

RESEARCH



ADELAIDE CBD

OFFICE MARKET OVERVIEW MARCH 2020

TENANTS FOCUSED ON NEW-GEN PRIME OFFICE

HIGHLIGHTS

Tenant demand continues to focus on new-gen prime office buildings, being those constructed post 2006. This trend is likely to continue, driven by accommodation quality benefits and more efficient floor plates resulting in potential reduction in rent expenses.

The Adelaide CBD vacancy rate has been falling consistently over the past 3 years, however, as at January 2020, the Adelaide CBD vacancy rate increased by 1.2% to 14.0%.

Investor demand remains strong as Adelaide continues to be viewed as an attractive value proposition with average prime yields across the Eastern Seaboard generally 100-200 basis points firmer than those being achieved in South Australia.

KEY FINDINGS

The **Adelaide CBD vacancy rate** has increased by 1.2% to 14.0% in the six months to January 2020.

Average **prime CBD gross effective rents** have increased by 4.6% on a YoY basis, from \$356/m² to \$373/m².

Adelaide CBD recorded a **net supply** of 20,572m² in the six months to January 2020. This figure is approximately 3.6 times above the 25-year average, making it the strongest net supply since 2013.

CY2019 saw total **sales volume** of \$787.49 million for properties above \$10 million in Adelaide CBD. This figure is significantly above the 10-year average of \$462.37 million.



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ECONOMIC OVERVIEW

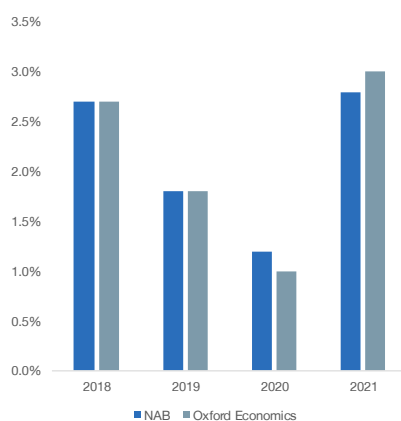
Growth outlook downgraded due to COVID-19

The evolving coronavirus outbreak poses downside risks for the global economy. While the number of new cases has slowed in China, the spread of the virus globally is weighing on economic activity although the severity and duration of the impact remain highly uncertain.

Consistent with the deterioration in the global outlook, growth in the Australian economy will slow in this year. At the time of writing, NAB forecasts real GDP growth will slow from 1.8% in 2019 to 1.2% in 2020, while Oxford Economics predicts growth will be a little weaker at 1.0%. These forecasts represent downgrades of 0.8 and 1.2 percentage points respectively to annual GDP growth since December 2019.

In Australia, the initial growth impact is being felt primarily through services exports such as tourism and education

FIGURE 1
Real GDP Growth Forecasts
Year average



Source: Knight Frank Research, NAB, Oxford Economics

due to travel restrictions and reduced demand. Household spending is also likely to soften due to weaker consumer sentiment and potential impacts on employment in impacted sectors. While the impact on office-based employment is likely to be more limited, demand is expected to be weaker in the short term because of the effects due to the uncertainty that exists and from a weaker economic climate.

Strong policy response to drive recovery

In 2019, the Reserve Bank of Australia (RBA) had lowered the cash rate three times in a bid to kickstart sluggish economy. This is before the bushfires and coronavirus threat came into play. More recently (19 March 2020), the RBA cut the cash rate to a historical low of 0.25%. The move comes just two weeks after the RBA revised the rate down to 0.50% at its regularly scheduled board meeting on 3rd March. This is the first out-of-cycle reduction since 1997. The emergency move to rate cut was due to the economic shock and potential large-scale unemployment from the coronavirus pandemic. The cash rate was last raised in November 2010.

Economic stimulus package in response to Covid-19

At the time of writing, the Federal Government announced a massive wage subsidy program at a cost of \$130 billion (6.5% of GDP), bringing the government's total stimulus to date to \$198 billion (9.9% of GDP). This is the largest single fiscal stimulus package in Australia's history, and provides a strong incentive for employers to retain staff.

