

- *Rental growth continues, albeit slower than previous periods*
- *Cash rate pauses, breathing new optimism into the market*
- *Yields soften further, however the leasing market is performing well*



Adelaide CBD Office

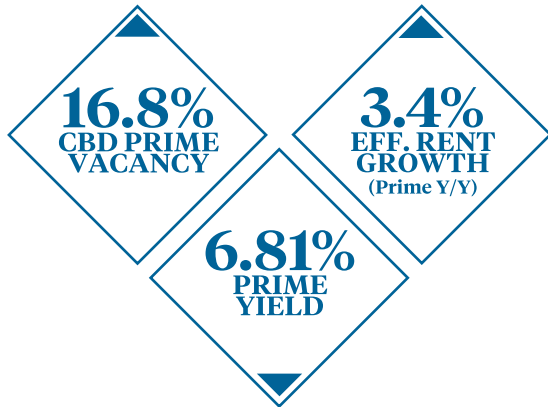
Market Report, September 2023

knightfrank.com/research



ADELAIDE CBD BUOYED BY LEASING MARKET

Recent cash rate pauses and increasing demand for high quality CBD space is breathing renewed optimism into the market.



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“The Adelaide office market is at a major transition point in the standard of accommodation, as a record amount of new supply comes on line. Owners of older vacant stock need to commit to major reinvestment to compete for tenants.”

◆ ◆

NICK BELL
PARTNER, VALUATION & ADVISORY SA

The Key Insights

The Adelaide CBD vacancy rates increased during the six months to July 2023, rising from 16.1% to 17.0%. Prime vacancy increased 2.0% to 16.8%, although skewed by prime supply additions in the period. Secondary vacancy remained the same at 17.1%.

Adelaide's significant supply of office space in 2023 has been revised to 87,016 sqm from the 92,016 sqm reported in the H2 2022 projections. Despite the revision, the figure remains a historic high, a large portion of this space is already pre-committed.

Total CBD asset sales over \$10 million value totalled \$217.6 million in the six months to July 2023, with an additional \$71.6 million settled or settling post-July 2023. This compares with \$363.3 million and \$61.0 million in H1 of 2022 and 2021, respectively.

Adelaide CBD prime yields softened 97 bps from 5.84% to 6.81%, with the yield spread to Sydney widening 63 bps to a current differential of 165 bps.

The City Fringe market saw reductions in both prime and secondary vacancy, with prime decreasing by 1.9% driven by a strong net absorption of 2,349 sqm, 2,803 sqm above the 10-year average of -364 sqm.

Adelaide CBD office market indicators – July 2023

GRADE	TOTAL STOCK SQM	VACANCY RATE %	SIX MONTH NET ABSORPTION SQM	SIX MONTH NET ADDITIONS SQM	AVERAGE GROSS FACE RENT \$/SQM	INCENTIVE %	EFFECTIVE RENTAL GROWTH % YOY	CORE MARKET YIELD %*
Prime	693,080	16.8	19,764	39,584	607	27.5 - 35.0	3.37	6.25-7.50
Secondary	825,720	17.1	-5,494	-6,240	444	35.0 - 45.0	2.76	6.75-8.50
Total	1,518,800	17.0	14,270	33,344				

Source: Knight Frank Research/PCA *assuming WALE 5.0 years

ADELAIDE ENJOYS COMPETITIVE RENTAL MARKET

Tenant demand outweighs buyer demand

Adelaide’s leasing market has been a beacon of light amidst a subdued investment market caused by the rising cost of capital. With purchasers maintaining a wait-and-see approach, tenant demand has been far stronger than purchaser demand, and rents have grown.

Despite robust demand and rental growth, the vacancy rate in the Adelaide CBD increased, rising from 16.1% to 17.0% in H1 2023. Breaking down the statistics by grade, the vacancy rate for prime CBD properties grew from 14.8% to 16.8% in the same period, while secondary vacancy rates remained stable at 17.1%.

