternative sectors.*

*We will be watching the evolution of a number of property sector themes in 2021 as these will give us clues to the trajectory of Melbourne property sector recovery this year and beyond.*

**Annabel McFarlane**

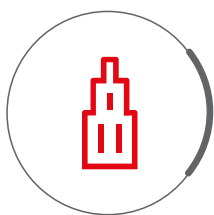
Senior Director, Strategic Research

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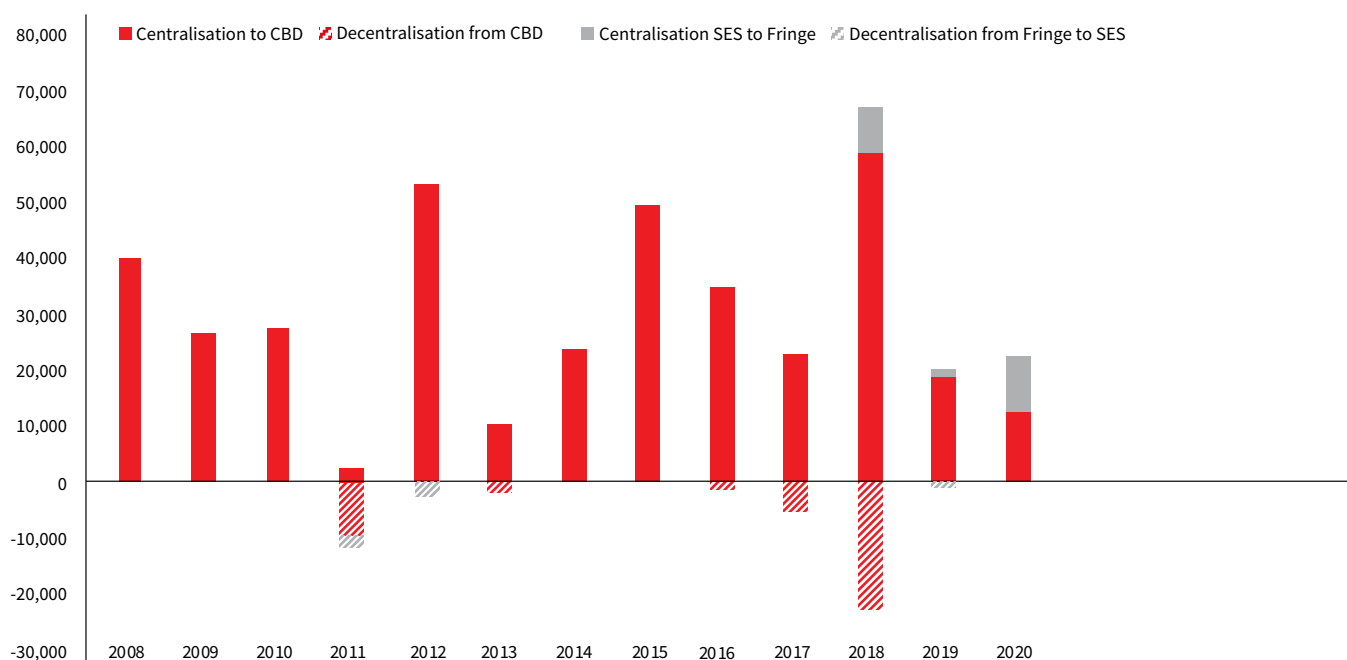


# 1. CBD reactivation



- Melbournians are slowly returning to the CBD. However, workplace restrictions remain in place. Only 50% of private and 25% of public sector workers are permitted to return to office workplaces.
- The City of Melbourne is providing grants and a program of summer events including live music, laneway activation and outdoor dining to attract people back to the CBD.
- Centralisation has been a theme in Melbourne's office markets for more than a decade. Whilst the workplace configurations that companies adopt will be varied, it is likely the CBD will remain the central hub. This means that for most businesses, the 'spoke' within a hub and spoke business model will be to work from home for some days. However, we may also see increased activity in our regional cities as companies assess technology capabilities and staff lifestyle requirements.

**FIGURE 3: Melbourne Centralisation, 2008 to 2020**

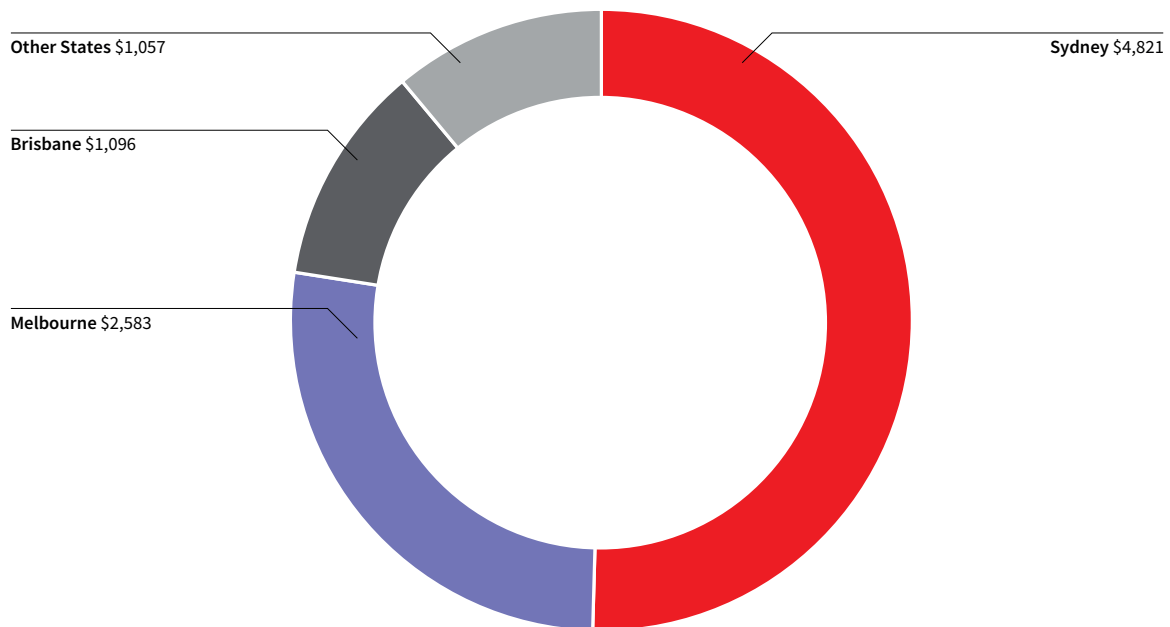


## 2. Ongoing investor confidence



- Melbourne's office markets attracted close to \$2.6 billion in 2020. This is an impressive result given the restrictions on physical inspections of commercial property in Victoria for many weeks. This compares to \$4.8 billion for Sydney and combined this represents 77% of all transaction volume in Australian office markets.
- Key non-CBD markets are particularly active. Brisbane and Melbourne's Fringe office markets and Macquarie park are the only three JLL tracked markets where year to date transaction volumes are above long-term averages.
- Melbourne's industrial market has recorded \$1.4 billion in transaction volumes over 2020. This compares to \$1.9 billion for Sydney and \$0.64 billion for Queensland. However, only Melbourne's industrial market has transacted above the 13-year annual average volume (\$1.07 billion pa).