TABLE 1
Adelaide CBD Office Market Indicators as at January 2020

Grade	Total Stock (m ²)*	Vacancy Rate (%)*	Six Months Net Absorption (m ²) [^]	Six Months Net Supply (m ²) [^]	Average Gross Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	624,387	13.9	11,825	29,500	540	31.0	6.26
Secondary	814,144	14.2	-11,935	-8,928	388	33.2	7.95
Total	1,438,531	14.0	-110	20,572			

Source: Knight Frank Research/PCA

*as at January 2020

[^]12 months to January 2020

[^]6 months to January 2020

TENANT DEMAND & ABSORPTION



Net Absorption & Outlook

Prime	23,126sqm 12 mths to Jan 20	
Secondary	-7,412sqm 12 mths to Jan 20	

Source: Knight Frank Research/PCA

Tenant demand concentrated on A Grade stock

In the six months to January 2020, Adelaide CBD has recorded negative net absorption of -110m². This figure is well below the 25-year average of 6,039m².

The negative net absorption was driven by Premium, B and C grade which totalled -17,309m². Despite this, the A grade stock had recorded positive net absorption of 17,120m² in the six months to January 2020.

Tenants attracted to new generation office buildings

Although the net absorption was concentrated in the A grade stock, much of the city's tenant demand is focussed on new generation prime office buildings that were constructed post-2006.

As at January 2020, the total vacancy for new generation prime office buildings in the core precinct is approximately 4.5%, whilst older prime office buildings have a vacancy rate of approximately 26.1%.

This trend is likely to continue as new generation buildings provide better accommodation and much more efficient floor plates which provides potential savings in rent. In addition, the new generation buildings can cater tenant for a longer term.

New entrants to the Adelaide CBD market

Historically, building owners have relied on tenant relocations or renewals, however over the past 2 years, we have seen an increase in new entrants to the Adelaide CBD. A recent new entrant is Victory Offices—a serviced office business which provides a flexible workspace has recently established a presence in Adelaide CBD (11 Waymouth Street).

Another new entrant to the Adelaide CBD market is Civil Aviation Safety Authority (CASA). The tenant has recently relocated from Kel Barclay Avenue, Adelaide Airport (suburban) to Grenfell Street, Adelaide (CBD).

Subdued outlook for secondary assets

The outlook for secondary grade office buildings is looking subdued as tenants continue to shift towards new generation prime office building. Hence, secondary building owners face amplifying requirements to reposition their assets through refurbishment and upgrades in order to retain appeal.

TABLE 2

Adelaide CBD Net Absorption

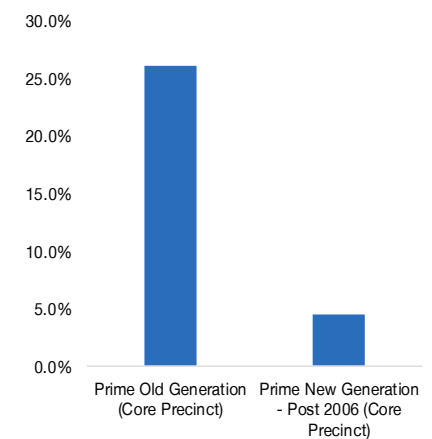
January 2020 vs July 2019 (6 months to...)

Precinct	January 20	July 19
Premium	-5,295m ²	0m ²
A Grade	17,120m ²	11,301m ²
Prime	11,825m²	11,301m²
B Grade	-8,006m ²	6,773m ²
C Grade	-4,008m ²	-1,756m ²
D Grade	79m ²	-494m ²
Secondary	-11,935m²	4,523m²
Totals	-110m²	15,824m²

Source: Knight Frank Research/PCA

FIGURE 2

Prime Old Gen vs Prime New Gen % of vacancy (core precinct)