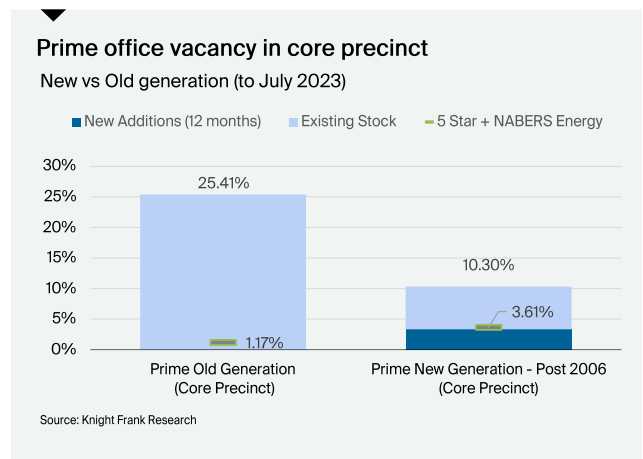
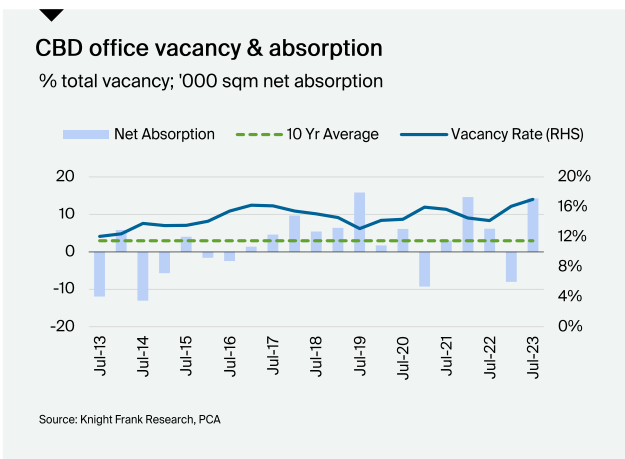
This alignment in vacancy between prime and secondary properties is somewhat misleading. The discrepancy can be largely attributed to the introduction of new supply during H1 2023, consisting of prime space, skewing the data by temporarily inflating the vacancy of new generation stock. A more accurate insight emerges when observing the precinct level. Notably, the vacancy rate in new generation prime CBD stock within the core precinct stands at 10.3%. In contrast, older prime core stock exhibits a markedly higher vacancy rate of 25.4%, underscoring a substantial demand disparity between these two categories.

Workplace wellness driving market trends

Businesses across Australia are seeing a bifurcation between working from home and from the office, according to new research. Hassell Studios reports that 15% of workers in Australia were working full-time from home in 2022/23, a decline from above 20% in 2021/22. In contrast, 52% of people are working fully from the office, an increase of 14% on 2021/22. Adelaide has been nation-leading in CBD office occupancy in 2023, with the last recorded occupancy data released by the PCA in March showing Adelaide up to 80% of pre-covid occupancy. This highlights a potential reversal of trends and signals a positive outlook for the Adelaide leasing market and CBD building owners.

Tenants needs are changing as ESG and wellness functionality continue to increase in priority. Research conducted by the Sax Institute and Victorian Government shows an ROI of between \$3-\$6 for every \$1 invested in workplace wellbeing. In Adelaide, this is confirmed by the 4.78% vacancy rate of A grade buildings with NABERS energy ratings of 5 and above.

While the investment market stabilises, there are opportunities for building owners looking to backfill vacancy to capitalise on ESG and ‘flight to quality’ trends to remain competitive and boost occupancy and rents.