**FIGURE 4: Total office sector transaction volumes 2020 (\$)**





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*We saw first hand investor confidence in Melbourne's CBD office market with the sale of 505 Little Collins Street and sale and leaseback of the RMIT building at 235-251 Bourke Street this year. Though lockdowns limited the ability to inspect there was significant buyer depth for these assets with some groups submitting bids sight unseen.*

*As illustrated by these sales, assets with limited vacancy exposure over the medium term are highly sought after. We expect relatively limited softening of yields for core well leased assets this cycle and corrections in capital values will largely be about income risk.*

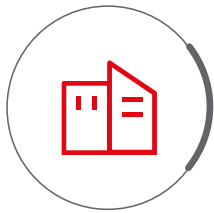
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Head of Middle Markets & Metropolitan Investments

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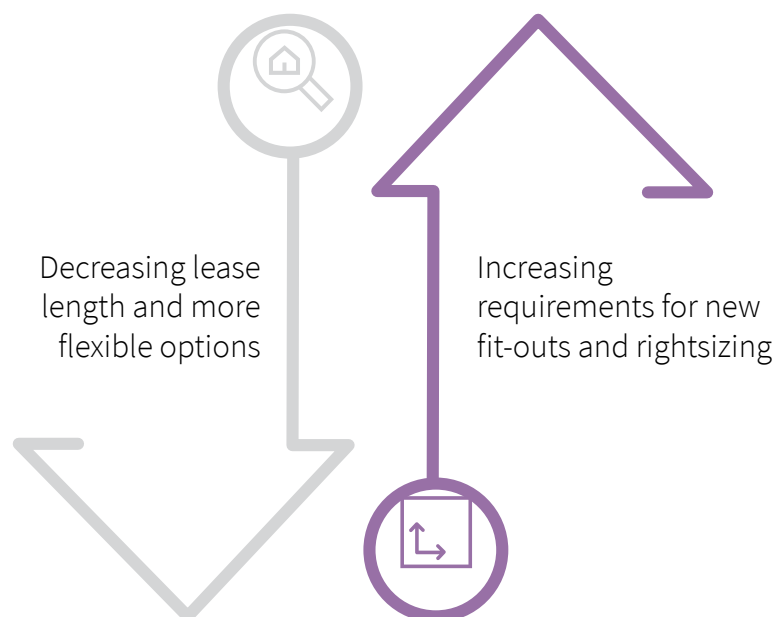


### 3. Rightsizing office leases



- Melbourne's office workers were subject to 'work from home if you are able to do so' orders for close to eight months. Office workers are returning to offices subject to distancing restrictions, but it will be some months into 2021 before post COVID normalised occupancy levels are reached.
- Lease enquiry activity slowed or stalled through most of 2020 as companies grappled with headcount, WFH preferences and productivity.
- As workers return to their places of work many companies may find that existing office spaces are no longer fit for purpose. We are likely to see increased activity as companies 'right size' and seek to redesign fit-outs with the help of generous landlord provided incentives.

**FIGURE 5: Rightsizing office leases**





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*Record levels of sublease space has been the story of 2020. NAB's decision to sublease 25,000sqm of 800 Bourke street is a notable illustration of how some groups are approaching new flexible working capabilities and expansion options.*

*Sublease space has continued to build throughout the year, but not all sublease space is equal. Short lease terms, poor fit-out and evidence that some groups will reabsorb the space when the restrictions are fully relaxed, mean that much of this space will not interest new occupiers.*

*The final month of 2020 saw very strong activity levels from a range of sectors as confidence increased pointing to a positive 2021.*

**Nick Drake**

Joint Head of Office Leasing, Victoria

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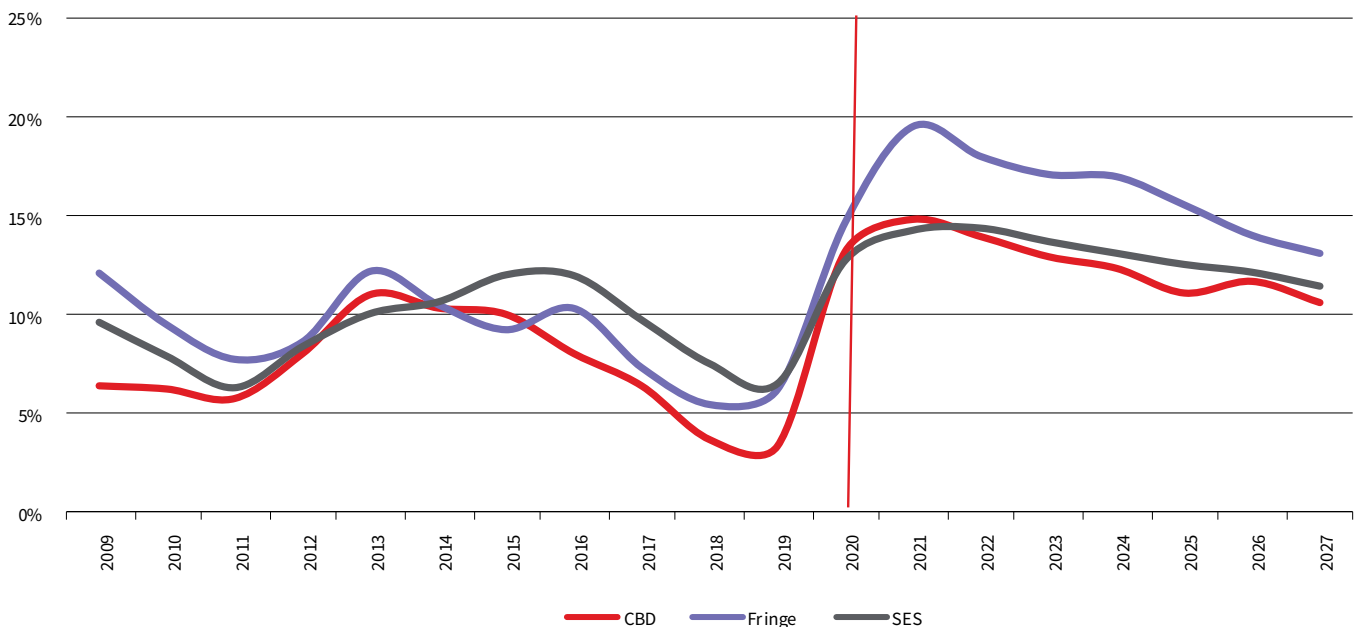