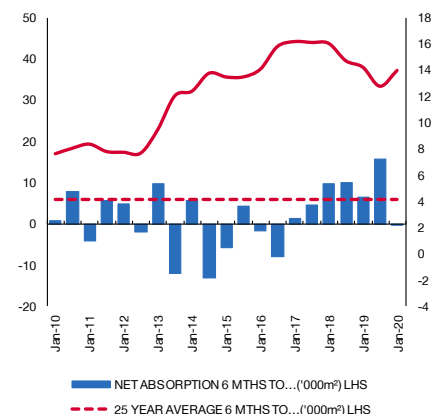


Source: Knight Frank Research

FIGURE 3

Adelaide CBD Net Absorption



('000m²) and % vacancy per 6 month period



Source: Knight Frank Research/PCA

SUPPLY & DEVELOPMENT

Vacancy Rate & Outlook

Prime	13.9% 40bps y-o-y	
Secondary	14.2% -60bps y-o-y	

Source: Knight Frank Research/PCA

GPO Exchange Tower boost net supply

In the six months to January 2020, Adelaide CBD recorded positive net supply of 20,572m². This figure is approximately 3.6 times above the 25-year average, making it the strongest net supply since 2013. The positive net supply was mainly attributed by the completion of the GPO Exchange Tower and U City which added 29,500m² of new space to the market.

At the same period, 87-95 Pirie Street (7,194m²) had been temporarily withdrawn from office stock due to full refurbishment. Another withdrawal in Adelaide CBD is from 245-259 Gilbert Street (1,200m²). The property had been withdrawn due to change of use.

New supply with no pre-commitments

The next major office supply proposed is the development of 108 Wakefield Street by Kyren Group. The development will comprise a 14-level A-Grade office tower disposed as ground floor retail and 13 upper levels of office space. The property is currently under construction without tenant pre-commitment and is scheduled for completion in Q4 2020. On completion, the property will have an NLA of approximately 14,880m².

Future pipeline requires further pre-commitments

The majority of the proposed office developments in Adelaide CBD are still subject to tenant pre-commitment. Developments such as 200 North Terrace (Le Cordon Bleu and Commercial & General), Festival Plaza (Walker Corporation), 42-56 Franklin Street

(Kyren) and 120 Frome Street (Leyton) would total approximately 95,000m² of office space if all were to proceed.

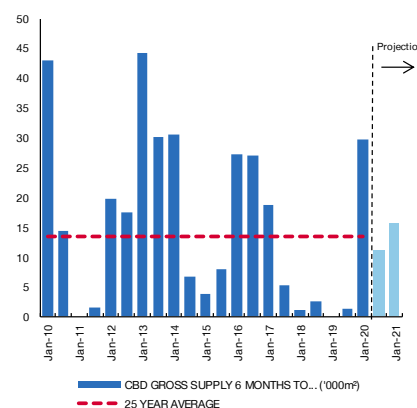
Recently, Department of Planning, Transport & Infrastructure (DPTI) pre-committed 10 floors (circa 17,500m²) on a \$300 million 20 storey office development at 73-85 Pirie Street, Adelaide. DPTI will be the anchor tenant, consolidating the department's seven city locations into one. The deal was struck with an initial term of 10 years, commencing in 2023.

Meanwhile, the Department of Human & Services (DHS) is still on the market for circa 29,000m² in 2023. If this requirement was to proceed, additional office supply is required. Also, it will have an impact on the vacancy rate for secondary office buildings due to large backfill space entering the market.

Vacancy rate has jumped

The Adelaide CBD vacancy rate has been falling consistently over the past 3 years. However, in the six months to January 2020, the Adelaide CBD vacancy rate increased by 1.2% to 14.0%. The increase was mainly driven by vacancy in premium and A grade buildings. It is important to note that the increase in A grade vacancy was due to 29,500m² of supply addition from GPO Exchange Tower and U City. Premium grade vacancy rate has experienced a notable increase from 2.6% to 15.3% in the six

FIGURE 4
Adelaide CBD Gross Supply Additions
% total vacancy



Source: Knight Frank Research/PCA

months to January 2020, highest since 2008. The increase was mainly driven by the relocation of Minister of Transport (from Wespac House to Port Adelaide).

