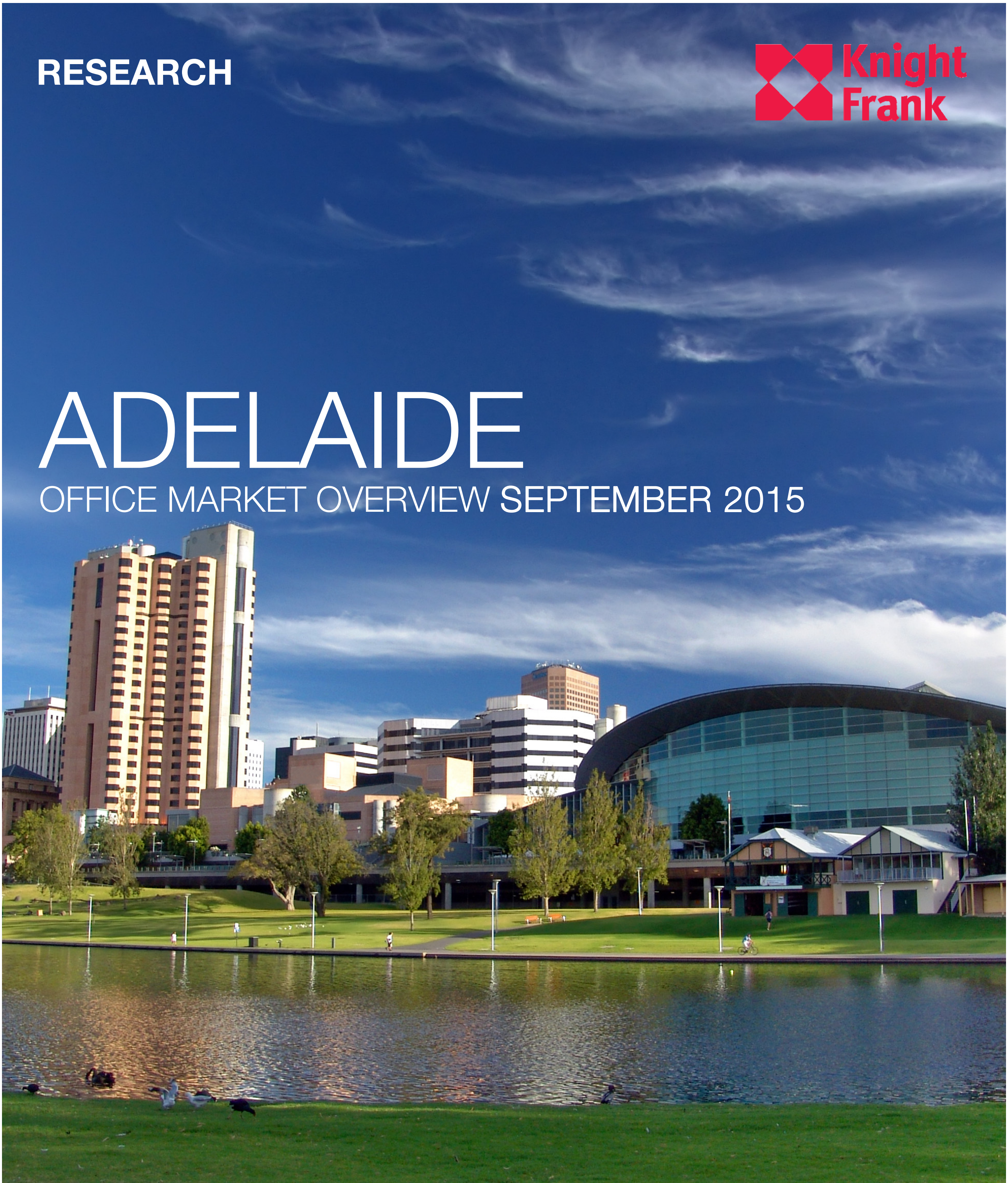
RESEARCH

ADELAIDE

OFFICE MARKET OVERVIEW SEPTEMBER 2015



HIGHLIGHTS

The Adelaide CBD vacancy rate remains unchanged at 13.5% in the six months to July 2015. However, vacancy in prime space has decreased while vacancy in secondary space has increased.