Recent significant tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	FACE RENT \$/SQM	TERM YRS	START DATE
Services Australia	60 King William Street	Core	30,000	670g	10	Jun-23
DPTI	83 Pirie Street	Core	18,000	670g	10	Jun-23
RAA	91 King William Street	Core	2,141	550g	5	Jun-23
Telstra	60 King William Street	Core	4,500	540n	7	Jul-23
SA Government	11 Waymouth Street	Core	2,928	640g	10	Feb-24

g Gross n Net *approximate (r) renewal conf Confidential

RENT GROWTH CONTINUES DESPITE HIGH SUPPLY

Development supply on track

In the six months to July 2023, the Adelaide CBD office market observed the finalisation of 60 King William Street, an A grade building in Adelaide’s core precinct. The building contributed a total of 39,584 sqm of new office space to the market, however, due to a pre-commitment rate of nearly 95%, only approximately 2,000 sqm entered the market as available space.

During the remainder of 2023, three further office developments are expected to be completed, yielding a combined 47,016sqm of additional space. This projection results in a revised cumulative 87,016 sqm of new development supply for the entire 2023 calendar year - a benchmark figure within PCA data records. Beyond this year, expectations outline approximately 30,000 sqm for the year 2024, while an additional 26,000 sqm is currently in preliminary stages or mooted. Amongst the upcoming developments are Walker Corporation's Festival Plaza tower and Palumbo's development at 185 Pirie Street. Both of these projects have reportedly secured significant tenant pre-commitments.

Another substantial endeavour includes ICD Property Group’s three-tower complex at Adelaide Central Market, spanning 21,000 sqm. Although delayed, the first stage of the markets component is underway.

In a collaborative initiative, Adelaide developers, Marlborough Capital and 1835 Capital, intend to develop ‘Trinity City’ at 88 North Terrace, offering 41,000sqm of office space directly adjacent to the heritage-listed Trinity Church. However, this development is yet to commence, and is subject to tenant pre-commitment.

Primed for choice; incentives and rents rise

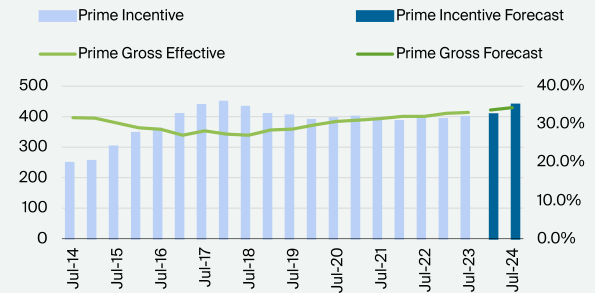
The Adelaide CBD is witnessing a rise in refurbishments, as owners try to keep older stock competitive. One such project is 150 Grenfell Street, which is undertaking a full scale reconstruction including façade, services and fitout and will offer up 9,300 sqm of updated space once complete in 2024.

As record new supply additions and refurbished stock comes to market, tenants are being spoilt for choice, creating a highly competitive environment. It is expected that low A grade property will see a rise in incentives as building owners try to backfill vacancy. This is already happening as average incentives for prime and secondary space rose slightly in H1 2023 from 31.2% to 31.8% and from 37.3% to 37.9%, respectively.

Gross rents have risen, and look to continue that way. As of July 2023, Adelaide CBD's average gross effective rents for prime and secondary stock increased by 3.4% and 2.8% y/y to \$414/sqm and \$276/sqm, respectively. Forecasts have prime rents increasing another 3.7% over the next 24 months.

