- *Prime yields soften for the first time since Q4 2016*
- *Occupier demand continues to focus on quality, new generation prime stock*
- *Purchasers risk/reward profiles are under review with the increase in cost of capital*

knightfrank.com/research

Adelaide CBD Office

Market Report, September 2022

DEMAND CONTINUES FOR NEW GENERATION BUILDINGS

Continued demand for high quality accommodation combined with secondary stock segregation drives value-add potential

10.1%
FRINGE VACANCY

6.7%
VACANCY
new generation prime office located in core precinct

5.26%
PRIME YIELD

"We are observing a continued demand for new generation prime stock, with minimal vacancy in prime buildings."

MARTIN POTTER

PARTNER, HEAD OF OFFICE LEASING SA

The Key Insights

Adelaide's total CBD vacancy rate marginally tightened from 14.5% to 14.2%, however vacancy increased in the Adelaide Fringe from 10.1% to 10.4% for the six months to July 2022.

Vacancy rates in the Adelaide Fringe are anticipated to tighten in line with the recent withdrawal and planned refurbishment of secondary stock.

Gross effective rents remain stable at $401/sqm for prime assets in Adelaide CBD whilst effective rents for secondary stock decreased 1.83% , from $273/sqm to $268/sqm.

$113.65 million in sales were transacted for CBD assets in the six months leading into July 2022 with a further $190.00 million currently under contract.

Adelaide CBD prime yields softened 13 basis points from 5.13% to 5.26%, converging to yields in Sydney and Melbourne although diverging from the average yield in Perth.

Adelaide CBD Office Market Indicators — July 2022

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	623,496	10.7	-690	0	582	25.0 - 35.0	1.73	4.75-6.50
Secondary	838,371	16.8	6,864	1,821	424	32.5 - 40.0	1.62	6.00-8.00
Total	**1,461,867**	**14.2**	**6,174**	**1,821**				

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

SEGREGATION OF SECONDARY ASSETS AS TENANTS SEEK QUALITY

Record low vacancy for prime assets as tenants seek quality stock

The Adelaide office market was very resilient through the pandemic and experienced little disruption compared to other larger cities. Sustained demand from government tenants and a broad mix of SMEs ensured that the market remained stable in the face of rising vacancy elsewhere. The overall vacancy rate in Adelaide stands at 14.2%, just as it did prior to the pandemic.

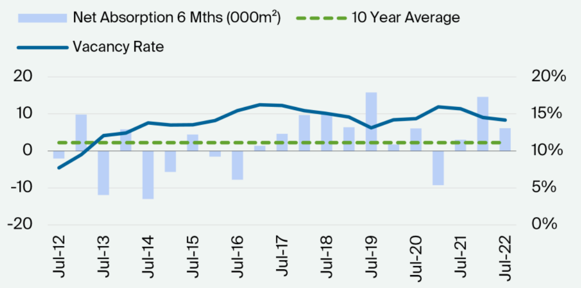
The prime vacancy rate for the overall market stands at 10.7%, relfecting a split between the older and the new generation stock. A closer inspection of vacancy across the Adelaide CBD reveals that supply levels are much tighter for the new generation CBD office stock completed after 2006, with current vacancy rate of 6.7%, up from 6.6% six months prior. A tighter vacancy rate of 1.9% is extrapolated excluding Kyren Groups 13 storey tower situated at 108 Wakefield Street as an outlier due to its position outside the Adelaide core.

Vacancy rates in older generation prime buildings reduced from 20.4% to 17.8% due to limited available space in new generation buildings. This trend is likely to occur until new supply is completed in late 2022 and early 2023.

Tenants continue to prioritise better quality, A grade accommodation in terms of amenities, sustainability features and overall appeal. As a result, refurbishment opportunities have arisen within the secondary market as owners seek to entice tenants to occupy the predicted backfill space. This is contributing to segregation within secondary stock as B grade buildings outperform their C grade counterparts to attract and retain tenants.

CBD Office Vacancy & Absorption

% total vacancy; '000 sqm net absorption



Source: Knight Frank Research, PCA

Net absorption remains above 10 year average for prime and secondary stock

Net absorption within the Adelaide CBD decreased significantly leading into August 2022 to 6,174sqm compared with 14,606sqm six months prior, however, well above the 10 year average of 2,538sqm. Prime and secondary stock recorded net absorption of –690sqm and 6,864sqm, respectively. We expect prime grade net absorption to significantly increase in 2023, in line with the completion of new stock.