New supply in Fringe market

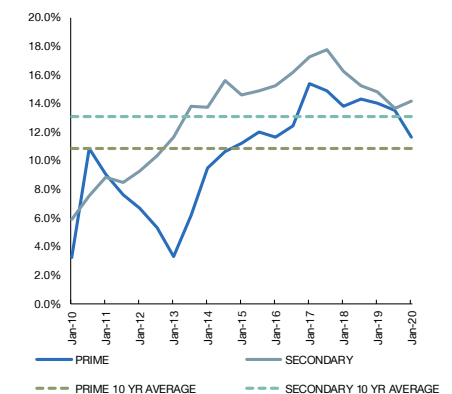
The Adelaide fringe has recorded a net supply of 1,361m² in the six months to January 2020. The supply was attributed by the completion of 162 Fullarton Road (2,161m²). At the same time, 210 Greenhill Road (800m²) have been withdrawn from the market to make way for a 7 level office building disposed as ground floor retail (portion), four levels of car parking including a basement level and three levels of office accommodation. The property is scheduled to complete in Q1 2021. On completion, Bridgestone will occupy the majority of the space.

TABLE 3
Adelaide CBD Vacancy Rates
July 2019 vs Jan 2020

Precinct	January 20	July 19
Premium	15.3	2.6
A Grade	13.8	12.3
Prime	13.9	11.6
B Grade	13.4	12.9
C Grade	15.3	14.5
D Grade	13.9	13.9
Secondary	14.2	13.6
Totals	14.0	12.8

