

An aerial photograph of the Adelaide Central Business District (CBD) and surrounding areas. The image shows a dense urban landscape with numerous high-rise buildings, lower commercial structures, and residential areas. A river, the River Torrens, flows through the lower right portion of the image. Large green spaces, including Adelaide Oval and various parks, are interspersed among the buildings. The overall scene is a comprehensive overview of the city's built environment.

RESEARCH



# ADELAIDE CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2019

NEW ENTRANTS DRIVE NET ABSORPTION

## HIGHLIGHTS

In the six months to July 2019, Adelaide CBD recorded positive net absorption of 15,824m, the strongest half yearly total since H2 2008.

The Adelaide CBD vacancy rate has shifted downward for five consecutive periods. As at July 2019, the total vacancy rate declined by 1.4% to reach 12.8%.

YTD 2019 sale transactions stand at \$285.37 million for properties above \$10 million in Adelaide CBD. At this rate, sales in 2019 should exceed the long term average.



## KEY FINDINGS

**Positive net absorption has been driven by new entrants.**

**Tenants are migrating from secondary to prime** office buildings, more particularly to new generation prime office buildings constructed post 2006.

Despite the recent negative net supply, **gross supply for Adelaide CBD is projected to be 28,270m<sup>2</sup>** over the next twelve months.

**Investor demand remains strong** with Adelaide 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.



**YEE NG**  
Research Analyst SA

## ECONOMIC OVERVIEW

Leasing market benefits from \$85 billion defence contracts and proposed mining expansions.

### Slowing growth but the outlook remains positive

Growth in the South Australian economy has softened consistent with national trends as slow income growth and weaker housing market conditions weigh on consumer spending. By contrast, government infrastructure spending and defence industry construction are supporting growth, while the lower Australian dollar is providing a boost to exports.

### Low cost of capital continues to benefit the property market

The Reserve Bank of Australia (RBA) has cut the cash rate in both June and July 2019 to a historic low of 1.0%. Further cuts in interest rates are expected in the near future. Market interest rates have declined significantly over the past year in response to more accommodative monetary policy and the softer growth outlook.

South Australia remains the only State with no stamp duty payable on commercial property. The low cash rate coupled with the abolition of stamp duty will continue to attract investment into the SA property market.

### BAE contribute to SA economy

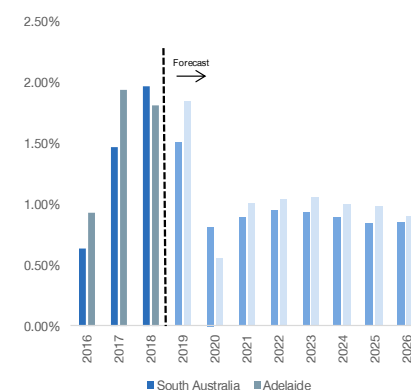
Investments from the defence industry have made a positive impact on employment growth with BAE Systems recently employing more than 80 graduates, and are expected to employ

an additional 100 graduates next year as the defence projects at Techport ramp up.

### "Ten Gigabit Adelaide" good for tenants & investors

"Ten Gigabit Adelaide", a high-speed fibre optic data network, has positively impacted Adelaide CBD sales and leasing demand. Agents have reported that "Ten Gigabit Adelaide" has attracted interest from investors and helped increase the appeal for tenants of relocating or establishing a presence in the Adelaide CBD. Example includes Technicolour - a global media post-production group - who have set up their Australian Headquarters in the Adelaide CBD. This is likely to generate up to 400 jobs and is expected to inject an economic benefit of up to \$250 million over the next decade.