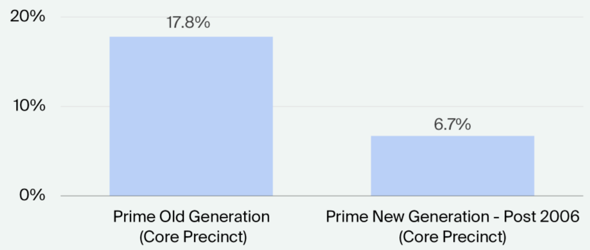
Adelaide leasing market receiving interest from new entrants

Leasing enquiries remain buoyant for the office space in the Adelaide CBD including interest from national corporates, governments and global enterprises with large tenancies of NLA in prime office buildings being secured. Recent active requirements of significance include Westpac Bank (4,000 - 7,000sqm), WSP/Golder (2,500 - 3,000sqm), and Accenture (700 - 1,000sqm) highlighting the good interest for large tenancies.

Global wine company, Accolade Wines, has relocated to the CBD, transferring around 160 staff to occupy 1,462sqm of sub lease space on Level 10 at 10 Franklin Street. In addition, the Department for Infrastructure and Transport pre-committed to Levels 4-14 within the recently completed 83 Pirie Street, who have recently moved into the building, occupying a total of 18,524sqm NLA on a 10 year term.

Prime Office Vacancy in Core Precinct

New vs Old generation (to July 2022)



Source: Knight Frank Research

LARGE SUPPLY FORECAST FOR 2023+

High level of completions forecast for 2023

The Adelaide CBD office market recorded 1,821sqm of new supply in six months to July 2022. Current major office development equating to a forecast supply of 116,500sqm in 2023, 20,000sqm in 2025, and a further 86,000sqm mooted, subject to tenant pre-commitment, is the largest injection of new supply on record, meeting tenants high demand for modern stock.

Major developments that have secured tenant pre-commitment include Charter Hall's 14 storey A grade tower at 60 King William Street, providing 43,600sqm (79.13% pre-commitment lease to Services Australia), in addition to Cbus' recently completed 17 storey A grade development at 83 Pirie Street (60.94% pre-commitment lease to DFIT) comprising 30,360sqm. Walker Corporation's Festival Plaza 44,500sqm development is also underway, with completion expected in Q4 2023 (50.56% pre-committed). These pre-commitment percentages were accurate as at July 2022, however we predict them to have increased since.

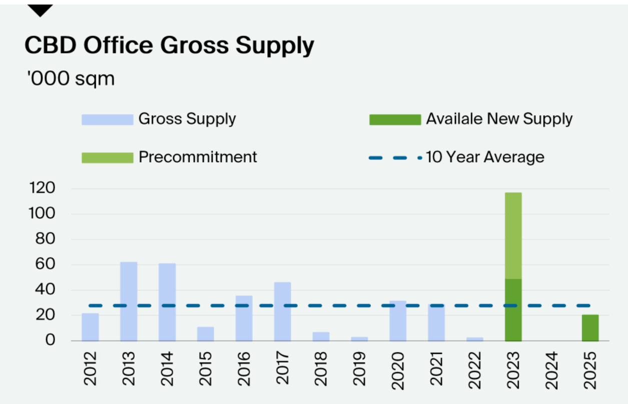
Other major developments include ICD Property Group's three towers at Adelaide Central Market offering 21,000sqm which has commenced and is currently in demolition and Palumbo's development at 185 Pirie Street. In addition, Malborough Capital and 1835 Capital have partnered, planning to develop 'Trinity City' at 88 North Terrace which will offer 65,000sqm of gross floor area directly behind the heritage listed Trinity Church set to commence in 2023.

Forecasted prime stock forces value add potential

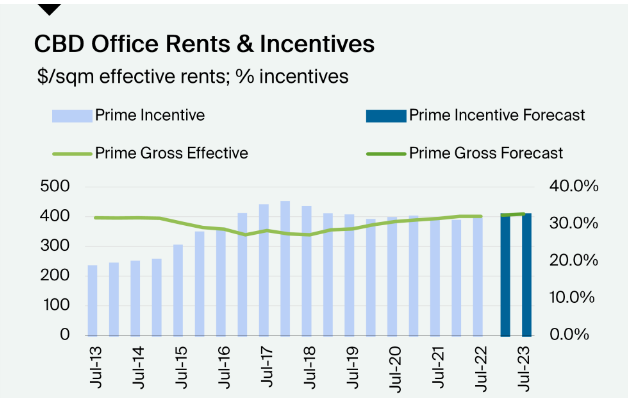
Older generation prime and secondary stock is predicted to be renovated/refurbished to meet the current demand before the completion of new stock is set to enter the market by the end of 2023. As new supply is completed, pursued and largely pre-committed, we expect vacancy to rise to 16.5% by the end of 2023 and an average net absorption of 13,166sqm over the next five years. We also predict secondary stock to experience higher vacancy and incentives, as building owners continually attempt to compete with the superior quality stock.