Available space and the level of competition in the leasing market has caused incentives to increase significantly across the CBD and Fringe, placing further downward pressure on effective rents.

Recent commercial property tax reforms will have a significant effect on sales and investment activity. Yields have continued to firm across the market in the six months to July 2015.

KEY FINDINGS

The Adelaide CBD recorded positive net absorption of 4,443m² for the six months to July 2015. This is primarily the result of major tenant relocations.

Average CBD prime gross face rents as at July 2015, were $499/m² ($396/m² net) and incentives averaging 24%.

Site works have begun at 170 Frome Street. The four level, 3,900m² building has secured a 38% pre commitment from Accounting firm Grant Thornton.

Secondary stock refurbishment is now a necessity to inhibit softening capital values in this sector. Further depreciation is likely for properties which have a high risk of pending vacancies

RORY DYUS
Research SA

SUPPLY & DEVELOPMENT

Projected supply in the Adelaide CBD is strong for 2015 / 2016. There is approximately 43,231m² of new and refurbished space coming to the market over this time period.

In the six months to July 2015, gross supply has seen a 47% increase from 3,706m² to 7,920m². However, in trend terms, Gross CBD supply is at a three year low (Figure 1) as the market deals with soft demand and attempts to backfill vacant and refurbished space.

The supply forecast for the next 12 months is above the previous 12 month period. There is approximately 43,231m² of new and refurbished space in the pipeline for the 2015/2016 period. Of that 70% (31,045m²) will be newly constructed office space and the remainder refurbished space.

The most significant addition will be Cbus Property's new building at 50 Flinders Street. The 12 storey 21,431m² building is 82% committed by People Choice Credit Union and Santos Ltd with completion scheduled for September 2015.

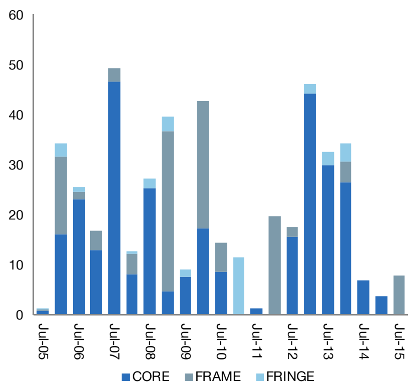
Construction is underway at 115 King William Street. The 25 storey, 6,900m² office building is being speculatively developed, having smaller 350m² floor plates.

Site works have begun on the "Frome on Flinders" development at 170 Frome Street. The building is a good example of how new space can attract quality tenants. Frome on Flinders will have a total NLA of 3,900m² and has a 38% pre commitment from accounting firm Grant Thornton. Grant Thornton will vacate their current premises at 67 Greenhill Road, Wayville in the Fringe office market.

Other notable developments mooted include Charter Hall's Precinct GPO development on the corner of Franklin Street and King William Street. The mixed-use project is in development assessment and proposes 40,000m² of office space across two towers and will compliment neighbouring Tower 8 at 12-26 Franklin Street which was completed in 2012. Development will likely be subject to major tenant pre commitments.

The South Australian Government has announced the redevelopment of the Festival Plaza / Riverbank precinct. The mixed-use development will revitalise under-utilised space and include a mooted 24-level office tower and expansion of the Casino. The project is still in early planning with the aim of construction completion in 2019.

FIGURE 1
Adelaide Gross Supply Additions
('000m²)



Source: Knight Frank Research/PCA

TABLE 1
Adelaide Office Market Indicators as at July 2015

Grade	Market	Total Stock (m²)	Vacancy Rate (%)	Annual Net Absorption (m²)	Annual Net Additions (m²)	Average Gross Face Rent ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	CBD	569,515	11.6	-2,234	0	499	24.0	7.00—8.00
	Fringe	37,297	5.6	-960	0	441	17.0	7.50—8.50
Secondary	CBD	809,830	14.9	980	-5,979	372	28.0	8.25—9.50
	Fringe	180,004	8.5	2,487	-2,867	340	17.5	8.25—9.25
Total Precinct	**CBD**	**1,379,345**	**13.5**	**-1,254**	**-5,979**			
	Fringe	**217,301**	**8.0**	**1,527**	**-2,867**			
Total Market	**Adelaide**	**1,596,646**	**12.8**	**273**	**-8,846**			

Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY

1. 169 Pirie St (ex BAB) # - 8,000m² [Lucid , Channel 9, Homestart]
Aus Property Developments - June 2015 - 75% comitmitted

2. 1 King William St # - ~12,500m² (ex Origin) [SA Govt]
Anvil Capital - Q3 2015 - 55% committed

3. 50 Flinders St - 21,431m² [People's Choice C.U. & Santos]
Cbus - Q3 2015 - 82% committed

4. 115 King William St - 6,900m²
Brinz Holdings - Q2 2016

5. 170 Frome St - 3,900m² [Grant Thornton]
Emmett Properties - 2016 - 38% committed

6. 185 Pirie St - 6,000m²
Palumbo / Pruszinski - 2016+

7. 186-190 North Terrace - 5,000m²
Adelaide Development Company (ADC) - 2017+

8. University of Adelaide AMNS^ - North Terrace
12,000m² University of Adelaide - 2016+

9. 102-120 Wakefield St - 16,500m ²
Kyren Group - 2017+

10. 42-56 Franklin St - 21,000m²
Private (Molfetas) - 2017+

11. Worldpark - Richmond Rd, Keswick - 22,600m²
Axiom (Stage B & C) - 2018+

12. Festival Plaza / Riverbank Precinct
Walker Corp/SA Government - 2019+

13. Tower 7 (Precinct GPO) - 12-26 Franklin St - 25,000m²
Charter Hall/Telstra Super Fund - 2019+

14. 130 Angas St (Hospital) - 25,000m²
Commercial & General - 2019+

15. Tower 4 (Precinct GPO) - 141 King William St - 15,000m²
Charter Hall/Telstra Super Fund - 2019+

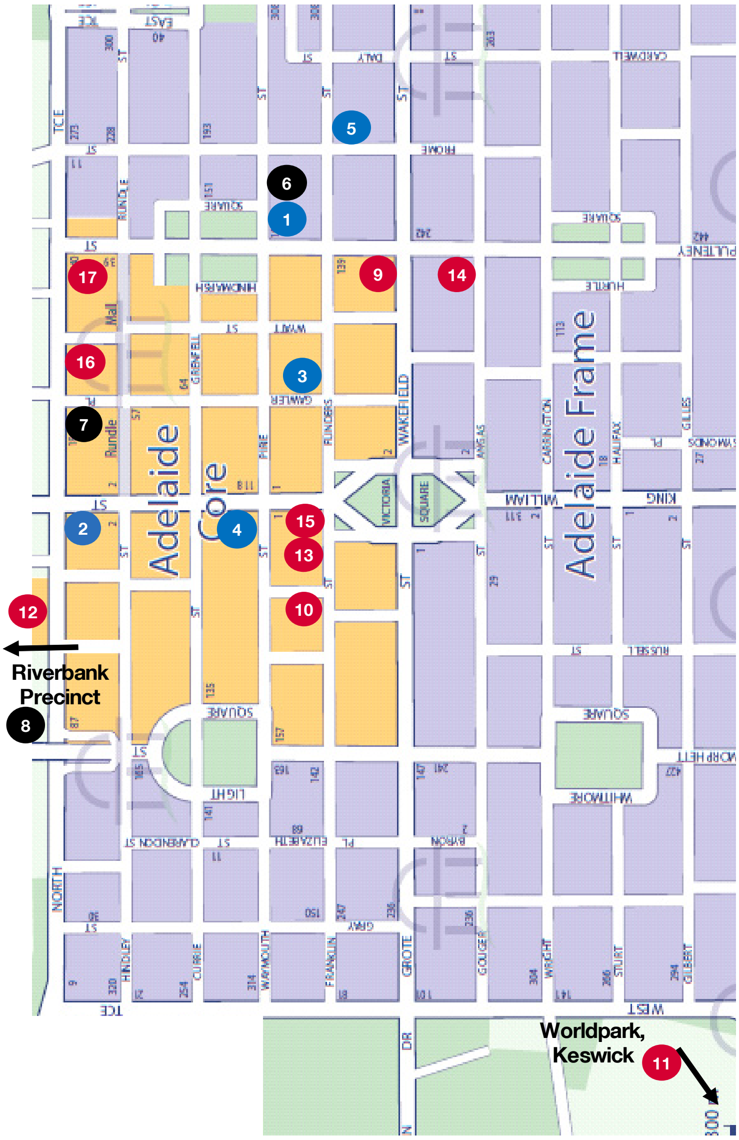
16. 200 North Terrace - 17,000m²
Maras/Le Cordon Bleu - 2019+