FIGURE 1  
**Employment Growth**  
South Australia and Adelaide  
% changes y-o-y basis



Source: Knight Frank Research/Oxford Economics

TABLE 1  
**Adelaide CBD Office Market Indicators as at July 2019**

Grade	Total Stock (m <sup>2</sup> )*	Vacancy Rate (%)*	Annual Net Absorption (m <sup>2</sup> )^	Six Months Net Supply (m <sup>2</sup> )^	Average Gross Face Rent (\$/m <sup>2</sup> )	Average Incentive (%)	Average Core Market Yield (%)
Prime	594,887	11.6	14,213	N/A	529	32.2	6.62
Secondary	823,072	13.6	8,005	N/A	383	33.9	8.15
<b>Total</b>	<b>1,417,959</b>	<b>12.8</b>	<b>22,218</b>	<b>-5,744</b>			

Source: Knight Frank Research/PCA

\*as at July 2019



^12 months to July 2019

^6 months to July 2019

# TENANT DEMAND & ABSORPTION



## Net Absorption & Outlook

<b>Prime</b>	14,213sqm 12 mths to Jul 19	
<b>Secondary</b>	8,005sqm 12 mths to Jul 19	

Source: Knight Frank Research/PCA

## New entrants to the Adelaide CBD market

Historically, building owners have relied on tenant relocations or renewals, however over the past 18 months, 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).

In addition to this, Beach Energy—an oil and gas exploration and production company has relocated from Conyngham Street, Glenside (suburban) to Flinders Street, Adelaide (CBD).

“As the market continues with a period of limited supply, we may see a further tightening in prime grade vacancy, buoyed by an improvement in underlying market fundamentals”

MARTIN POTTER  
Partner  
Head of Office Leasing,  
South Australia



## Largest net absorption since January 2009

In the six months to July 2019, Adelaide CBD has recorded positive net absorption of 15,824m<sup>2</sup>. This is 2.6 times above the 25-year average, making it the strongest result in Adelaide CBD since January 2009, when absorption was 41,252m<sup>2</sup>.

Positive net absorption has been driven by tenant expansion and new entrants to Adelaide CBD. Notable examples in addition to Beach Energy include Boeing (new entrant) and BAE Systems (suburban to Adelaide CBD).

## Tenants attracted to new generation office buildings

Much of the city's tenant demand is focussed on new generation prime office buildings that were constructed post-2006. Total vacancy for new generation prime office buildings in the core precinct is approximately 6.8%, whilst older prime office buildings have a vacancy rate of approximately 12.7%.

## Subdued outlook for net absorption in secondary assets

Despite B Grade achieving positive net absorption, the short-term outlook for secondary office in Adelaide CBD looks subdued. This is mainly due to a number of tenants who are set to relocate from secondary office buildings to prime grade office buildings. An example of this is BHP & SA Attorney General who are both relocating from B Grade office buildings to the GPO Exchange Tower on completion.

TABLE 2

### Adelaide CBD Net Absorption

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

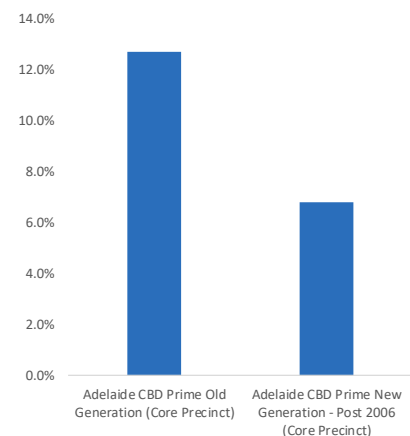
Precinct	January 19	July 19
Premium	103m <sup>2</sup>	0m <sup>2</sup>
A Grade	2,809m <sup>2</sup>	11,301m <sup>2</sup>
<b>Prime</b>	<b>2,912m<sup>2</sup></b>	<b>11,301m<sup>2</sup></b>
B Grade	-714m <sup>2</sup>	6,773m <sup>2</sup>
C Grade	2,577m <sup>2</sup>	-1,756m <sup>2</sup>
D Grade	1,619m <sup>2</sup>	-494m <sup>2</sup>
<b>Secondary</b>	<b>3,482m<sup>2</sup></b>	<b>4,523m<sup>2</sup></b>
<b>Totals</b>	<b>6,394m<sup>2</sup></b>	<b>15,824m<sup>2</sup></b>

Source: Knight Frank Research/PCA

FIGURE 2

### Prime Old Gen vs Prime New Gen

% of vacancy (core precinct)

