RESEARCH

ADELAIDE

OFFICE MARKET OVERVIEW SEPTEMBER 2016

HIGHLIGHTS

The Adelaide CBD vacancy rate increased from 14.1% to 15.8% in the six months to July 2016. This was largely the result of an increase in supply with the completion of refurbished space.

The disparity between occupancy markets and capital markets continues to widen. In the six months to July 2016, prime yields have compressed whilst effective rents have decreased.

Forecast supply in the CBD remains subdued. Mooted development includes Charter Hall's GPO development and the Walker Corporations Riverbank Precinct redevelopment.

KEY FINDINGS

In the six months to July 2016, CBD prime yields have firmed by six basis points and secondary yields have firmed by five basis points, despite ongoing weak leasing fundamentals.

C and D grade office space accounts for approximately one third of the market. These two grades contain the highest vacancy at 16.8% and 20.0% respectively.

In the six months to July 2016, average prime CBD incentives increased marginally from 28% to 29%, resulting in a decrease in average effective rents.

Following $531.45 million of sales in Q1 2016, sales activity moderated in Q2. With the current stock on the market it is likely that H2 2016 will produce increased volumes and stronger results.

RORY DYUS
Research SA

SUPPLY & DEVELOPMENT

Forecast supply is anticipated to be below historic levels as the market transitions from the end of the recent supply cycle. This may aid in stabilising the vacancy rate as the market absorbs existing stock.

The Adelaide CBD recorded an increase in gross supply of 26,946m² in the six months to July 2016, approximately 48% above the 25 year average. This is primarily due to the supply of 17,378m² of refurbished space at 81-95 Waymouth Street. The remaining supply was the result of the completion of other full or partial refurbishments, such as 1,800m² of space at 82-98 Wakefield Street and the partial completion of refurbished floors at 1 King William Street.

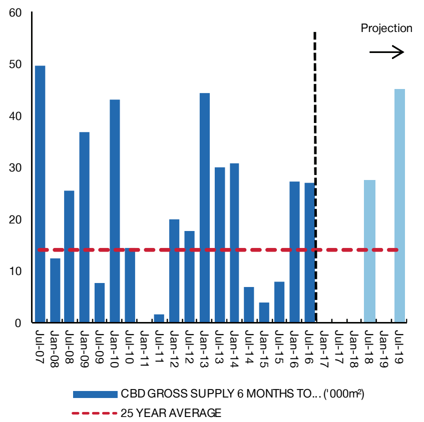
In the six months to July 2016, net supply was 19,127m² after accounting for stock withdrawals. Of note is 2,924m² being demolished at 228-230 & 231 North Terrace for the construction of student accommodation and 1,800m² at 106 Currie Street being withdrawn for apartment/hotel conversion.

Construction of 115 King William Street is approaching its final stages. The speculative building on a small site offers 6,775m² over 25 levels and whole floors of approximately 271m² each, with no known tenant commitment. 170 Frome Street is also on track for completion by the end of the year. The four level 3,900m² building has a 38% tenant pre-commitment from accounting group Grant Thornton.

Looking ahead, forecast supply is anticipated to be benign until the next stage of the supply cycle. This should aid in stabilising the vacancy rate as the market absorbs existing stock.

The next wave of potential supply is headlined by Charter Hall's Precinct GPO development. The proposed development is likely to include approximately 36,500m² of office and retail space over two towers. Smaller developments of note in the pipeline include 185 Pirie Street, an eight-level, 6,000m² development, Adelaide Development Company's 5,000m² at 186 -190 North Terrace and Kyren Group's 16,500m² at 102-120 Wakefield, all of which are currently seeking tenant pre-commitment.