17. 11-13 Austin Street - 30,975m²
Eklipse Capital - 2019+

Under Construction/Complete

DA Approved / Confirmed

Mooted / Early Feasibility



Source of Map: Property Council
NB. Dates are Knight Frank Research estimates
Major tenant precommitment in [brackets] next to NLA
Major refurbishment
Office NLA quoted (>3,000m²)

* Owner occupier
^Adelaide Medical & Nursing School
~ note total NLA is 18,247m²
C.U. Credit Union
BAB Bendigo & Adelaide Bank

TENANT DEMAND & RENTS

Net Absorption

The Adelaide CBD recorded a positive net absorption of 4,443m² for the six months to July 2015 (Figure 2) and negative net absorption of -1,254m² over the past 12 months. The fringe recorded a positive net absorption of 888m² and 1,527m² over the same time periods.

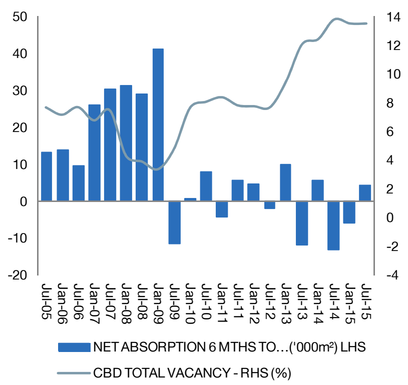
A number of leasing transactions have contributed to the positive net absorption result, highlighting demand for modern well located office space. Some of the largest contributors are the South Australian Government Department of Social Services occupying 3,079m² of space at 55 Currie Street, Channel 9 occupying 2,700m² at 169 Pirie Street, AHPRA occupying 2,139m² at 80 Grenfell Street, Elders occupying 896m² at 80 Grenfell Street and the Australian Institute of Business occupying 2,000m² at 27 Currie Street.

This was balanced by a number of relocations and contractions within the market. Most notably SA Water reducing their space by 1,613m² and Deloitte reducing their space requirement by 1,452m² at 11 Waymouth Street, URS vacating 1,470m² at 70 Light Square and taking up less space in 91 King William Street and SKM reducing their tenancy by 1,200m² at 33 King William Street.

FIGURE 2

Adelaide CBD Net Absorption

('000m² LHS) vs Total Vacancy Rate (% RHS)



Source: Knight Frank Research/PCA

Vacancy

According to the PCA, the Adelaide CBD vacancy rate has remained unchanged at 13.5% over the six months to July 2015. This is above the 25 year average of 12.1% and a marginal annual decrease of 30 basis points since the July 2014 result of 13.8%.

Changes in vacancy in prime space can be attributed to existing CBD tenants relocating, expanding or consolidating their CBD footprint, rather than increased demand from new tenants moving into the CBD. Vacancy in Premium office buildings saw a 130 basis point decrease to 9.4% as a result of AON taking up new space in 91 King William Street. Similarly, A grade vacancy decreased marginally moving from 12.1% to 11.8% in the six months to July 2015. 63 Pirie Street now remains over 65% vacant after AON's move and 27 Currie Street will be over 50% vacant pending Elders move to 80 Grenfell Street.