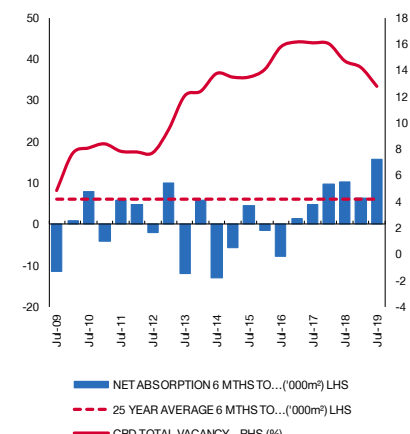


Source: Knight Frank Research

FIGURE 3

### Adelaide CBD Net Absorption

('000m<sup>2</sup>) and % vacancy per 6 month period



Source: Knight Frank Research/PCA

# SUPPLY & DEVELOPMENT



## Vacancy Rate & Outlook

<b>Prime</b>	11.6% -240bps y-o-y	
<b>Secondary</b>	13.6% -160bps y-o-y	

Source: Knight Frank Research/PCA

## Low supply and high withdrawal

In H1 2019, Adelaide CBD recorded negative net supply of -5,744m<sup>2</sup>, which is significantly below the 25-year average of 12,782m<sup>2</sup>. The negative net supply was mainly attributed to the withdrawal of 51 Pirie Street (4,650m<sup>2</sup>) and 124 Waymouth Street (2,424m<sup>2</sup>). Both of these withdrawals have been driven by a change of use, with 51 Pirie Street to be redeveloped into a 28 storey hotel and 124 Waymouth Street to be redeveloped into a 17 storey student accommodation facility comprising 721 beds.

Gross supply for Adelaide CBD is projected to be 26,070m<sup>2</sup> in the six months to January 2020 and 2,200m<sup>2</sup> in the six months to July 2020, providing a total supply of 28,270m<sup>2</sup> over the next twelve months. The majority of this supply has already been pre-committed.

## GPO Exchange Tower coming soon

The main source of supply over the next six months is the development of Charter Hall's GPO Exchange Tower. The development will comprise a 20-storey building disposed as ground floor retail, levels 1 & 2 car parking, levels 3 - 19 office, and a rooftop plant room spanning over 2 levels. On completion, the property will have an NLA of 24,500m<sup>2</sup>, with 87.7% of the NLA pre-committed by the SA Attorney General's Department and BHP.

## Future pipeline requires further pre-commitments

The majority of the proposed office developments in Adelaide CBD are still subject to tenant pre-commitment.

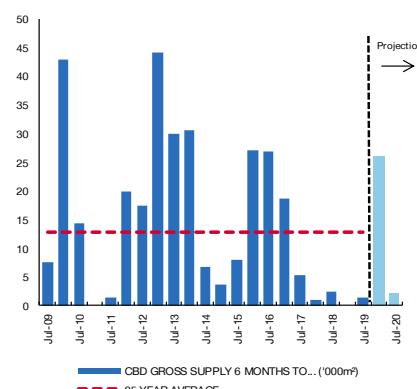
Developments such as 73-85 Pirie Street (Cbus Property "Planet Nightclub"), 200 North Terrace (Le Cordon Bleu and Commercial & General) and Festival Plaza (Walker Corporation) would total approximately 96,000m<sup>2</sup> office space if all were to proceed. Despite this, Kyren Group has commenced building a 14 level office tower at 102-108 Wakefield Street without any known tenant pre-commitment. The development is expected to be completed in Q3 2020 and will comprise approximately 14,880m<sup>2</sup> of office space.

The next round of the supply cycle is likely to deliver in 2023, with Department of Human & Services (DHS) and Department of Planning, Transport & Infrastructure (DPTI) on the market for circa 15,900m<sup>2</sup> (DHS) and 24,000m<sup>2</sup> (DPTI) in 2023. If these requirements were to proceed, additional office supply is likely required.

## Vacancy rates continue to drop

The Adelaide CBD vacancy rate has been falling consistently since peaking at the end of 2016 at 16.2%, bringing the vacancy down by 1.4% to 12.8% in the six months to July 2019. This marks one of the largest percentage drops since January 2008. The decrease in vacancy was mainly driven by solid net absorption coupled with the withdrawals of 51 Pirie Street and 124 Waymouth Street.