FIGURE 1
Adelaide Gross Supply Additions
('000m²)



Source: Knight Frank Research/PCA

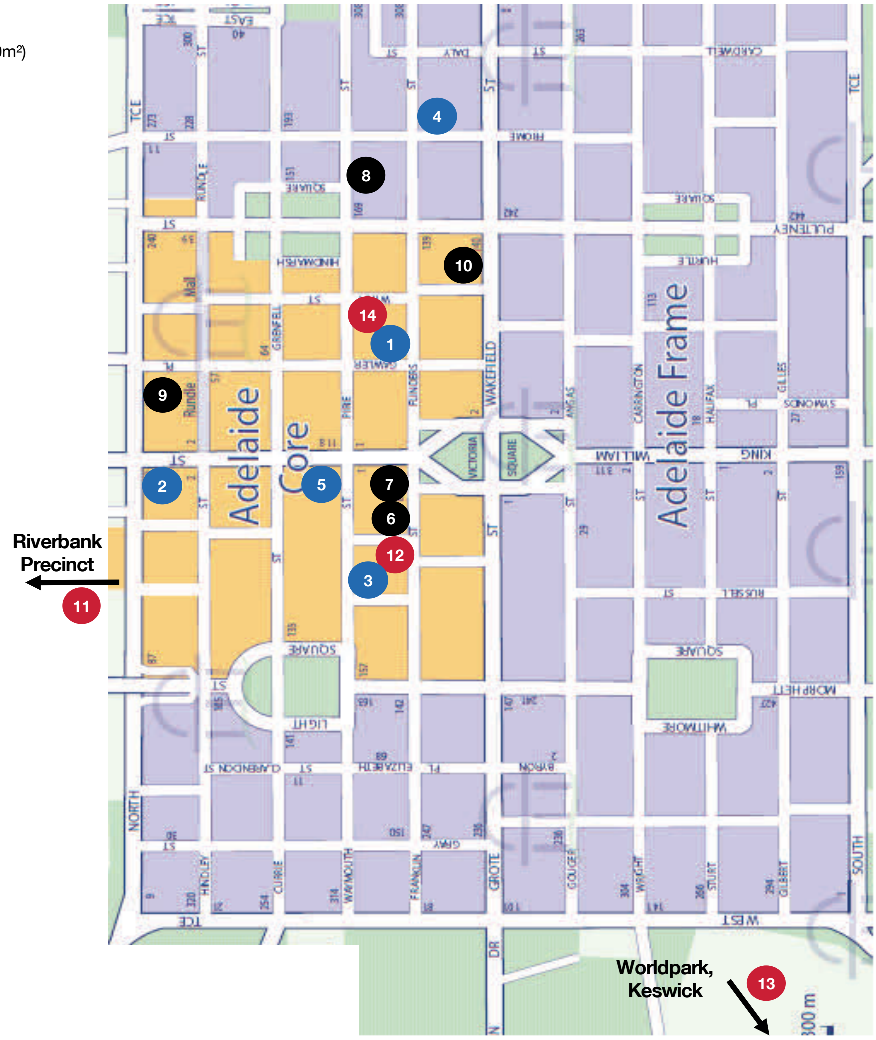
TABLE 1
Adelaide Office Market Indicators as at July 2016

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	591,087	15.4	-2,850	21,572	502	28.7	7.00—7.50
	Fringe	37,297	2.1	1,300	0	442	18.0	7.25—8.25
Secondary	CBD	814,578	16.2	-6,549	4,748	378	30.1	8.00—9.25
	Fringe	178,112	11.9	-7,808	-1,892	345	19.0	8.00—8.75
Total Precinct	**CBD**	**1,405,665**	**15.8**	**-9,399**	**26,320**			
	Fringe	**215,409**	**10.2**	**-6,508**	**-1,892**			
Total Market	**Adelaide**	**1,621,074**	**15.1**	**-15,907**	**24,428**			

Source: Knight Frank Research/PCA NB. CBD includes the Core & the Frame precincts