Rents remain stable into 2022

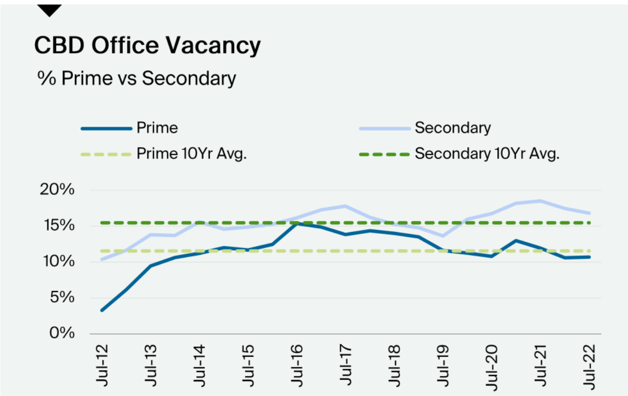
As at July 2022, Adelaide CBD average gross effective rents remained at $401/sqm for prime stock and decreased 1.8%, from $273/sqm to $268/sqm, for secondary stock. Prime and secondary average incentives have increased leading into September 2022 at 31.2% and 36.7%, respectively. Economic rents for pre-committed buildings have set benchmarks which we anticipate will have a positive impact on rental growth for the existing new generation stock, however, secondary rental growth is expected remain subdued in the near term.