TABLE 2

Adelaide CBD Vacancy Rates (%)

Grade	Jul 2015	Jan 2015	Jul 2015
Premium	11.6%	10.7%	9.4%
A Grade	11.2%	12.1%	11.8%
Prime	**11.2%**	**12.0%**	**11.6%**
B Grade	14.7%	10.7%	11.1%
C Grade	14.9%	17.0%	17.2%
D Grade	19.0%	19.2%	19.7%
Secondary	**15.6%**	**14.6%**	**14.9%**
Total	**13.8%**	**13.5%**	**13.5%**

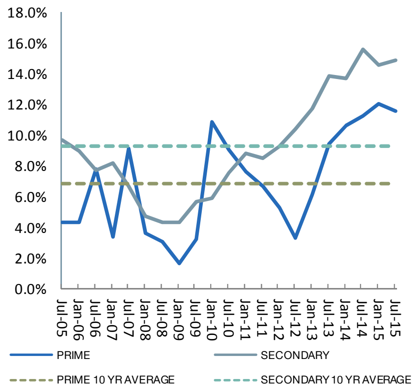
Source: Knight Frank Research/PCA

Vacancy in secondary space increased marginally from 14.6% to 14.9% in the six months to July 2015 (Figure 3). C grade and D grade were the largest contributors, recording the highest levels of vacancy for the past 10 years. It is possible that the gap between prime and secondary vacancy will remain for some time, especially if demand for newer and better presented office space persists.

FIGURE 3

Adelaide CBD

Prime vs Secondary Vacancy Rate (%)



Source: Knight Frank Research/PCA

A combination of vacant floor space and attractive incentives on new leases is making tenant relocations feasible for tenants approaching lease expiry. On average, incentives on new leases are more attractive than incentives on lease renewals, aided by the current low cost of borrowing and to facilitate new fit outs.

Fringe vacancy decreased from 8.3% to 8.0% in the six months to July 2015. Recent leasing deals have been led by Viterra who have moved their offices from South Terrace in the CBD frame to 186 Greenhill Road on the fringe, taking up 2,500m² of space on a new 10 year lease. This was made possible by a contraction of KBR which had a head lease over the whole of the building.

TABLE 3

Adelaide Fringe Vacancy Rates

Grade	Jul 2014	Jan 2015	Jul 2015
A Grade	3.1%	5.6%	5.6%
Prime	**3.1%**	**5.6%**	**5.6%**
B Grade	14.8%	8.8%	8.7%
C Grade	10.1%	8.5%	8.3%
D Grade	13.3%	16.9%	9.6%
Secondary	**11.3%**	**8.8%**	**8.5%**
Total	**9.9%**	**8.3%**	**8.0%**

Source: Knight Frank Research/PCA

Tenant Demand

There has been some small improvement in tenant demand within prime CBD space over the past six months, with a positive net absorption of 2,186m². This is supported by strong results in Premium and A grade space and a result of a few large moves. An example of this is APA who have moved from B grade space at 30 Currie Street to A grade space 400 King William Street expanding and taking up a total of 3,158m² of space over levels 1 and 6 within the eleven storey building.

The 17,878m² (ex ATO) building at 85 Waymouth Street will see its first tenants in four years. The South Australian Government Department of Environment Water and Natural Resources will lease circa 9,000m² in the building which reportedly included an incentive of circa 40%.

Weak demand in secondary space is encouraging building owners to refurbish or redevelop to better place their assets in the market by improving building appeal and environmental credentials. In addition, tenants are seeking the efficiencies from consolidating their space. An example of this is Breast Screen SA who have consolidated space occupied at 1 Goodwood Road, 28 Greenhill Road and 50 Greenhill Road in the Fringe. They have relocated to 1,764m² in the recently refurbished building at 169 Flinders Street, on a new 15 year term.

Developers that are willing to take on the risk of constructing new office buildings are accepting the challenge of the current below average demand.

For example, Emmett Properties' new "Frome on Flinders" development at 170 Frome Street has secured a pre-commitment from accounting firm Grant Thornton for 1,500m² of the total 3,900m² on a 10 year lease term. Similarly, site works on the Palumbo Groups new building at 185 Pirie Street are pending and commencement is likely to be subject to securing a major tenant. The eight level building will introduce 6,000m² of new space upon completion.