MAJOR OFFICE SUPPLY

1. 50 Flinders St - 20,572m^2 [People's Choice C.U., Santos, BUPA]
   Cbus - October 2015 - 91% committed (Santos Subleasing 7,000m^2)
2. 1 King William St # - 18,247m^2 [SA Govt, Enzen, Commonwealth]
   Anvil Capital - October 2015 - 64% committed
3. 81-95 Waymouth St # - 17,378m^2 [SA Govt]
   KTS Properties - May 2016 - 70% committed
4. 170 Frome St - 3,900m^2 [Grant Thornton]
   Emmett Properties - H2 2016 - 38% committed
5. 115 King William St - 6,775m^2 [No Pre-commitment]
   Brinz Holdings - H2 2016
6. GPO Tower (Precinct GPO) - 12-26 Franklin St - 24,000m^2
   Charter Hall/Telstra Super Fund - 2019+
7. GPO Plaza (Precinct GPO) - 141 King William St - 12,500m^2
   Charter Hall/Telstra Super Fund - 2019+
8. 185 Pirie Street - 6,000m^2
   Palumbo / Pruszinski - 2018+
9. 186-190 North Terrace - 5,000m^2
   Adelaide Development Company (ADC) - 2018+
10. 102-120 Wakefield St - 16,500m ^{2}
    Kyren Group - 2018+
11. Festival Plaza / Riverbank Precinct - 40,000m^2
    Walker Corp/SA Government - 2019+
12. 42-56 Franklin St - 21,000m^2
    Private (Molfetas) - 2019+
13. Worldpark - Richmond Rd, Keswick - 22,600m^2
    Axiom (Stage B & C) - 2019+
14. 57-61 Wyatt Street - 4,180m^2
    Private - 2019+



- Under Construction/Complete (blue)
- DA Approved / Confirmed (black)
- Mooted / Early Feasibility (red)

Source of Map: Property Council
NB. Dates are Knight Frank Research estimates
Major tenant pre-commitment in [brackets] next to NLA
Major refurbishment
C.U Credit Union
Office NLA quoted (>3,000m^2)

TENANT DEMAND & RENTS

Net Absorption

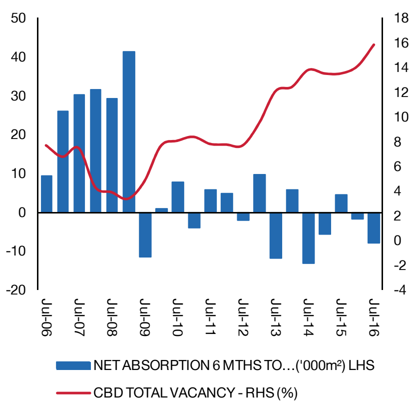
Although decreasing by slightly to 6.4% in July 2016, the South Australian unemployment rate remains above the national rate of 5.7%. There have been various high profile company collapses and contractions which have resulted in job losses across the state.

In the six months to July 2016, the take up of space has been weak and the Adelaide CBD recorded a negative net absorption of -7,822m² and -9,399m² over the past 12 month period.

More specifically, prime CBD space recorded a negative net absorption of -1,910m² in the six months to July 2016 and -2,850m² over the past 12 months. Secondary space experienced weaker results, recording -5,912m² in the six months to July 2016 and –6,549m² over the past 12 months.

Weak absorption and an above average vacancy rate are evidence of a sluggish market and tenant contractions outweighing tenant demand. Another possible contributor to negative net absorption includes a decrease in tenant space requirements when relocating or moving as a result of efficiency gains, especially into newer or recently refurbished space.

FIGURE 2
Adelaide CBD Net Absorption
('000m² LHS) vs Total Vacancy Rate (% RHS)



Source: Knight Frank Research/PCA

Vacancy

In the six months to July 2016, the Adelaide CBD vacancy rate increased from 14.1% to 15.8%, the highest result in over 16 years and remains above the 25 year average of 12.2%. Both prime and secondary vacancy have continued to trend upward, with a spike in prime vacancy more recently, reducing the spread between the asset classes (see Figure 3).

Prime vacancy increased from 12.5% to 15.4% in the six months to July 2016, this translates to a 27% increase in vacant prime stock which now stands at 90,802m². Over the same time period, vacancy in secondary space has increased from 15.2% to 16.2%. More specifically, an increase from 11.1% to 14.2% in B Grade stock was balanced by decreases in vacancy for both C and D Grade office space (see Table 2).