## 4. Office vacancy to peak



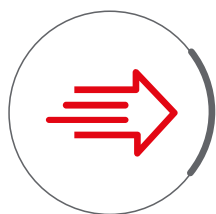
- Completion of substantially preleased CBD office assets has contributed to significant backfill space. Sublease space availability and contractions have also accelerated in 2020.
- CBD vacancy increased from a 30-year record low (3.4%) in March to 13.2% by 4Q20 and is expected to peak in the region of 15% by the end of 2021.
- Whilst the worst may be over, JLL expects further negligible or slightly negative net demand in 2021 before a stronger recovery in 2022. Effective rents across Melbourne's office markets are expected to start rising again from 2022.

**FIGURE 6: Melbourne office market vacancy**



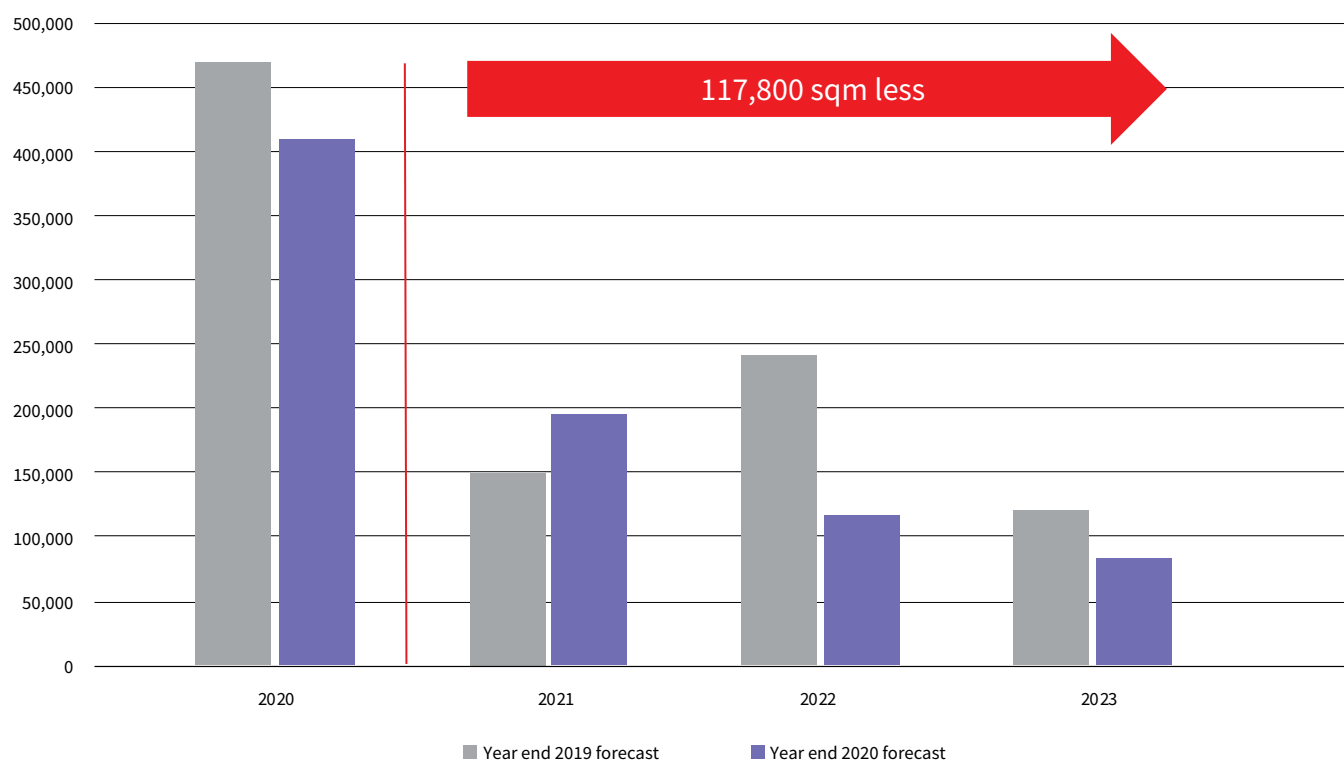


## 5. Office supply impacts



- Melbourne's record office supply cycle is slowing. Two new assets and a major refurbishment will complete in the CBD, and further supply will be delivered in Fringe precincts in 2021. Many projects in the CBD, Fringe and suburban office markets are being deferred.
- However, new stock has gained relevance throughout 2020. JLL's occupier surveys suggest wellness, cleanliness, technology and new office stock have increased in importance.
- In addition, corporate statements announcing carbon neutral targets have accelerated since the Australian bushfires in early 2020. Many AREITs are at the forefront of carbon neutral initiatives within their portfolios and we see this trend continuing.