Rental Levels

Average CBD prime gross face rents have increased marginally from $494/m² to $499/m² in the six months to July 2015 (Figure 4). However, on a gross effective basis, rents have decreased by 4.0% to $379/m² as a result of a significant increase in incentives over the same time period, increasing from 20% to 24% (Figure 5).

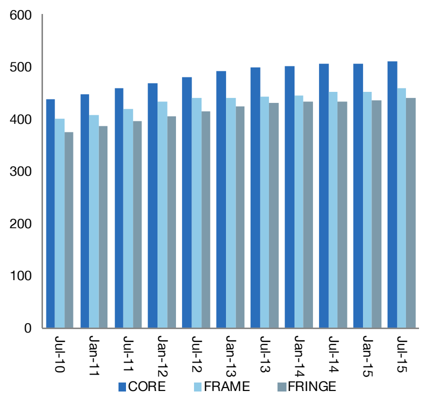
Average CBD secondary gross face rents have increased from $369/m² to $372/m² in the six months to July 2015. Average secondary gross effective rents have followed a similar trend, decreasing by 4.3% as a result of incentives increasing from 25% to 28% over the same time period. Incentives are at their highest levels in 15 years, with prime space averaging 24% and secondary space averaging 28%. Near record high incentives can be attributed to the amount of vacant space available and the competition that exists between the landlords.

Rental levels in the Fringe have increased for both prime and secondary space. Average Fringe prime gross face rents have increased marginally to $441/m² and secondary gross face rents increased to $340/m². In similar fashion to the CBD, Fringe incentives have increased substantially, placing downward pressure on effective rents. Incentives on prime space increased from 15% to an average of 17% and incentives on secondary space also increased from 15% to an average of 17.5% over the same six month period.

FIGURE 4

Adelaide Prime Gross Face Rents

By precinct ($/m²)

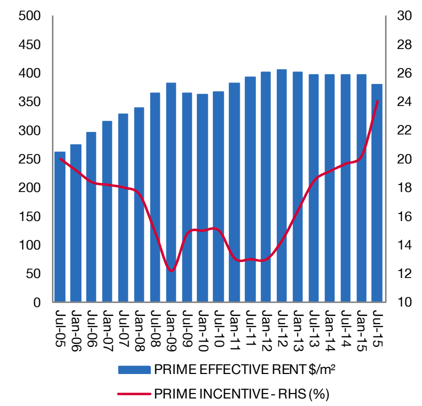


Source: Knight Frank Research

FIGURE 5

Adelaide CBD Prime Incentives vs. CBD Gross Effective Rents

July 2005—July 2015 (m² LHS, % RHS)



Source: Knight Frank Research

TABLE 4

Recent Leasing Activity Adelaide CBD and Fringe

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
85 Waymouth Street	9,000#	N/A	12#	40#	SA Government	Mar-16
190 Flinders Street	984	390g	5	25#	Dimension Data	Aug-15
186 Greenhill Road*	2,569	322g	10	N/A	Viterra	Aug-15
91 King William Street	896	520g	10	30#	AON	Jul-15
121 King William Street	970	390n	5	30#	Regus	May-15
400 King William Street	3,158	455g	12	25#	APA	May-15
70 Franklin Street	2,034	470g	12	20#	PWC	Mar-15
169 Flinders Street	1,764	390g	15	25#	Breast Screen	Dec-14

`estimated incentive calculated on a straight line basis g Gross n Net *Fringe #Circa

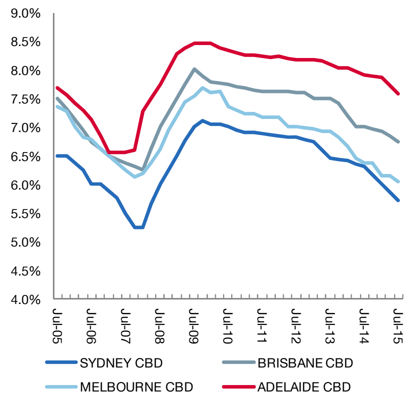
Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

FIGURE 6

Adelaide CBD vs Eastern States CBD Prime Yields

% Analysed Core Market Yield



Source: Knight Frank Research

Investment activity has been slow in 2015, following $515.23 million worth of sales in the latter part of 2014. There has been $111.8 million worth of sales >$10 million so far in the 2015 calendar year. The active sales period in 2014 was aided by the sale of the SachsenFonds Portfolio to Lend Lease APPF Commercial, for $175.2 million in September 2014. The portfolio included office buildings at 60 Flinders Street, 80 Flinders Street, 60 Light Square (on-sold immediately to Primewest) and the Flinders Link car park at 61-67 Wyatt Street. Other notable sales in the latter half of 2014 included 151 Pirie Street for $72 million and a 50% interest of Westpac House at 91 King William Street for $74 million.