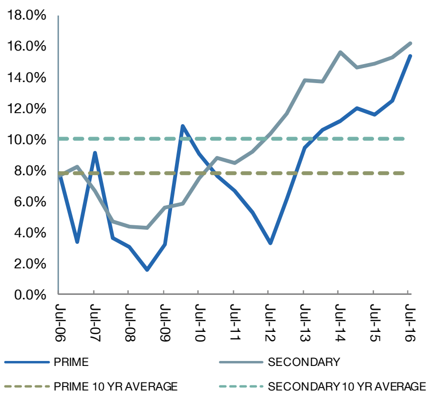
The Fringe market experienced similar movements, recording an increase in overall vacancy, rising from 7.1% to 10.2% (see Table 3). Despite Fringe A Grade vacancy decreasing from 5.6% to 2.1%, the overall change is largely the result of increases in C Grade vacancy from 7.9% to 12.8%. This was partially tempered by 1,362m² withdrawn at 161 Greenhill Road which is undergoing refurbishment. Nonetheless, the Fringe is a comparatively small market and therefore susceptible to comparatively minor fluctuations in vacancy.

TABLE 2
Adelaide CBD Vacancy Rates (%)

Grade	Jul 2015	Jan 2016	Jul 2016
Premium	9.4%	7.7%	8.3%
A Grade	11.8%	12.8%	15.9%
Prime	**11.6%**	**12.5%**	**15.4%**
B Grade	11.1%	11.1%	14.2%
C Grade	17.2%	17.9%	16.8%
D Grade	19.7%	20.6%	20.0%
Secondary	**14.9%**	**15.2%**	**16.2%**
Total	**13.5%**	**14.1%**	**15.8%**

Source: Knight Frank Research/PCA

FIGURE 3
Adelaide CBD Vacancy Rates
Prime vs. Secondary Grade (%)



Source: Knight Frank Research/PCA

Whilst vacancy remains well above the historic average it is noted that secondary space holds the highest proportion of vacancy within the CBD. C and D grade stock account for approximately 31% of total CBD office space. As at July 2016, C Grade stock had a vacancy factor of 16.8% and D Grade stock had a vacancy factor of 20.0%.

Redundant C and D Grade stock is providing developers with opportunities. An example of this is Urbanest which purchased 228-230 & 231 North Terrace and will demolish this for the construction of a 22 level, 450 bed purpose built student accommodation facility. The 1,236m² site is strategically located adjacent to the University of Adelaide and UniSA campuses.

TABLE 3
Adelaide Fringe Vacancy Rates (%)

Grade	Jul 2015	Jan 2016	Jul 2016
A Grade	5.6%	5.6%	2.1%
Prime	**5.6%**	**5.6%**	**2.1%**
B Grade	8.7%	5.6%	7.6%
C Grade	8.3%	7.9%	12.8%
D Grade	9.6%	9.6%	21.5%
Secondary	**8.5%**	**7.4%**	**11.9%**
Total	**8.0%**	**7.1%**	**10.2%**

Source: Knight Frank Research/PCA

Tenant Demand

Over the 12 months to July 2016, white collar employment in the Adelaide CBD continued to stagnate. By sector, increases of note include 12.8% by 'Wholesale Trade' and 6.2% by 'Information Media and Telecommunications', which were largely offset by substantial decreases in 'Mining' by -13.6% and 'Manufacturing' recording a -6.7% decrease.

White collar employment in the CBD is forecast to stabilise over the current financial year with the expectation of annual growth of 0.8%. The forecast for the next 2-3 years is modest with annual increases of between 1.0 - 2.0% over this period.

Vacant space and above average incentives are facilitating tenant movements. In the six months to July 2016, leasing deals of significance include the Australian Institute of Business leasing 5,590m² at 27-39 Currie Street, accounting for approximately 47% of the building's NLA, for a five year term.

1 King William Street remains a good example of an older building which has been subject to significant refurbishment works and as a result has continued to attract quality tenants. Recent deals in the building include Enzen Global, occupying 1,160m² for seven year term, and the Bank of China occupying 440m² of office and 220m² of ground floor retail space for a term of 12 years. This follows other significant deals, including the Commonwealth Government (AAT), SA Government (DPTI) and Uni Super Management. The building is now 64% leased.

Leasing in the Fringe market remains the most active for requirements under 1,000m². Recent leases of significance include Dr Jones and Partners occupying approximately 577m² at 226 Greenhill Road for a seven year term. The tenancy had been vacant for around four years. International Telecommunications company Huawei have leased 512m² at 140 Greenhill Road for a term of three years.