CBD office rents & incentives

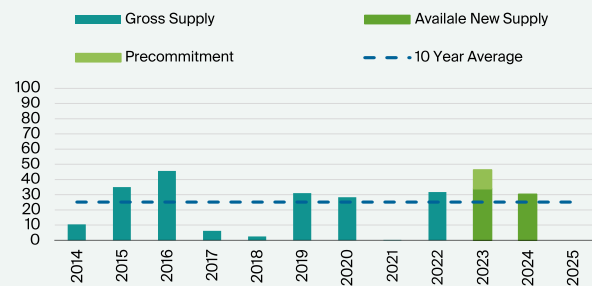
\$/sqm effective rents; % incentives



Source: Knight Frank Research

CBD office gross supply

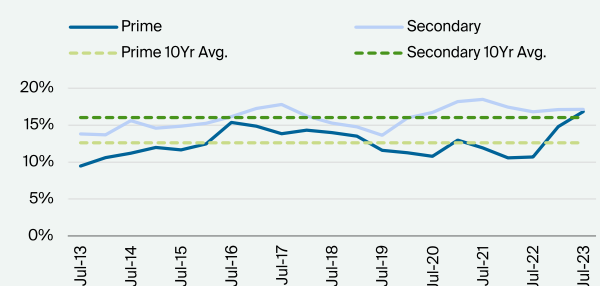
'000 sqm



Source: Knight Frank Research, PCA

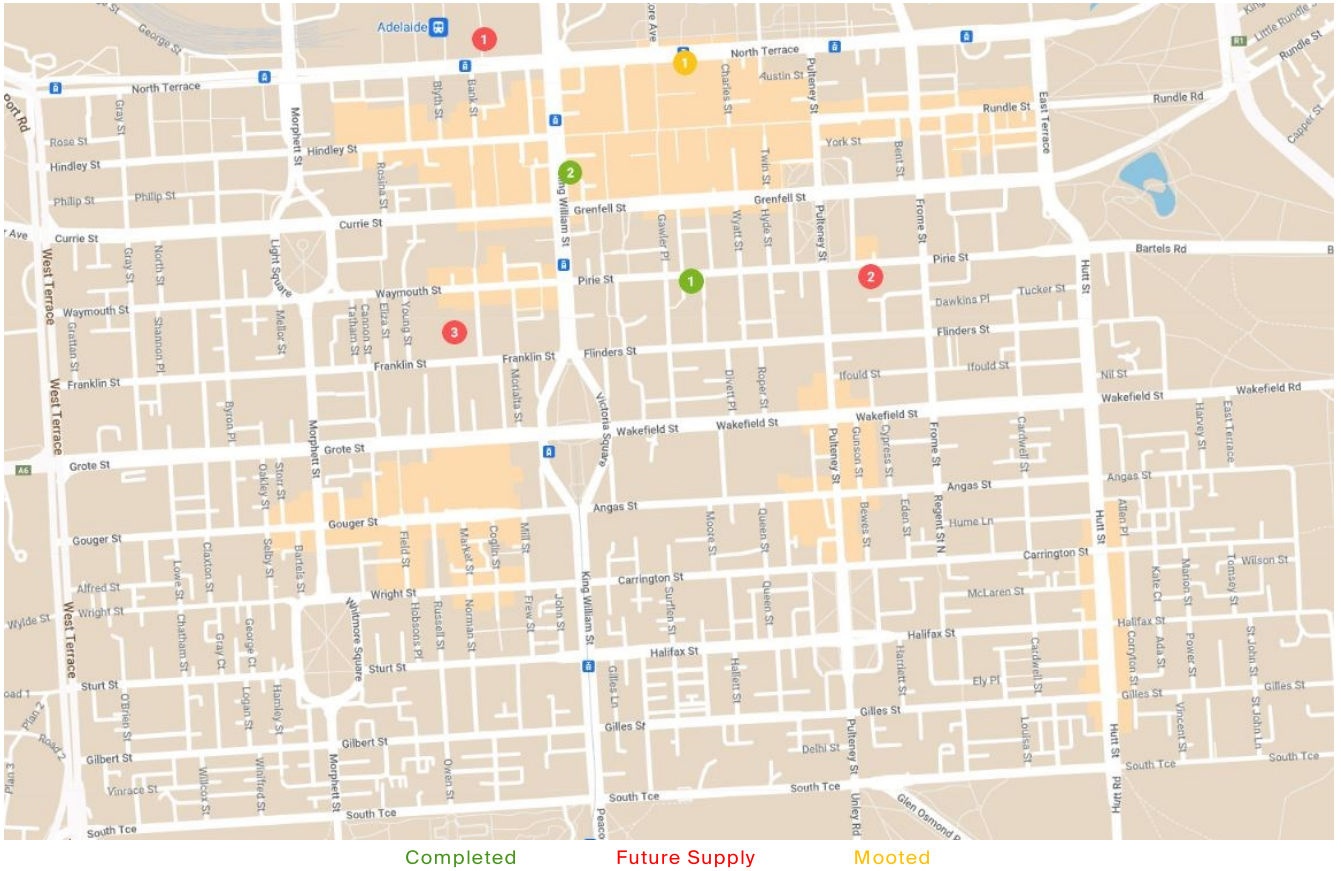
CBD office vacancy

% prime vs secondary



Source: Knight Frank Research

MAJOR CBD OFFICE SUPPLY



Adelaide major office supply

ADDRESS	AREA (SQM)	DEVELOPER	MAJOR TENANTS	COMMITMENT LEVEL (%)	STAGE	EST. DATE OF COMPLETION
1 83 Pirie Street	30,000	Cbus Property	DPTI, ANZ, HWL Ebsworth		COMPLETED - Q4 2022	
2 60 King William Street	40,000	Charter Hall	Services Australia, Telstra, NAB		COMPLETED - Q2 2023	
1 Festival Plaza, Station Road	49,500	Walker Corporation	Flinders University, Deloitte	44.9	Construction	Q4 2023
2 185 Pirie Street	6,328	The Palumbo Group	Defence Housing Australia	22.9	Construction	Q3 2023
3 42-56 Franklin Street	21,000	Kyren Group			Construction	Q4 2024

NB. Dates are Knight Frank Research estimates; Office NLA quoted c Circa *Not Settled *Knight Frank Assessment

Adelaide major office supply (Mooted / DA)

ADDRESS	AREA (SQM)	DEVELOPER	PRECINCT	FLOORPLATE SIZE* (SQM)	STAGE	EST. DATE OF COMPLETION
1 200 North Terrace	26,000	Commercial & General	Core	2,100	DA Approved	Mooted

NB. Office NLA quoted *Approximate

CBD LANDSCAPE SHIFTS AMIDST SLOWING MARKET ACTIVITY

Purchasers not meeting vendor expectations

Through H1 2023, the Adelaide CBD saw three transactions above \$10 million that settled, reflecting a total sales volume of \$217.6 million. This is 40% down on the \$363.3 million in H1 2022, but 256% up on the \$61.0 million in H1 2021. This excludes the July 2023 settled sale of 99 Frome Street (\$13.0 million) and pending settlement of 63 Pirie Street (\$58.6 million) which had settlement delayed until December 2023. Including these transactions, volumes equate to \$289.2 million.

Amongst the settled sales were 211 Victoria Square and 45 Pirie Street. 211 Victoria Square, is a 17-level A-grade office building purchased by Adelaide-based property syndicate, Harmony Property Investments for \$130.5 million. The property was purchased in a single-asset unit trust available to wholesale investors. The asset also includes a three level annex building comprising 27 carparks, end-of-trip facilities and office space on Level 2, with a direct link to the main building over Morialta Street.