FIGURE 4  
Adelaide Gross Supply Additions  
% total vacancy



Source: Knight Frank Research/PCA

Despite the recent drop in the vacancy rate, the short-term outlook for secondary assets is subdued in Adelaide CBD. The new supply coming onto the market (GPO Tower) will impact the secondary market with SA Attorney General & BHP likely to leave significant backfill vacancy.

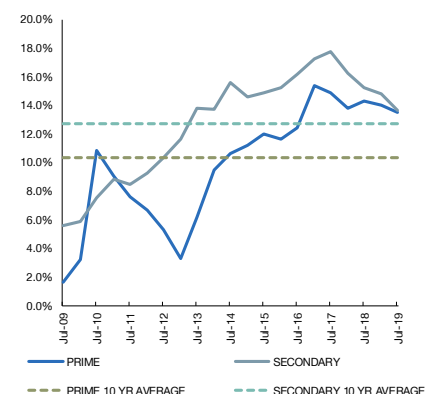
We understand SA Attorney General has a lease tail (c15,000m<sup>2</sup>) of approximately 2.9 years at 45 Pirie Street before they relocate to GPO. PCA measure the vacancy data based on occupied space and therefore the lease tail at 45 Pirie Street will be considered as vacant in forthcoming PCA data. On a positive note, BHP has increased its tenure from approximately 6,400m<sup>2</sup> to 10,000m<sup>2</sup>.

TABLE 3  
Adelaide CBD Vacancy Rates  
July 2019 vs July 2020

Precinct	July 18	July 19
Premium	2.8	2.6
A Grade	14.8	12.3
<b>Prime</b>	<b>14.0</b>	<b>11.6</b>
B Grade	14.5	12.9
C Grade	15.7	14.5
D Grade	16.7	13.9
<b>Secondary</b>	<b>15.3</b>	<b>13.6</b>
<b>Totals</b>	<b>14.7</b>	<b>12.8</b>