**FIGURE 7: Melbourne CBD and Fringe office Supply Pipeline**



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*555 Collins Street's successful pre-commitment to a major global technology company was a notable highlight in 2020. However, the impact won't be felt in JLL's research numbers until its completion in mid-2023. We are expecting a significant increase in leasing activity in 2021 but relocations, consolidations and contractions are more likely than expansions. The prime grade market contains most of the backfill space created by 2020's new supply completions and we see this sector as being particularly active as flight to quality becomes a new theme and businesses adapt to the new way of working.*

**James Palmer**

Joint Head of Leasing, Victoria

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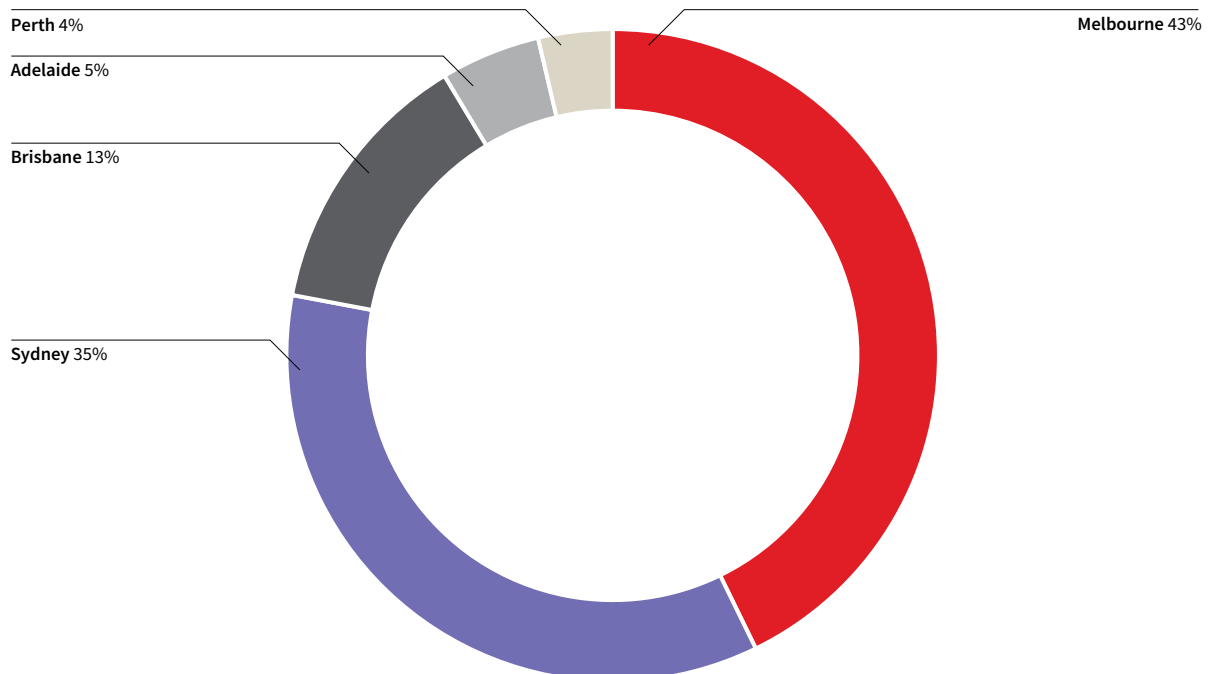


## 6. Industrial markets adjust



- Both 2020 and 2021 are expected to be above-average years for completions, however 66% of this space is already pre-committed. Lacking availability of new assets will be exacerbated by a decline in speculative stock over the short-term.
- Gross take up in Melbourne's industrial markets has accounted for 43% of all take up in Australian markets in 2020. New deals for CSL(118,000 sqm) and DHL(90,000 sqm) took 2020 gross take up to over one million sqm for the second consecutive year.
- However, through 2021, short-term COVID related retail and distribution centre leases will expire. Renewal will largely depend on the extent the increase in online retailing, forced upon consumers through the year, is maintained.

**FIGURE 8: Gross Industrial Take-Up by Market Q4 2019 - Q4 2020**





## 7. Investment in intermodals



- Victoria has traditionally relied exclusively on road transport to move freight to and from the Port of Melbourne and around the state. This will become increasingly challenging as traffic in the port increases from 3 million Twenty Food Equivalent Units (TEUs) in 2019 to a forecast 8.9 million TEUs by 2050.
- In order to combat this, state and federal government announcements in September and December 2020 confirmed commitment of over \$40 million in funding to the development of an integrated container rail shuttle system operating between the Port of Melbourne and suburban intermodal terminals at Altona (West), Somerton (North) & Dandenong South (South East).
- The first of these developments is expected to get underway in Dandenong South in 2021, where Salta will develop a significant new industrial park and the government will connect the site to the existing train line. This new mode of freight transport provides a significant opportunity for owners and occupiers to gain a competitive advantage by co-locating to the terminals.

**FIGURE 9: Map of proposed Intermodal terminal suburban locations**





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*Melbourne's logistics sector is proving resilient. Rents and incentives remained stable throughout 2020. This is impressive given the large volume of supply delivered to the market.*