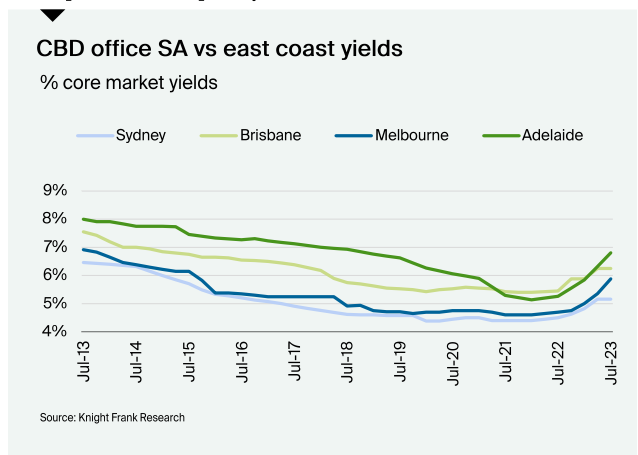
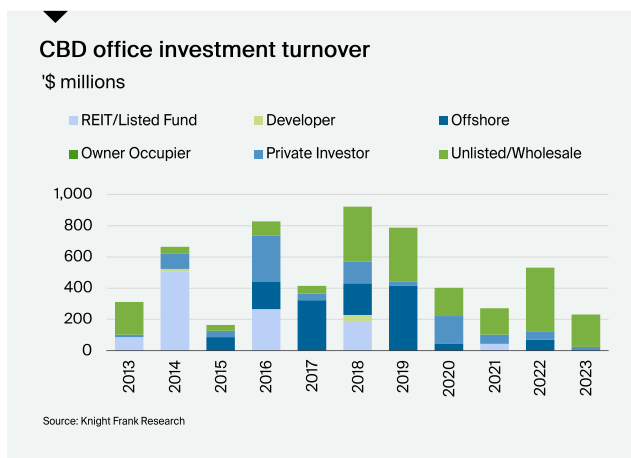
Similarly, 45 Pirie Street, a 19-level A-grade office building, was

purchased for \$76.5 million through a collaboration between Adelaide's Curated Capital and Sydney's Realside Property. The price is significantly lower than the \$105 million it sold for in 2016, reflective of its current 75% vacancy rate due to the Attorney Generals Office vacating nearly 15,000sqm of the building in 2019, plus major capital expenditure requirements.

There have been a handful of \$10+ million properties listed for sale that were ultimately pulled from the market, due to the widening gap between vendor expectations and what buyers are willing or able to pay.

Yields soften as data catches up to observations

Amidst slowed market activity, average CBD prime yields softened a further 97 bps from H2 2022. This downward trend marks a substantial decline of 167 bps since the historically low figures observed in Q4 2021. This ongoing adjustment has broadened the divergence from Sydney's prime yields, expanding the spread by 63 bps to a current differential of 165 bps. This disparity is enhanced with South Australia's exemption of stamp duty on commercial transactions.



Recent significant sales

PROPERTY	PRICE \$M	CORE MARKET YIELD % [^]	NLA SQM	\$/SQM NLA	WALE [^]	PURCHASER	VENDOR	SALE DATE
63 Pirie Street*	58.60	7.01	11,210	5,227	3.4	Capital Property Funds	Raptis Group	U/C
99 Frome Street	13.00	6.42	3,432	3,788	1.03	Private	Private	Jul-23
45 Pirie Street	76.50	7.23	19,611	7,394	0.3	Curated Capital / Realside	AEP Investment Management	May-23
50 Hindmarsh Square	10.64	6.09	2,170	4,903	2.4	Pelligra Group	PPI Funds Management	Mar-23
211 Victoria Square	130.50	6.85	17,774	7,342	6.4	Harmony Property	Private Syndicate	Feb-23

c Circa *Not Settled [^]Knight Frank Assessment

FRINGE MARKET ATTRACTING ATTENTION

Vacancy drops amidst near-record absorption

The Adelaide City Fringe saw a moderate reduction in vacancy from 11.0% to 10.4% during H1 2023. Both prime and secondary vacancy rates declined in this period, with prime decreasing by 1.86% and secondary by 0.27%. This was attributed to the limited net supply (1,242 sqm) and higher than average net absorption (2,439 sqm). This is the most substantial six-month absorption rate since 2020 and significantly surpasses the 10-year average of -364sqm. Given the small scale of the Fringe market, any movements in occupancy carry greater impact upon vacancy rates.