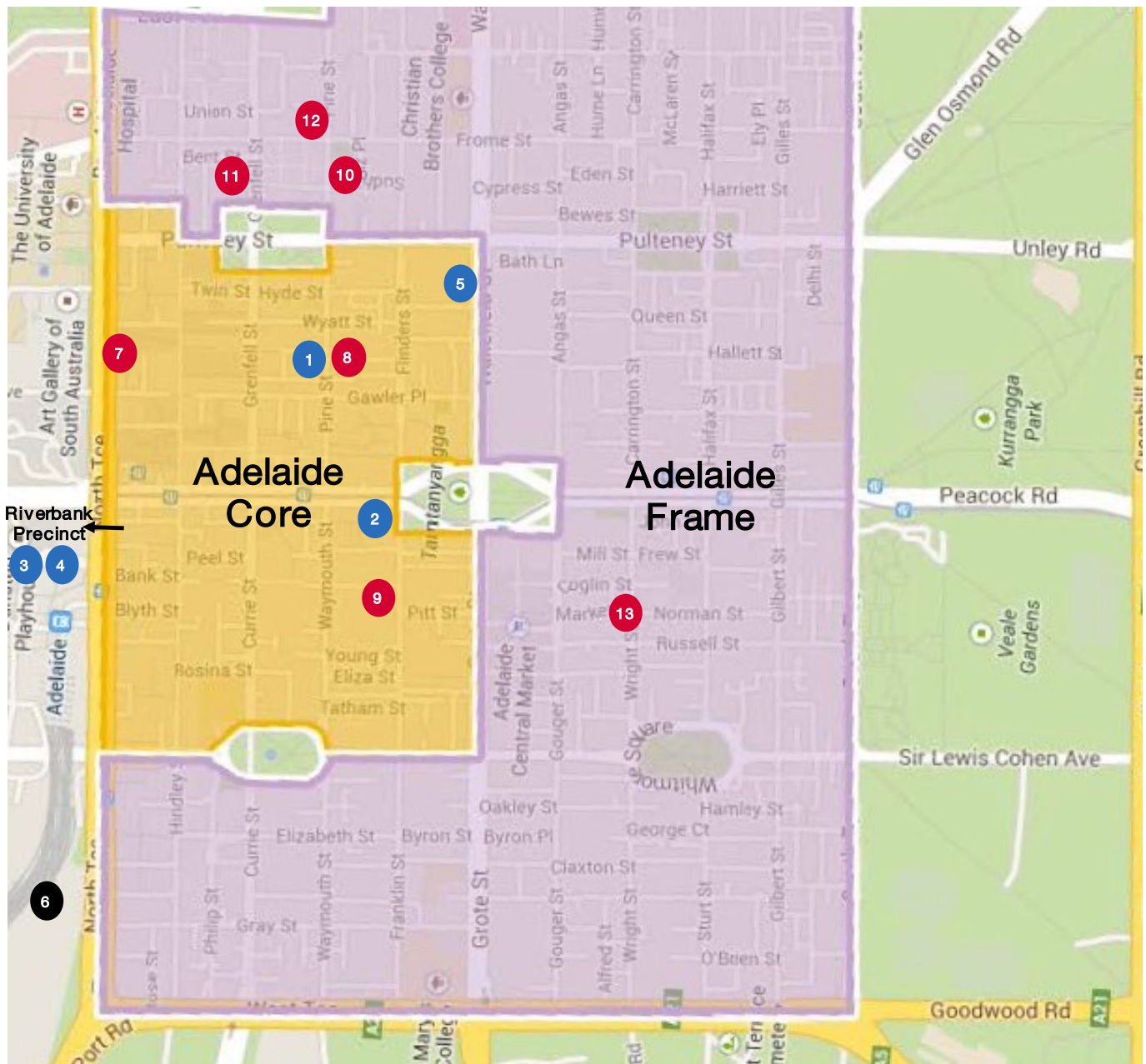
Source: Knight Frank Research/PCA

FIGURE 5  
Adelaide CBD Vacancy  
% total vacancy



Source: Knight Frank Research/PCA

# MAJOR OFFICE SUPPLY



1 74 Pirie Street # - 1,570m<sup>2</sup>  
Maras Group - Q3 2019

2 GPO Tower, 2-10 Franklin Street -  
24,500m<sup>2</sup> [SA Govt & BHP]  
Charter Hall - Q3 2019 - 87.7%  
(approximately) committed

3 Festival Plaza / Riverbank Precinct<sup>^</sup> -  
40,000m<sup>2</sup> (Car Park Only, Office TBC)  
Walker Corp / SA Government - 2020

4 Adelaide Casino, North Terrace  
Local Private Developer - 2020 - 15%  
committed

5 102-120 Wakefield Street - 16,500m<sup>2</sup>  
Kyren Group - 2020+

6 SAHMRI 2, North Terrace - 31,000m<sup>2</sup>  
Commercial & General

7 200 North Terrace - 26,000m<sup>2</sup> (office)  
4,000m<sup>2</sup> retail [Le Cordon Bleu]  
Commercial & General - H2 2020 - N/A

8 73-85 Pirie Street - 30,000m<sup>2</sup>  
Cbus Property

9 42-56 Franklin Street - 21,000m<sup>2</sup>  
Kyren Group - 2020+

10 185 Pirie Street - 6,000m<sup>2</sup>  
Palumbo - 2020+

11 150-162 Grenfell Street# - 1,288m<sup>2</sup>  
Kambitsis Group - 2020+

12 120 Frome Street - 7,300m<sup>2</sup>  
Leyton Property - Q1 2021

13 76-88 Wright Street - 10,300m<sup>2</sup> (office)  
Private - Q2 2022 (Mixed Use - Retail,  
Commercial, Apartments)

Under Construction

Confirmed

Development Application/ Mooted /  
Early Feasibility

Source of Map: PCA

NB. Dates are Knight Frank Research estimates.  
# Refurbishment

\* Mixed use development comprising retirement  
living, respite accommodation, retail and office  
<sup>^</sup> Festival Plaza is under construction (Car Park-  
ing). Office component is subject to pre-  
commitment.