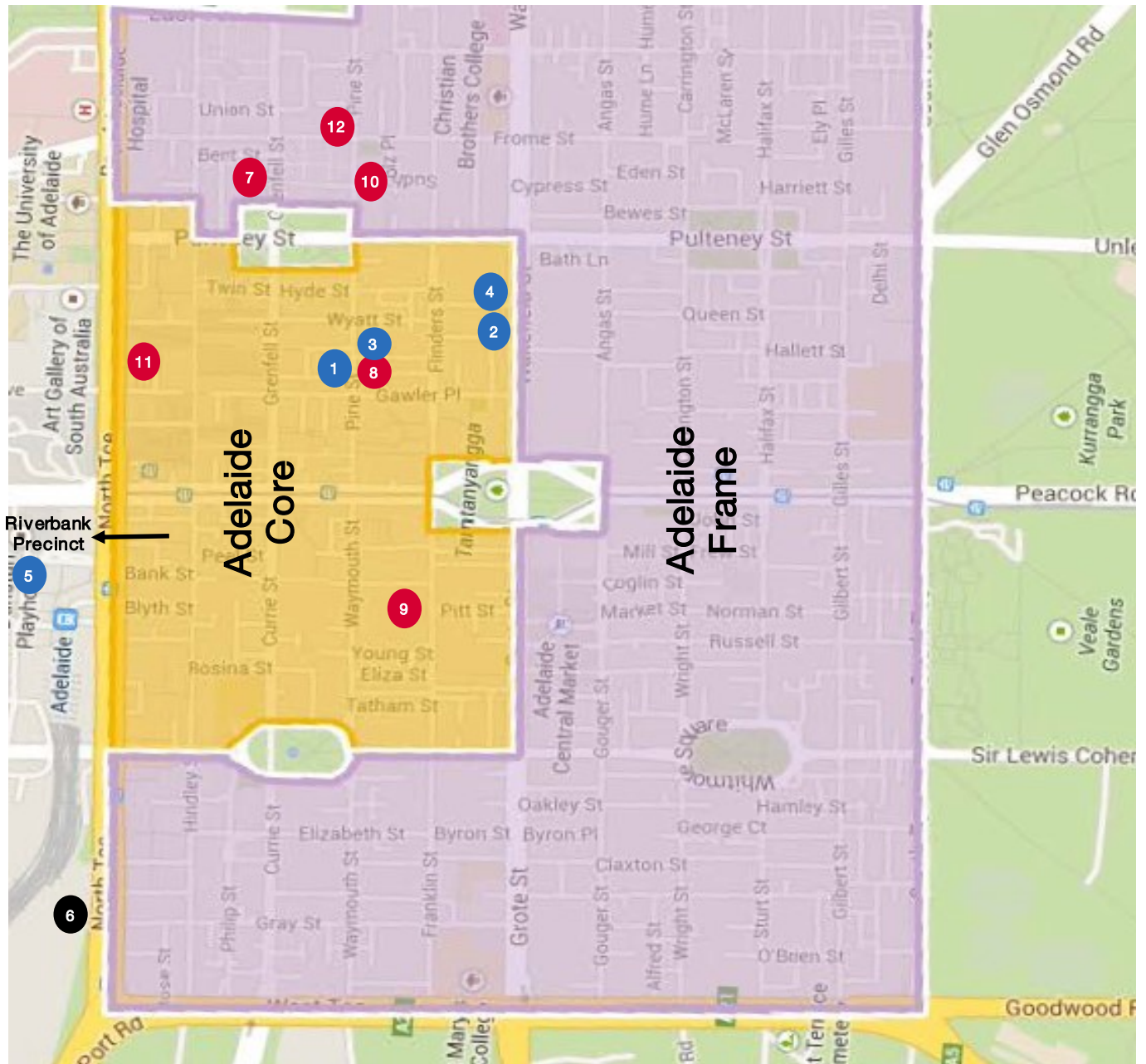
Source: Knight Frank Research/PCA

FIGURE 5
Adelaide CBD Vacancy
% total vacancy



Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY



- 1 74 Pirie Street # - 1,570m²
Maras Group - Q1 2020
- 2 82-98 Wakefield Street # - 2,200m²
Q2 2020
- 3 87-95 Pirie Street # - 7,194m²
Pelligra Group - Q2 2020
- 4 102-120 Wakefield Street - 16,500m²
Kyren Group - Q4 2020
- 5 Festival Plaza / Riverbank Precinct[^] - 40,000m² (Car Park Only, Office TBC)
Walker Corp / SA Government - 2021
- 6 SAHMRI 2, North Terrace - c24,000m²
Commercial & General

- 7 150-162 Grenfell Street # - 9,317m²
Kambitsis Group - 2020
- 8 73-85 Pirie Street - c31,000m² [DPTI]
Cbus Property - 2023
- 9 42-56 Franklin Street - 21,000m²
Kyren Group - mooted
- 10 185 Pirie Street - 6,000m²
Palumbo - mooted
- 11 200 North Terrace - 26,000m² (office)
4,000m² retail [Le Cordon Bleu]
Commercial & General - mooted
- 12 120 Frome Street - 7,300m²
Leyton Property - Q1 2022

● Under Construction
● Confirmed
● Development Application/ Mooted / Early Feasibility

Source of Map: PCA
 NB. Dates are Knight Frank Research estimates.
 # Refurbishment
 c Circa
 * Mixed use development comprising retirement living, respite accommodation, retail and office
[^] Festival Plaza is under construction (Car Parking). Office component is subject to pre-commitment.

RENTS & RECENT TRANSACTIONS

Rents, Incentives & Outlook

Prime Rents (g)	\$540/sqm face 2.27% y-o-y \$373/sqm eff 4.57% y-o-y	↗
Secondary Rents (g)	\$388/sqm face 1.44% y-o-y \$259/sqm eff 2.50% y-o-y	→
Incentives	P:31.0% S:33.2%	↘

Most leasing activity has been for prime office

Over the past six months, leasing transactions have predominately occurred in prime office buildings. A notable example is Victory Offices, a serviced office business which provides a flexible workspace has established a presence in Adelaide CBD. The deal was struck at \$426/m² p.a. net face rent with an initial term of 10 years.

In addition, Aurecon, an engineering company has also expanded & relocated from a B grade office, 55 Grenfell Street (c1,600m²) to an A grade office, 25 Grenfell Street (c2,500m²). The deal was negotiated on a \$500/m² p.a. gross face rent with an initial term of 10 years.

Furthermore, Department Veteran Affairs (DVA) has relocated from 199 Grenfell Street (B Grade) to 91 King William Street (Premium).