The South Australian Government has been restructuring its position within the CBD by divesting a number of assets. Most recently, the State Administration Centre portfolio is currently under negotiation. The portfolio comprises 200 Victoria Square, 30 Wakefield Street, 31 Flinders Street, 220 Victoria Square, 24 Flinders Street and 12 Victoria Place with a combined net lettable area of 61,612m². The portfolio is expected to contract in one line for circa $200 million.

Further divestment by the South Australian Government includes the recent sale of 60 Wakefield Street and 21 Divett Place. The six level "B Grade" office building at 60 Wakefield Street and the 10 level State Forensic Centre at 21 Divett Place were purchased by syndication firm Ascot Capital in association with Finance Mutual Australia (FMA) for $37.5 million on a core market yield of 7.56% and leaseback term of 12 years to the State Government.

The investment outlook is positive as a result of a few key macro economic changes. The South Australian Government has abolished stamp duty on commercial property transactions, stamp duty on genuine corporate reconstructions and the transfer of units and unit trusts. Further accommodating investment, is the record low cash rate as set by the Reserve Bank. These changes will help stimulate and foster local, national and international investment.

The current level of demand is not being driven by leasing market fundamentals as these are weak at present. There is a clear disparity between capital markets and occupancy markets as yields are moving ahead of office fundamentals. The demand is a result of the movement of capital from lower yielding investments such as term deposits, bonds and a volatile share market, to higher yielding long term investments, such as property.

Adelaide has seen strong interest from a range of local and private investors, syndicates and offshore institutional investors, typically for A or Premium assets with secure and stabilised tenancy profiles. However, there seems to be a range of purchasers emerging with an appetite to move up the risk curve, given prime assets of this type are often tightly held.

Over the past ten years average prime yields in the Adelaide CBD have followed a similar trend to that of the eastern states by steadily firming post GFC. (Figure 6).

TABLE 5

Recent Sales Activity Adelaide

Address	Price $ million	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
131 Grenfell Street *	20.00	N/A	4,052	4,936	4.4	Centuria (CPFL)	Centuria (CMA)	Jun-15
60 Wakefield St & 21 Divett	37.50	7.56	12,660	2,962	12	SA Government	Ascot Capital & FMA	Mar-15
81 Flinders St	41.30	8.18	9,812	4,209	3.9	Norelco Holdings	Private Investor	Feb-15
49-51 Pirie St	13.00	N/A	6,179	2,104	2.1	Charter Hall (CPOF)	Private Investor	Jan-15
91 King William St ^	74.00	7.93	31,399	4,714	3.6	Arena Investment	Abacus Property Fund	Nov-14
SachsenFonds Portfolio	175.20	N/A	36,302	N/A	2.5	SachsenFonds	Lend Lease (APPF)	Sep-14
151 Pirie St	72.00	7.32	12,571	5,727	5.7	Real I.S.	Padman Pty Ltd	Dec-14

Source: Knight Frank Research ^purchase of 50% interest *transfer from CPFL to CMA

Prime yields in Adelaide remain 100-150 basis points above that of Sydney, Brisbane and Melbourne, making Adelaide an attractive investment opportunity.

In the six months to July 2015, average yields for both prime and secondary assets have continued to decrease. Both prime and secondary yields are now below their respective ten year averages for the first time since before the GFC of 2007-2008 (Figure 7). In the six months to July 2015, yields for prime assets firmed by 26 basis points and now average 7.59%. Yields for secondary assets firmed by 19 basis points and now average 8.96%.