Rental Levels

Increased vacancy and a highly competitive environment has allowed tenants to be more selective with the quality of space they demand. Despite marginal increases in face rents, the increase in CBD Prime and Secondary incentives have resulted in decreases in effective rents.

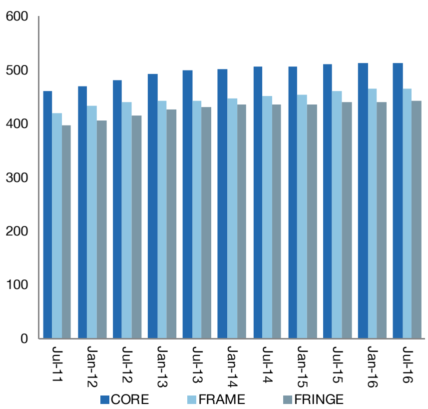
Average prime gross face rents in the CBD remained unchanged over the past six months to July 2016 at $502/m² with average prime incentives increasing marginally from 28% to 29%. Subsequently, there has been a -1.7% decrease in gross effective rents from $364/m² to $358/m² over the same period.

As at July 2016, average secondary gross face rents increased marginally from $376/m² to $378/m² with average incentives increasing from 29% to 30%. As a result, the average gross effective rate has decreased from $268/m² to $264/m².

Rental levels in the Fringe have risen modestly for both prime and secondary space. In the six months to July 2016, average Fringe prime gross face rents increased marginally from $441/m² to $442/m² and secondary gross face rents increased from $340/m² to $345/m².

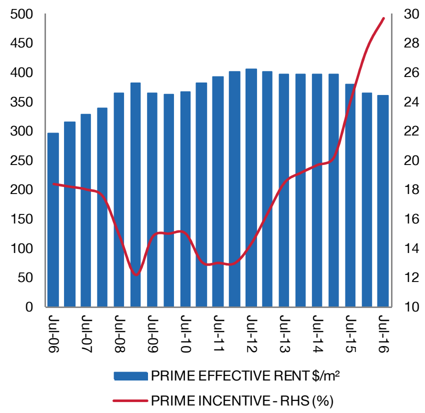
Incentives in the Fringe market stand at approximately 18% for prime and 19% for secondary space, with gross effective rents of $362/m² and $279/m²

FIGURE 4
Adelaide Prime Gross Face Rents
By precinct ($/m² p.a)



Source: Knight Frank Research

FIGURE 5
Adelaide CBD Prime Incentives vs. CBD Gross Effective Rents
Jul 2006—Jul 2016 ($/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
1 King William Street	1,160	495g	7	30	Enzen Global	Sep-16
50 Flinders Street	1,775	430n	12	30	Bupa Australia	Aug-16
70 Hindmarsh Square	870	420g	7	30	AMP Services	Aug 16
169 Pirie Street	1,215	350n	10	35+	HAMB Systems	Jul-16
226 Greenhill Road*	577	400g	7	30	Dr Jones & Prt's	Jun-16
1 King William Street	440	535g	12	#	Bank of China	Jun-16
27-39 Currie Street	5,590	378g	5	20	AIB	May-16
140 Greenhill Road*	512	290n	3	15	Huawei	Apr-16

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

Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Following sizeable sales volume in Q1 2016 totalling $531.45 million, market activity moderated in Q2 2016. No significant CBD Office transactions greater than $10 million occurred despite a few significant assets reported as being under contract or entering due diligence.

Historically, Adelaide sales have largely been dominated by private investors and syndicates, but the CBD has received increased interest from overseas and institutional investors (see Figure 6). This is evidenced by Blackstone's purchase of 80 Grenfell Street for $400 million with a core market yield of circa 6.50% and Singapore based Norleco Holdings' purchase of 100 Waymouth Street for $73 million with a core market yield of 6.57%.

Potential purchasers have reportedly been shortlisted for the sale of The Motor Accident Commission national portfolio. In Adelaide, this includes 121 King William, a circa 12,600m² A Grade building, and 99 Gawler Place, a circa 11,000m² B Grade building, both of which are located in the CBD Core.