# RENTS & RECENT TRANSACTIONS

## Rents, Incentives & Outlook

<b>Prime Rents (g)</b>	\$529/sqm face 2.28% y-o-y \$359/sqm eff 5.84% y-o-y	↗
<b>Secondary Rents (g)</b>	\$383/sqm face 1.21% y-o-y \$253/sqm eff 3.39% y-o-y	→
<b>Incentives</b>	P:32.2% S:33.9%	↘

### 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 Aurecon, an engineering company that has recently committed to expand & relocate from 55 Grenfell Street (c1,600m<sup>2</sup>) to 25 Grenfell Street (c2,500m<sup>2</sup>).

Another recent leasing transaction is Department Veteran Affairs (DVA). DVA has committed to relocate from 199 Grenfell Street (B Grade) to 91 King William Street (Premium).

Despite the high level of leasing activity in prime assets, there have also been notable leasing transactions in secondary buildings such as Technicolor, who recently occupied approximately 4,000m<sup>2</sup> over three levels at 178 North Terrace (B Grade) for an initial term of 10 years.

### Decrease in incentives reflects improvements in effective rental growth

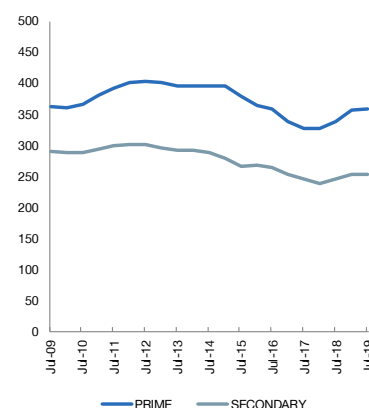
In the six months to July 2019, average prime face rents in Adelaide CBD office have remained similar at \$529/m<sup>2</sup>. Despite this, average prime incentives have contracted from 32.5% to 32.2%, and this has led to some uplift in prime gross effective rents. Over the past twelve months, average prime CBD gross effective rents have increased by 5.8%, from \$339/m<sup>2</sup> to \$359/m<sup>2</sup>.

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. This growth momentum is likely to continue given the high demand for prime office space, particularly new generation office buildings constructed post 2006.

### GPO Exchange Tower sets new record rents in SA

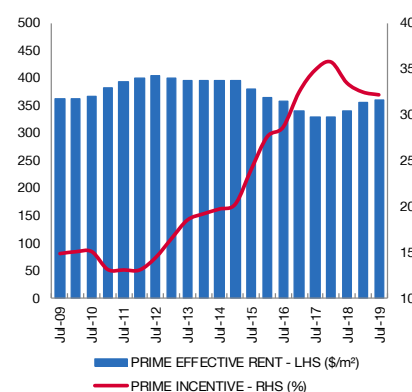
Although prime office face rents have remained static over the past six months, the completion of GPO Exchange Tower will set a new benchmark in rents with deals stuck at circa \$650/m<sup>2</sup> p.a. gross. As at July 2019, prime office rents range from \$475/m<sup>2</sup> p.a. gross to \$560/m<sup>2</sup> p.a. gross in Adelaide CBD.

FIGURE 6  
Adelaide CBD Gross Effective Rent  
Prime vs Secondary (\$/m<sup>2</sup> p.a average)



Source: Knight Frank Research

FIGURE 7  
Adelaide CBD Prime Incentives vs  
Gross Effective Rent  
\$/m<sup>2</sup> LHS, % RHS



Source: Knight Frank Research



TABLE 4  
Recent Leasing Activity Adelaide CBD

Address	NLA m <sup>2</sup>	Face Rent \$/m <sup>2</sup>	Term (yrs)	Incentive (%)`	Tenant	Start Date
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
178 North Terrace, Adelaide	4,000*	#	10	#	Technicolor	March 2019
80 Flinders Street, Adelaide	3,230	532g	7	#	Beach Energy	June 2019
80 Flinders Street, Adelaide	2,654	555g	7	#	BAE	November 2018

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

# INVESTMENT ACTIVITY & YIELDS

## Current Yields & Outlook

Prime	6.00% - 7.25% -59bps y-o-y	
Secondary	7.75% - 8.75% -25bps y-o-y	

## Positive outlook for CBD sales above \$10 million

YTD 2019 sale transactions currently stand at \$285.37 million for properties above \$10 million in Adelaide CBD. At the current rate, sales volume for CY2019 should exceed the ten year average, especially given a number of office buildings in Adelaide CBD are currently under offer.