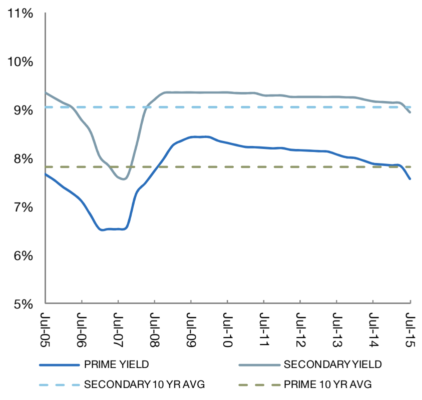
The recent firming of CBD yields has been driven by heightened activity from Australian and overseas funds, institutional groups, domestic syndicates and private investors. Recent sales such as 60 Wakefield and 21 Divett Place and the SachsenFonds Portfolio are evidence that Adelaide is attracting both local and offshore investment.

It is likely that the changes to commercial property taxation, record low interest rates and steady competition in the market will further grow investment activity. Prime assets with strong income streams and long term lease covenants are anticipated to attract the highest demand, leading to a further firming of yields.

Whilst increasing in the past 12-18 months, buyer depth has been more selective within the secondary market. Pricing parameters and a softer yield range for secondary assets indicate that demand in this sector of the office market continues to remain inconsistent.

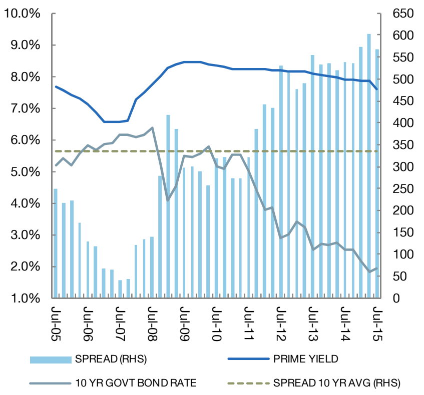
Investment yields in the Fringe office market have firmed modestly, prompted by the changes within the CBD investment market. In the six months to July 2015, yield ranges collectively firmed 25 basis points across the market. Fringe prime yields now range between 7.50% and 8.50% and fringe secondary yields now range from 8.25% to 9.25%.

FIGURE 7
Adelaide CBD Core Market Yields
Averages by Grade



Source: Knight Frank Research

FIGURE 8
Adelaide CBD Yields & Spreads
Core Market Yields vs 10 Yr Govt Bond Rate



Source: Knight Frank Research/RBA

Outlook

- The limited face rental growth which currently exists in the leasing market is being led by those tenants seeking efficiencies through relocating or the consolidation of space.
- It is likely that additional secondary stock will become available as tenants move to better quality space with attractive incentives on offer.
- The pending redevelopment of the Festival Plaza / Riverbank Precinct will revitalise and have significant benefits for the northern edge of the CBD core, adding an additional 39,000m² of new office space.
- The investment market will continue to be favourable, aided by commercial property tax reform and accommodative borrowing conditions.
- Demand for prime investments with secure and stable tenancy profiles is strong nationally and given Adelaide's position, there is potential for further firming of yields in the short term.
- Cbus Property's new building at 50 Flinders Street is nearing completion and will be the most significant addition to the CBD in 2015.
- The (ex ATO) building at 85 Waymouth Street will be partially tenanted after being vacant since 2011, highlighting the importance of secondary stock refurbishment to attract tenant activity.

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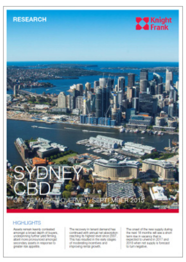
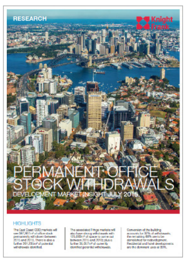
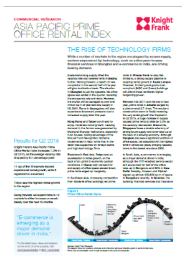


Sydney CBD Office Market Overview September 2015

St Kilda & Southbank Office Market Brief September 2015



Australian Office Stock Withdrawals July 2015



Asia Pacific Prime Office Rental Index Q2 2015

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