Sales volumes have continued to be most active under the $10 million mark. Assets with a secure tenancy profile in this price bracket have experienced some yield compression. Whilst Adelaide Prime CBD yields have firmed modestly they remain approximately 150 to 200 basis points above East Coast yields (see Figure 7).

Adelaide based property group Commercial & General are in the process of capital raising for five buildings in the State Administration Centre Portfolio. This Portfolio comprises 31 Flinders Street (Education Building), 200 Victoria Square (State Administration Centre), 30 Wakefield Street (Wakefield House) and 220 Victoria Square (Torrens Building).

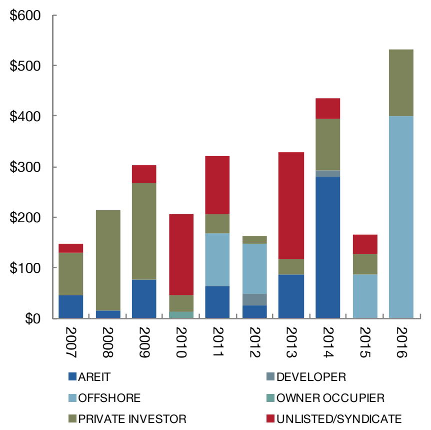
The portfolio is to be leased back to the SA Government for a term of 12 years from settlement for an initial gross rental of $19,400,000 p.a.

The three phase reduction of stamp duty on commercial property transactions which commenced in December 2015 is expected to accommodate further investment in the CBD and improve the attractiveness of South Australia as an investment option. The next one third reduction is scheduled for July 2017 and full abolition of the tax will take effect from July 2018. Included in the reform is the abolition on stamp duty on transfers of units and unit trusts and the removal of the $1 million stamp duty landholder threshold.

FIGURE 6

Adelaide CBD Sales by Purchaser

2007 to 2016 year to date ($million)

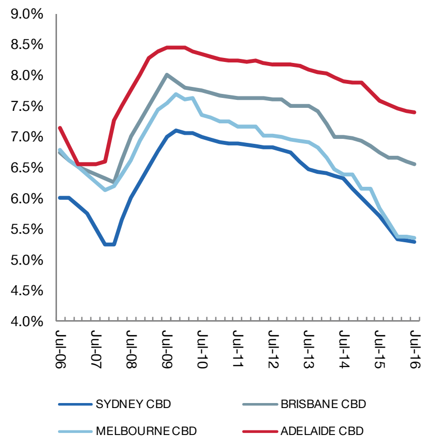


Source: Knight Frank Research
N.B. 2016 is calendar year to date only

FIGURE 7

Adelaide CBD vs East Coast Yields

2006-2016—prime office



Source: Knight Frank Research

TABLE 5

Recent Sales Activity Adelaide

Address	Price $ million	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
30 Flinders Street	63.50	7.30	13,835	4,590	4.4	Shakespeare ~	Private	Mar-16
19 Grenfell Street	39.20	8.86	10,786	3,634	2.1	Grenfell Street Nominees	Shakespeare ~	Feb-16
30 Currie Street	28.75	8.22	9,184	3,130	1.1	Private	Shakespeare ~	Jan-16
80 Grenfell & Rundle Place #	400.00	c.6.50	46,635*	8,577	9.8	epc.Pacific	Blackstone **	Jan-16
100 Waymouth Street	73.00	6.57	12,305	5,933	8.0	Cromwell Property	Norelco Holdings	Dec-15
60 Wakefield St & 21 Divett Place	37.50	7.56	12,660	2,962	12.0	SA Government	Ascot Capital & FMA<	Mar-15
81 Flinders Street	41.30	8.18	9,812	4,209	3.9	Norelco Holdings	Private Investor	Feb-15

~ Shakespeare Property Group **Blackstone Singapore Pte. Ltd <Finance Mutual Australia
* Combined lettable area of office & retail components # Mixed-use asset comprising office building, retail centre & car park

Source: Knight Frank Research

In the six months to July 2016 CBD prime yields firmed modestly by six basis points to 7.39%, remaining below the 10 year average of 7.82%. The period also saw the average yield range for prime assets tighten by 25 basis points to 7.00%-7.50%. Average CBD secondary yields have firmed by five basis points to 8.67% with the yield range remaining between 8.0% and 9.25% (see Figure 8).