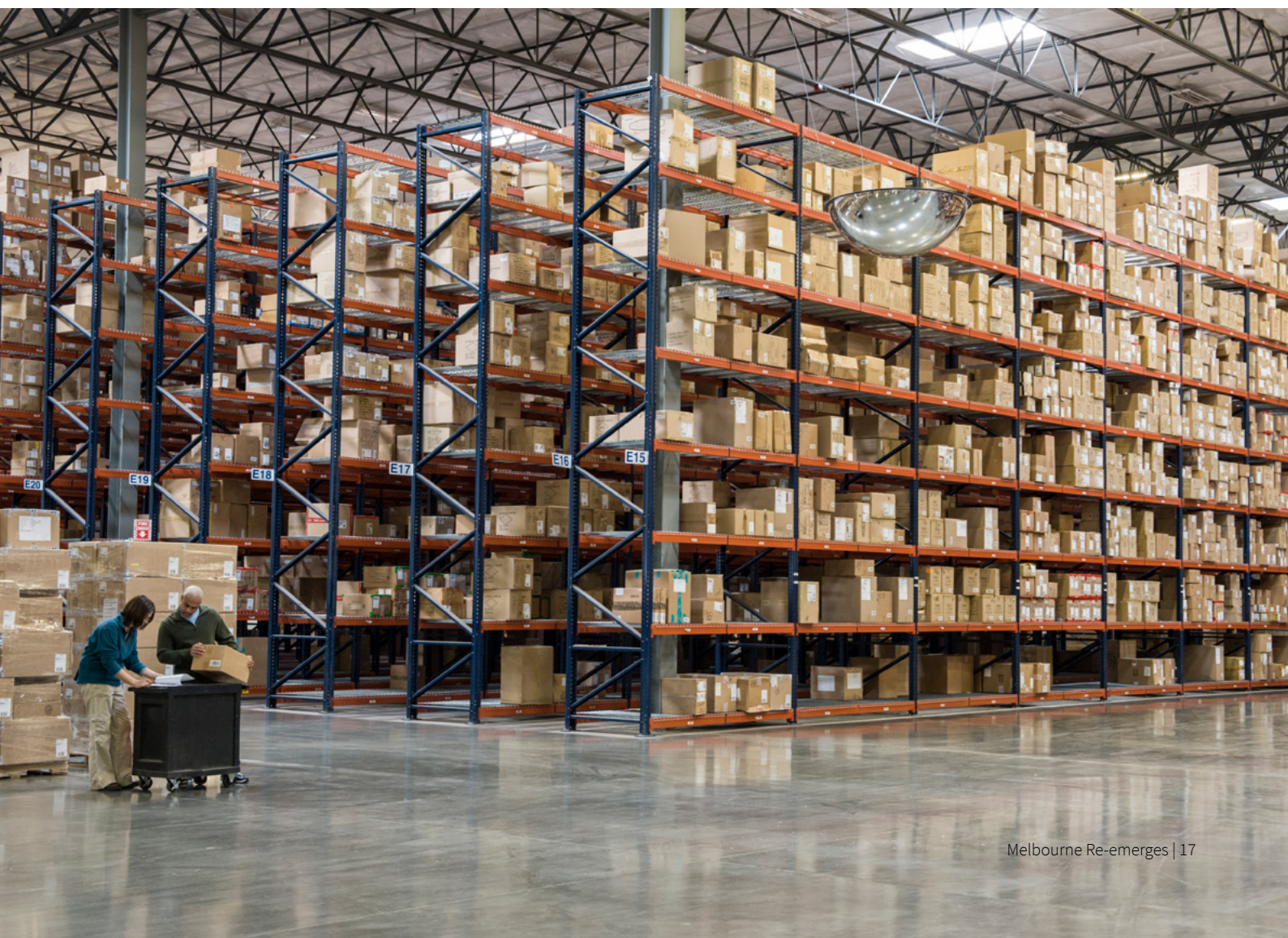
*The sector has been supported by increasing reliance on e-commerce through the lockdowns and some short term capability expansion.*

*We are expecting supply chain to have increasing focus in 2021 and institutional investors to look to smaller lots to provide end to end solutions for their occupiers.*

**Matt Ellis**

Head of Industrial, Victoria

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## 8. Retail values reset



- JLL is currently forecasting Melbourne regional and sub regional capital values to decline 27% and 23% respectively (from 2019 peak to 2022 trough) in the current cycle which has been driven by a reset in rents and weak investor sentiment for larger retail assets.
- In response to this structural reset, many landlords have been extracting value from retail assets through mixed-use development, a theme that has been particularly relevant to Melbourne given generally larger amounts of excess land compared to Sydney.
- This year Vicinity unveiled mixed-use plans for sub regional asset Box Hill central which include an office tower and over 1,900 apartments. Vicinity is also progressing plans for an additional office tower at Chadstone to join the existing hotel and office tower. QIC commenced construction at Eastland on a new 14,000 sqm office tower in July.

### QIC: Eastland office and hotel





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*Retail transaction volumes were subdued in 2020, driven by limited activity in the sub-regional and regional shopping centre sector, with only one sub-regional transacting in Victoria. Investors are predominately focused on assets with a high weighting towards defensive, non-discretionary retailers, or assets which provide strong land holdings in Metropolitan areas.*

*We expect this theme of retail divergence to continue in 2021, with sub \$100m convenience retail to dominate transactions. However, the relative appeal of yields in other retail sub-sectors will attract new capital sources and generate buyer opportunities.*

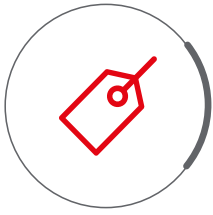
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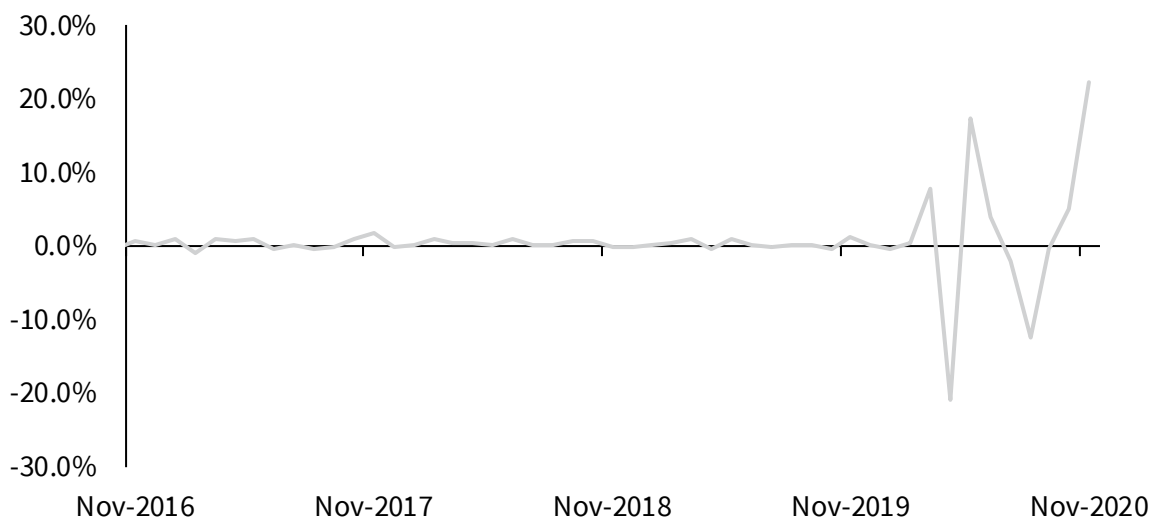


## 9. Driving retail transformation



- Victoria's State Government has extended its Commercial Tenancy Relief Scheme which implements the National Cabinet's Mandatory Code – to 28 March 2021. The extension provides further support for eligible small businesses. However, the additional winding back of JobKeeper and insolvency relief policy means that the future still remains uncertain for many retailers.
- While most retailers were only able to open their stores for the last few days of October, retail turnover rebounded 22.4% in November, driven by strong growth across discretionary categories. Consumers appear to be optimistic with the Westpac-Melbourne Consumer Sentiment Index at its highest level since October 2010 – marking a ten year high.
- Vacancy is anticipated to rise in 2021 as government relief ends. Although vacancy will put pressure on asset income, it provides opportunities for landlords to remix tenants to favour structural changes, away from heavily challenged categories such as fashion. Landlords will continue to proactively release space where possible to non-traditional retail tenants. There have been examples of co-working providers taking space in Victorian shopping centres in 2020 including Lygon Court (Creative Cubes) and Eastland (Waterman). Medical, education, fitness and entertainment tenants are becoming more prevalent sources of leasing demand.