One of the properties currently under contract is 25 Grenfell Street. The property was recently contracted by Singaporean based REIT Soilbuild Business Space for \$134.22 million which reflects a core market yield of circa 6.75% and a W.A.L.E of 4.87 years.

In addition, 80 Flinders Street is currently under contract to an interstate property fund— Centuria for \$127 million. The sale price includes the adjoining multi-level car park (61-67 Wyatt Street) and reflects a blended core market yield of 6.11% and a W.A.L.E of 4.75 years for the office building.

A recently settled sale includes 55 Currie Street. The property was transacted for \$148.25 million to a Singapore listed property trust, Suntec REIT— ARA managed, reflecting a core market yield of 7.39% and a W.A.L.E of 4.21 years (by income).

## High demand from interstate & off-shore

Demand in Adelaide is predominately from interstate and off-shore capital, more particularly from Singapore. This is partly due to the attractive value proposition for investors seeking higher income returns as average prime yields across the Eastern Seaboard are 100-200 basis points firmer than South Australia. Furthermore, improving leasing market sentiment coupled with

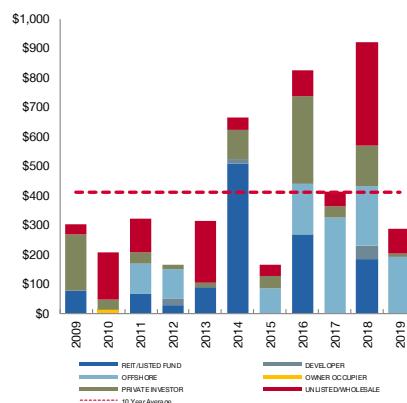
the low cost of capital has further attracted investment into the property market.

## Yields compress further

Yields for prime assets across the Adelaide CBD market continue to firm. In the six months to July 2019, average Adelaide CBD prime yields edged in by 14 basis points, from 6.76% to 6.62% and secondary yields also firmed by 8 basis points, from 8.23% to 8.15%.

FIGURE 8

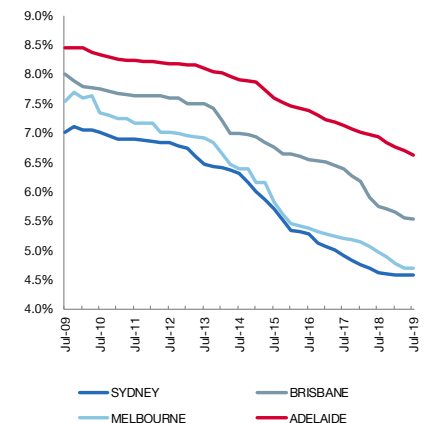
### Adelaide CBD Sales \$10 million + By Purchaser Type (\$m)



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 <sup>2</sup>	\$/m <sup>2</sup> NLA	WALE yrs	Vendor	Purchaser	Sale Date
80 Flinders Street, Adelaide (incl car park)	A	127.00	6.11 (blended)	12,154	6,593	3.29	Lendlease	Centuria	U/C
25 Grenfell Street, Adelaide	A	134.22	c6.75	25,039	5,360	4.87	Credit Suisse	Soilbuild Business Space	U/C
55 Currie Street, Adelaide	A	148.25	7.39	26,200	5,658	4.21	AEP Currie Pty Ltd	Suntec REIT (ARA)	Sep-19
121 King William Street, Adelaide	A	82.25	6.58	12,408	6,593	3.34	Motor Accident Commission	Charter Hall Direct PFA Fund	May-19
99 Gawler Place, Adelaide	B	41.87	7.57	11,157	3,753	1.9	Blackstone	Fortius	Jul-19

# undisclosed c circa



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