Decrease in incentives resulting in effective rental growth

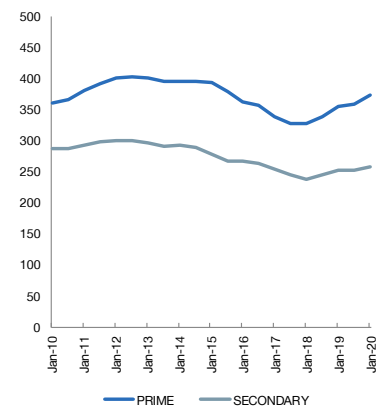
In the six months to January 2020, average prime face rents in Adelaide CBD office have increased approximately 2.0% to \$540/m². Meanwhile, average prime incentives have contracted from an average of 32.1% to 31.0%. This resulted in some uplift in prime gross effective rents. Over the past twelve months, average prime CBD gross effective rents have increased by 4.6%, from \$356/m² to \$373/m².

The decrease in incentives has been driven by an increase in demand for prime office space as many tenants are seeking to relocate to prime office assets at the end of their lease terms.

GPO Exchange Tower sets new record rents in SA

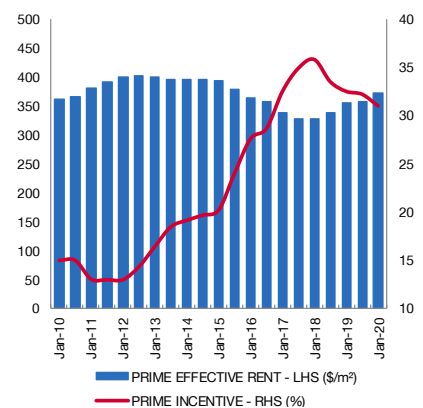
Although prime office face rents have remained static over the past six months, the completion of GPO Exchange Tower has set a new benchmark in rents with deals stuck at circa \$650/m² p.a. gross. As at January 2020, prime office rents range from \$450/m² p.a. gross to \$625/m² p.a. gross in Adelaide CBD.

FIGURE 6
Adelaide CBD Gross Effective Rent Prime vs Secondary (\$/m² p.a average)



Source: Knight Frank Research

FIGURE 7
Adelaide CBD Prime Incentives vs Gross Effective Rent
\$/m² LHS, % RHS



Source: Knight Frank Research



TABLE 4
Recent Leasing Activity Adelaide CBD

Address	NLA m ²	Face Rent \$/m ²	Term (yrs)	Incentive (%)`	Tenant	Start Date
80 Grenfell Street, Adelaide	810	525g	10	#	Commonwealth Govt	August 2020
26 Finders Street, Adelaide	700	430g	5	#	Opex Consulting	March 2020
11 Waymouth Street, Adelaide	1,614	426n	10	#	Victory Offices	March 2020
25 Grenfell Street, Adelaide	2,500*	500g	10	#	Aurecon	March 2020
91 King William Street, Adelaide	2,100*	535g	7	#	Department Veteran Affairs	January 2020
2-10 Franklin Street, Adelaide	10,000*	#	10	#	BHP	October 2019
2-10 Franklin Street, Adelaide	11,500*	#	12	#	SA Attorney General	October 2019
30 Currie Street, Adelaide	2,616	435g	10	#	Red Cross	September 2019

`incentive calculated on a straight line basis g gross sg semi-gross n net # undisclosed * approximately

INVESTMENT ACTIVITY & YIELDS

Current Yields & Outlook

Prime	5.75% - 7.00% -50bps y-o-y	
Secondary	7.00% - 8.50% -29bps y-o-y	

Another strong year for Adelaide CBD office transaction above \$10m

CY2019 year saw total office sale volume of \$787.49 million for properties above \$10 million in Adelaide CBD. This figure is well above the 10-year average of \$462.37 million.

The total sales figures in CY2019 was driven by a few properties with the majority of the demand coming from interstate and overseas. Sales such as 25 Grenfell Street, 80 Flinders Street and 55 Currie Street comprise approximately \$410 million of the CY2019 sales volumes.