**FIGURE 10: Monthly turnover growth - VIC**





## 10. Revenue recovery for hospitality



- In 2019 the airline route between Melbourne and Sydney was the fifth busiest in the world. Melbourne airport passenger numbers declined from 3.1 million in September 2019 to less than 36,000 in September 2020.
- Strengthening passenger numbers will have positive flow-on effects for airlines, rental cars, but also hotels and restaurants - particularly in CBD locations.
- State borders are slowly reopening. The NSW / VIC border opened in November after four and half months. Business and leisure travel has recommenced, through snap decisions by individual states to re-close state borders in response to small virus outbreaks is testing travel confidence. There is no doubt some business travel will be shelved into the future and reduced flight schedules will remain while international borders are closed or restricted.

**FIGURE 11: Busiest airline routes - Top 10 Global Domestic Routes 2019**

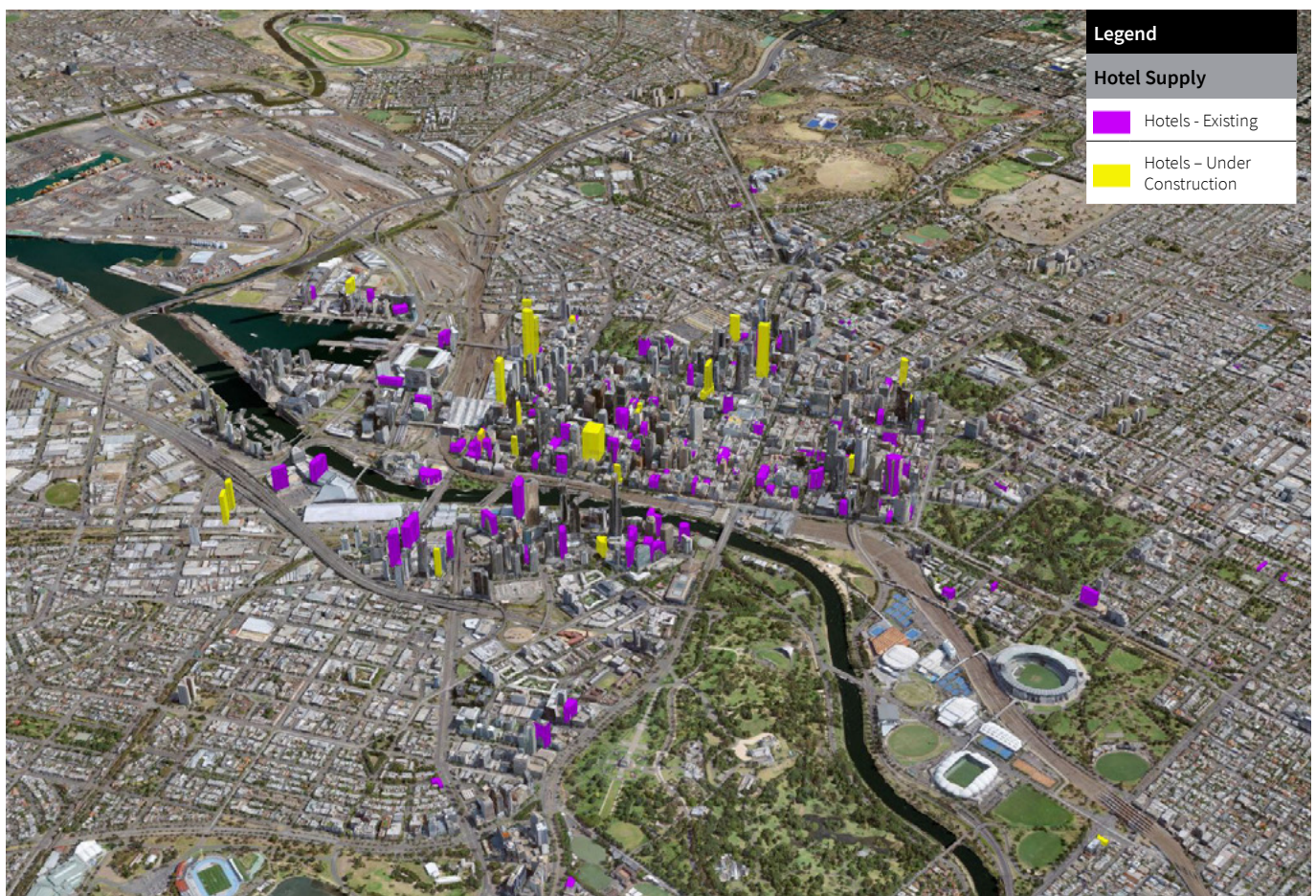
Route			Seats
CJU-GMP	Jeju	Seoul Gimpo	17,426,873
CTS-HND	Sappore New Chitose	Tokyo Haneda	12,498,468
FUK-HND	Fukuoka	Tokyo Haneda	11,400,018
HAN-SGN	Hanoi	Ho Chi Minh	10,253,530
MEL-SYD	Melbourne	Sydney	9,958,500
BOM-DEL	Mumbai	Delhi	8,230,822
PEK-SHA	Beijing Capital	Shanghai Hongqiao	8,117,461
JED-RUH	Jeddah	Riyadh	8,018,205
HND-OKA	Tokyo Haneda	Okinawa	7,704,098
HND-ITM	Tokyo Haneda	Osaka Itami	7,248,300

# 11. Hotel sector green shoots



- Melbourne's current city hotel supply wave is underpinned by strong city accommodation pre-COVID occupancy levels (80%-85%). Approximately 5,260 hotel rooms are under construction which will increase Melbourne's total number of hotel rooms by 21%, a significant addition to stock levels.
- Pandemic related restrictions on movement and travel has resulted in hotel occupancy plummeting to just 23%. Though some hotel operators have benefited from government contracts some recently completed hotels are yet to open. Challenges will be most pronounced for weaker assets.
- Major banks have largely withdrawn funding from the sector and other risky asset classes including residential development projects and this is providing opportunity for non-bank lending activity to increase further through 2021.