The Fringe is an attractive location for many businesses with close proximity to the CBD, high traffic volume, accessibility, and ample parking. However, a notable drawback of several locations in the Fringe is the lack of adequate public transportation infrastructure, which has spurred the emergence of alternative locations like Mawson Lakes, Thebarton and Bowden gaining popularity as a result. Despite this, the Fringe is still attracting occupiers. In a recent leasing transaction, a subsidiary of a medical assistance company

listed on the ASX has agreed to lease space on Greenhill Road for a duration of 5 + 5 years at a rate of \$430/sqm per annum on a gross face basis.

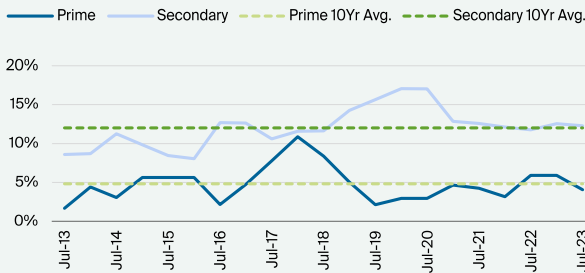
Rental growth continues despite yield softening

During the same six-month period, prime gross effective rents in the Fringe experienced a slight uptick, rising \$8 to \$364/sqm. Similarly, secondary gross effective rents witnessed an increase from \$283/sqm to \$287/sqm. Incentives remained steady for both prime and secondary assets, maintaining an average of 25.0%. Meanwhile, average outgoings increased for both prime and secondary assets, rising from \$106/sqm to \$111/sqm and from \$101/sqm to \$106/sqm, respectively.

Average prime yields in the Fringe softened by 38 bps, from 6.50% to 6.88%. This is on top of a 45 bps rise observed in the second half of 2022. Similarly, average secondary yields rose to 7.40% up 37 bps in this period, adding to a 50 bps increase during the latter half of 2022. As elsewhere in the investment market, increased cost of capital is impacting pricing.

Fringe office vacancy

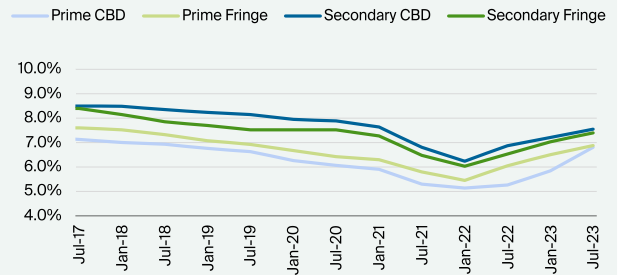
% prime vs secondary



Source: Knight Frank Research

Office CBD vs fringe yields

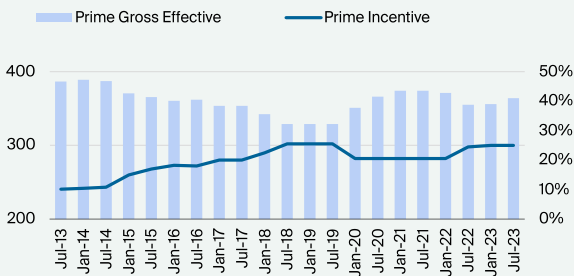
% core market yields



Source: Knight Frank Research

Fringe office rents & incentives

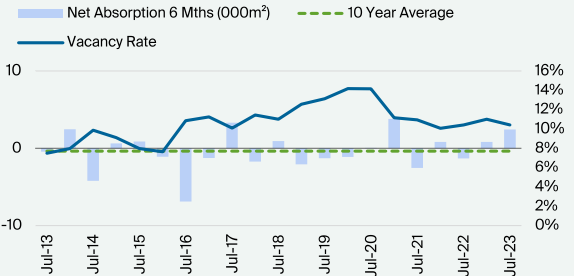
\$/sqm prime effective rents; % prime incentives



Source: Knight Frank Research

Fringe office vacancy & absorption

% total vacancy; '000 sqm net absorption



Source: Knight Frank Research, PCA

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.



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