Investment activity in the secondary market remains inconsistent where purchasers have continued to show a mixed tolerance for risk. Purchasers with the ability to reposition secondary assets and secure tenants have the opportunity to benefit from steady investment demand in the short term.

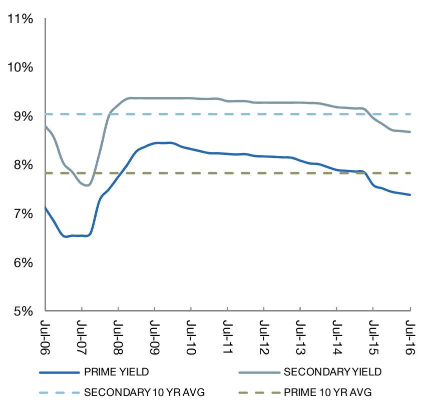
Yield compression evidenced across the market has primarily been the result of capital market trends, namely the cost of finance, with a record low cash rate. Contributing to this is the attractiveness of property compared to other forms of investment such as Government Bonds, which have experienced more aggressive compression over the same time period (see Figure 9).

There is a disparity between high activity levels in capital markets and inconsistent performance in occupancy markets, as yields continue to move ahead of leasing market fundamentals. The risk in this situation is that whilst any further short term compression will likely be driven by capital markets, long term compression will need to come from improving market fundamentals.

Nevertheless, in the current market, it is anticipated that were a prime asset with a secure and stabilised tenancy profile offered to the market for sale, yields would continue to show a firming bias whilst demand exceeds supply, and whilst the cost of debt remains at such low levels.

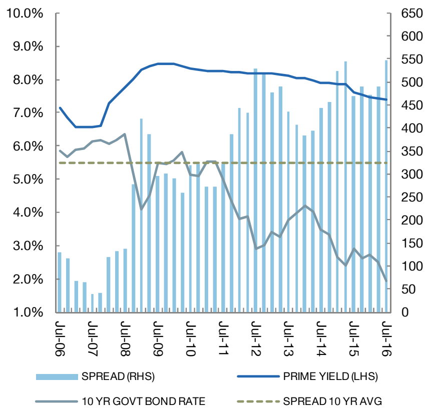
Investment yields in the Fringe office market remain largely unchanged. As at July 2016, prime yields averaged 7.73% and secondary yields averaged 8.50%. Typically, prime yields ranged between 7.25% and 8.25%, while fringe secondary yields ranged from 8.00% to 8.75%.

FIGURE 8
Adelaide CBD Core Market Yields
Yields and Averages by Grade



Source: Knight Frank Research

FIGURE 9
Adelaide CBD Yields & Spreads
Core Market Yields vs 10 Yr Govt Bond Rate



Source: Knight Frank Research/RBA

Outlook

- Mooted development post 2018 / 2019 includes Charter Hall's Precinct GPO development and the Walker Corporations proposed Festival Plaza / Riverbank Precinct redevelopment. Should these developments come to fruition they will provide in excess of 40,000m² of new space.
- The leasing market is likely to remain accommodative for prospective tenants. Tenants approaching lease expiry may take advantage of a surplus of quality vacant space, above average incentives on offer and the limited growth in face rents.
- Building owners of secondary stock with high vacancy that can reposition their assets through refurbishment and upgrades have the potential to attract new tenants. Examples of successes include 81-95 Waymouth Street and 1 King William Street.
- Despite moderate results in Q2 2016, the spread between Adelaide CBD and East Coast CBD yields will likely support Adelaide's appealing investment value proposition. It is likely that additional prime stock will come to the market in H2 2016.
- Prime assets with secure income streams and long term lease covenants are anticipated to remain in high demand, leading to a potential further firming of yields. Although the extent to which is likely to be less than more recently experienced.
- Redundant secondary stock may provide further opportunities for redevelopment or conversion to alternate uses. A recent example is Urbanest's proposed redevelopment of 228-230 and 231 North Terrace for purpose built student accommodation.

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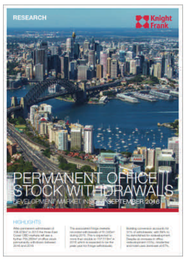

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