**FIGURE 12: Hotel Stock, Existing and under construction**





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*The Melbourne hotel market will no doubt face some short term challenges as we navigate our way through a major room night demand shock coupled with the largest historical new supply pipeline in the city.*

*In saying this, the fundamentals of the market remain exceptionally strong and with this new supply, comes an overall improved product offering within Melbourne, setting the market up for an exciting and positive long term growth story*

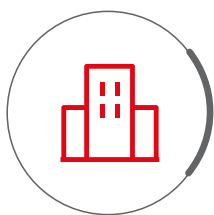
**Peter Harper**

Managing Director, Head of Investment Sales - Hotels & Hospitality Group

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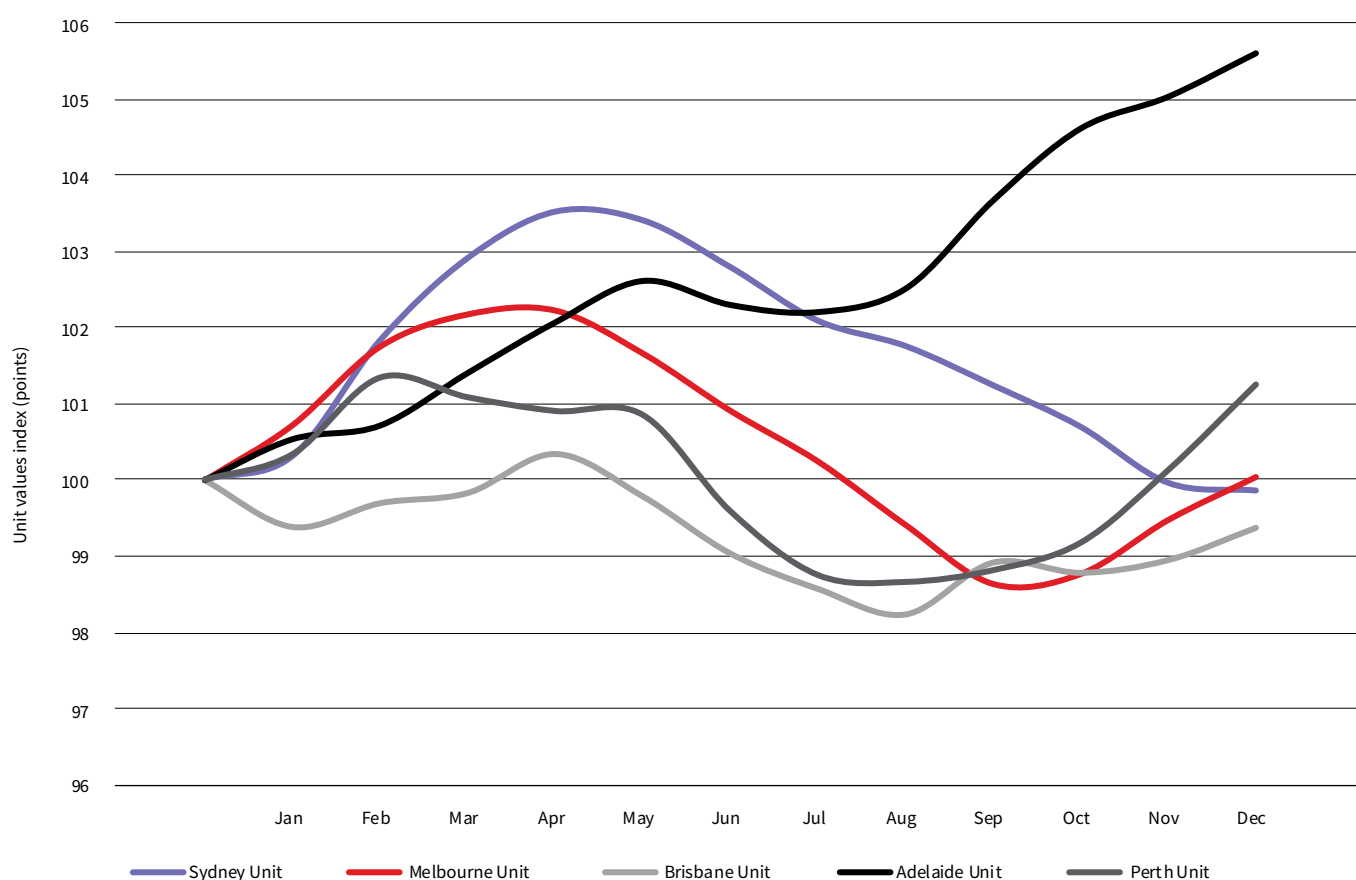


## 12. Residential recovery begins



- The risk of a hard landing and a residential price correction of more than >30% is low. Melbourne's dwelling value index shows that from peak to trough the correction has been in the 6% range and that the recovery has started.
- Residential unit developments that are currently under construction are largely pre-sold and resales within some projects indicate values have held up well. There is little consensus on the scale of population growth recovery. Deloitte access economics projects strong population growth from 2023. Its likely the residential apartment development sector will remain subdued until then.
- However, the nascent build to rent sector is gaining traction. In November this year, following similar changes in NSW, the Victorian State government halved land tax levied on build to rent (BTR) developments from 2022 to 2040 together with full exemption from the Absentee Owner Surcharge until 1 January 2040. JLL estimates there are 1,840 institutional grade BTR units in Australia, but none yet completed in Melbourne. However, of the ~8,130 units in the Australian pipeline expected to complete by 2024, ~5,770 units (70%) are in Melbourne.