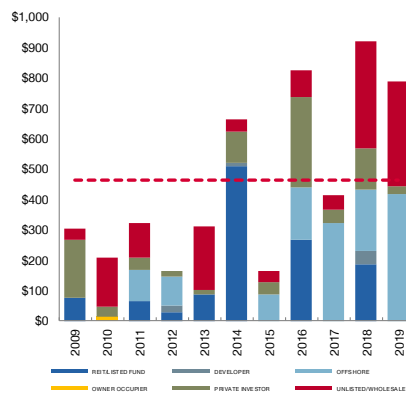
More recently, a Sydney based fund, Realside acquired a 50% interest in a \$200 million portfolio. The portfolio as a whole comprises three (3) commercial buildings in CBD and one (1) in the Fringe. The deal was negotiated off-market and reflects a core market yields ranging from 6.58% to 7.40% for "Rundle Square" 141-159 Rundle Mall, Adelaide 7.00% for 100 Pirie St, Adelaide 6.58% for 169 Pirie St, Adelaide and 6.95% for 186 Greenhill Rd, Parkside.

Yields compress further

Yields for prime assets across the Adelaide CBD market continue to firm. As at January 2020, Adelaide CBD prime yields range from 5.75% - 7.00%, while secondary yields range from 7.00% - 8.50%. On average, the prime yields edged in by 36 basis points, from 6.62% to 6.26% in the six months to January 2020. At the same time, the secondary yields edged in by 20 basis points, from 8.15% to 7.95%.

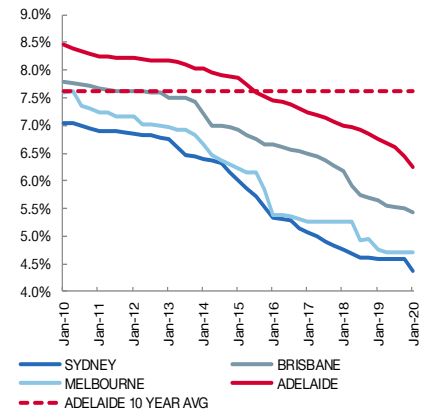
Attractive yields in SA and a low cost of capital continue to attract investors to South Australia. Currently, average prime yields across the Eastern Seaboard are generally in excess of 100-200 basis points firmer than in Adelaide.

FIGURE 8
Adelaide CBD Sales \$10 million +
By Purchaser Type (\$m)



Source: Knight Frank Research

FIGURE 9
Adelaide CBD vs East Coast Yields
Prime Core Market Yields



Source: Knight Frank Research

TABLE 5

Recent Sales Activity Adelaide CBD

Address	Grade	Price \$ mil	Core Market Yield %	NLA m ²	\$/m ² NLA	WALE yrs	Vendor	Purchaser	Sale Date
27-39 Currie Street, Adelaide	B	31.00	7.88	11,871	\$2,611	0.4	Kerth Investments	Acure Asset Management	Dec-19
100 Waymouth Street, Adelaide	A	85.00	6.27	12,305	\$6,908	5.2	Norelco Pty Ltd	Real I.S	Dec-19
151-159 Pirie Street, Adelaide	A	92.50	5.92	12,596	\$7,343	3.4	Padman Health Care Pty Ltd	Blackrock	Dec-19
25 Grenfell Street, Adelaide	A	134.22	c6.75	25,039	5,360	4.87	Credit Suisse	Soilbuild Business Space	Nov-19
80 Flinders Street, Adelaide (incl car park)	A	127.00	6.11 (blended)	12,154	6,593	3.29	Lendlease	Centuria	Sep-19

undisclosed c circa

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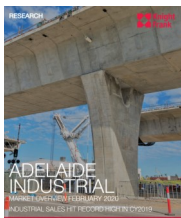
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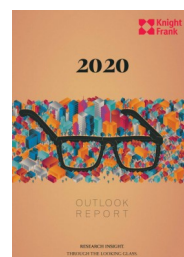
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Market Overview
February 2020



Sydney CBD Office
Market Overview
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Australian Residential
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2020 Outlook Report
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