**FIGURE 13: Greater Capital City Unit Prices**





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*Alternative sector investors are often motivated by the counter cyclical nature of these assets. While student accommodation has been particularly affected by this crisis because of closed international borders, periodic bans on elective surgery and challenges in aged care, other sectors have been largely unaffected by the pandemic.*

*We have seen increasing interest in build to rent projects throughout 2020 and we expect this trend to continue in 2021.*

**Noral Wild**

Head of Alternative Investments

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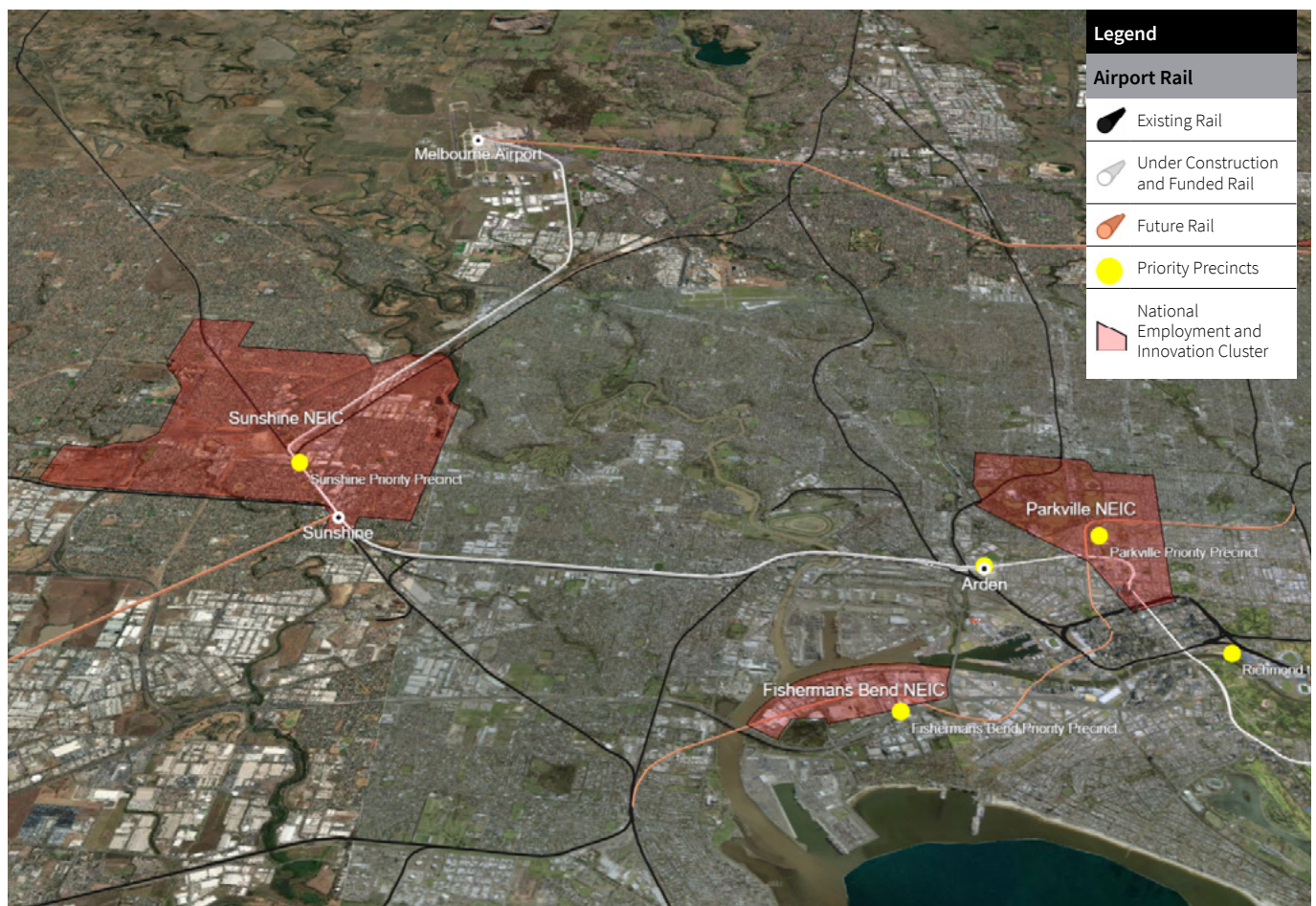


## 13. Airport rail link gets funding



- Melbourne's Airport rail link received federal and state funding in a joint announcement on 23rd November 2020 each committing A\$5bn in funding for the project.
  - More than 67m passengers are projected to use Melbourne Airport by 2038.
  - Construction to begin in 2022.
  - Target opening date of 2029.
- In November 2020 the federal government also announced joint funding (\$800m) for a major new vaccine manufacturing facility with CSL at Melbourne Airport Business Park.
- Property impacts include increased industrial and office sector investment and take up activity in Melbourne Airport precincts. Site acquisition and planning activity at Sunshine. Longer term additional benefit for Arden, Parkville and station on the Cranbourne and Pakenham lines:

**FIGURE 14: Airport rail link through Sunshine**



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*At the start of 2020 the Melbourne Metro Office market was poised for an acceleration of new supply in the market with over 1,000,000 of tracked permitted office space in some stage of the development process. As occupier sentiment changed we saw many of these projects put on hold or withdrawn from the market all together. The protracted lockdown in 2020 saw very limited leasing activity however some of the highlights included Bunnings taking 14,000sqm of space at Growthpoint's 20,000sqm speculative development at 572 Swan Street which reached practical completion in March 2020.*

*There are several major speculative projects completing in the Yarra precinct with nearly 100,000 due to complete by the end of 2021 as well as a large amount of sub-lease space coming into the market which will see the vacancy rate continue to lift towards the end of the year. Interest has started to flow from some CBD occupiers looking to decentralise which will benefit much of the fringe and suburban market.*

*We are also seeing demand lift for emerging markets in the north and west as a result of new infrastructure initiatives by government.*

**Josh Tebb**

Senior Director, Office Leasing - Victoria

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# Outlook



- Market conditions are likely to remain volatile for many months into 2021. Geopolitical and pandemic challenges, including Australia's trade disputes with China, possible resurgence of the virus within the community and /or challenges with vaccination roll out, pose a threat to fragile confidence.
- However, in comparison to other geographies, Australia is in an enviable position and stakeholders in Melbourne's property markets have reason to be optimistic. The worst of the economic downturn has now passed, and restrictions on activities are progressively being lifted. Due to the timing of summer holidays and the influence of cautious approaches to the pandemic by internationally headquartered corporates it is likely to be some months before Melbourne's property markets will reach a post COVID normal.
- Positive indicators of activity in other states suggest that confidence, jobs growth and consumer spending will continue to rebound quickly in Victoria's property markets, and this bodes well for 2021.











Photo by Mitchell Luo on Unsplash

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