Source: Knight Frank Research, PCA

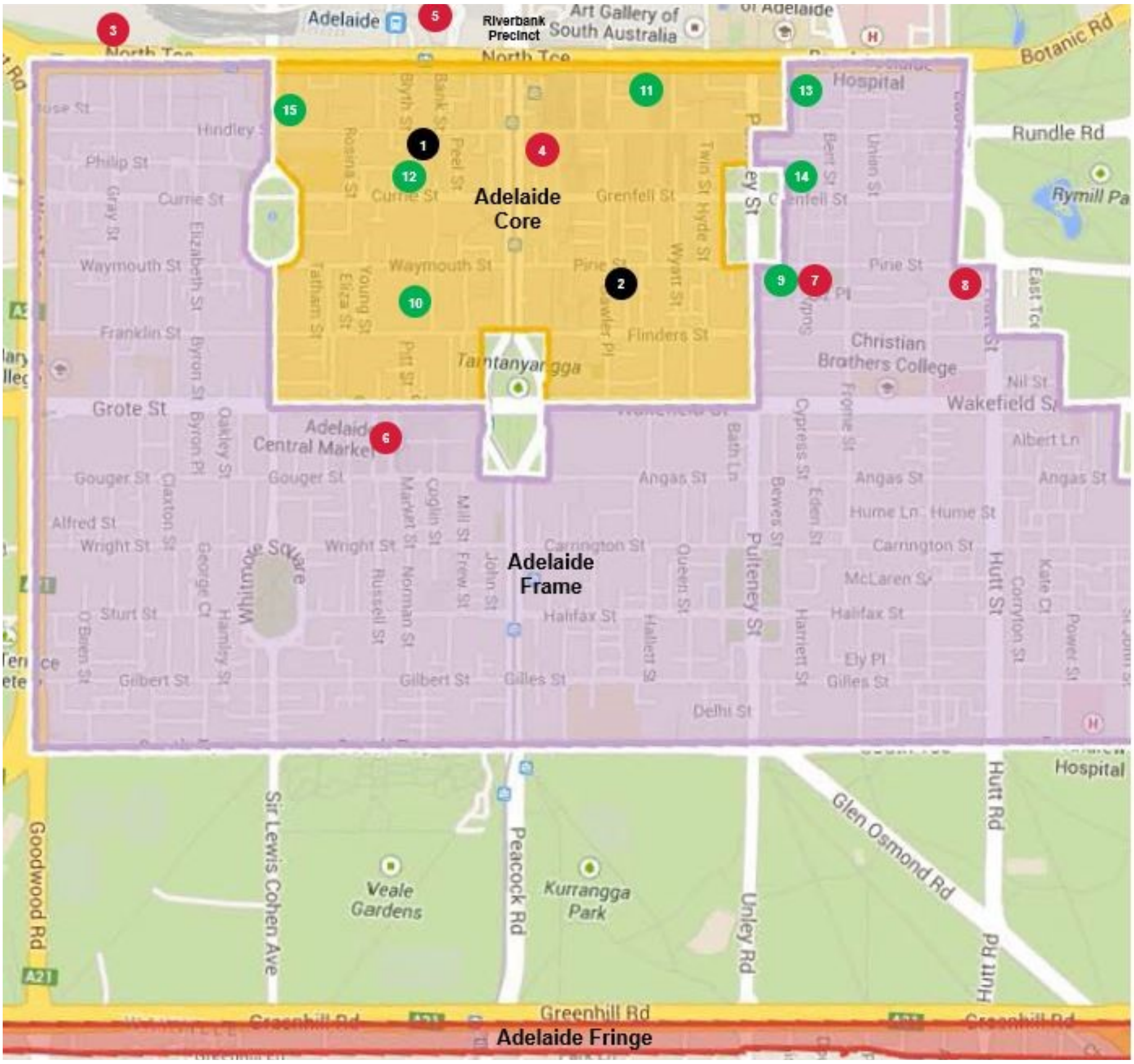


Source: Knight Frank Research



Source: Knight Frank Research

MAJOR CBD OFFICE SUPPLY



RECENTLY COMPLETED

1 5 LEIGH STREET—1,730 SQM (OFFICE/ RETAIL)
GINOS HOLDINGS

2 83 PIRIE STREET—32,000 SQM [SA GOVERNMENT—DPTI]
CBUS—60.94% COMMITTED

UNDER CONSTRUCTION/ MAJOR PRE-COMMITMENT

3 SAHMRI 2, NORTH TERRACE—20,000 SQM (OFFICE) [SA GOVERNMENT & SAHMRI]
COMMERCIAL & GENERAL. 2025

4 60 KING WILLIAM STREET—40,000 SQM (OFFICE) & 3,000 SQM (RETAIL)
CHARTER HALL— 79.13% COMMITTED. 2023

5 FESTIVAL PLAZA—40,000 SQM (OFFICE) & 4,500 SQM (RETAIL)
WALKER CORPORATION—50.56% COMMITTED. 2023

6 CENTRAL MARKET—15,000 SQM (OFFICE) & 6,000 SQM (RETAIL)
ICD PROPERTY— 45% COMMITTED

7 185 PIRIE STREET – 6,300 SQM
PALUMBO

8 299 PIRIE STREET— 6,160 SQ (OFFICE) .Q4 2023

DEVELOPMENT APPROVED

DEVELOPMENT APPLICATION/MOOTED/ EARLY FEASIBILITY

9 211-217 PIRIE STREET— 10MW TIER IV DATA CENTRE
NEXTDC LTD—EARLY FEASIBILITY

10 42-56 FRANKLIN STREET—21,000 SQM
KYREN - MOOTED

11 200 NORTH TERRACE—26,000 SQM (OFFICE) & 3,000 SQM (RETAIL)
COMMERCIAL & GENERAL - MOOTED

12 62 – 80 CURRIE STREET— (OFFICE/HOTEL)
PRIVATE DEVELOPER —2023+

13 FREEMASONS HALL— 33,000 SQM | 2,000 SQM (OFFICE) 1,000 SQM (RETAIL)
FREEEMASONS BRANCH-2023+

14 150-165 GRENFELL STREET—MOOTED

15 'TRINITY CITY' 88 NORTH TERRACE— 65,000 SQM
MALBOROUGH CAPITAL & 1835 CAPITAL. 2025

NB Dates are Knight Frank Research estimates
Major tenant commitment in [brackets] net to NLA approximate

DEMAND REMAINS STRONG FOR CORE ASSETS

Demand for investment assets continues

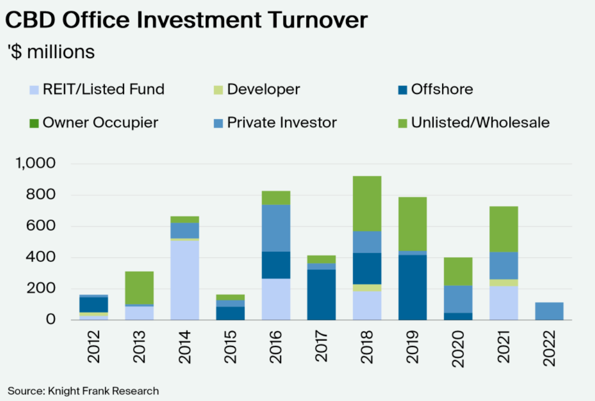
Three sales above $10 million have settled in Adelaide CBD since February 2022, reflecting a total sales volume of $113.65 million. However, this excludes 210 Grote Street, 99 Gawler Place, 63 Pirie Street and 50 Hindmarsh Square which are yet to settle. Including these assets, transaction volumes measure $304.29 million in total, with additional major assets likely to exchange prior to Q1 2023.

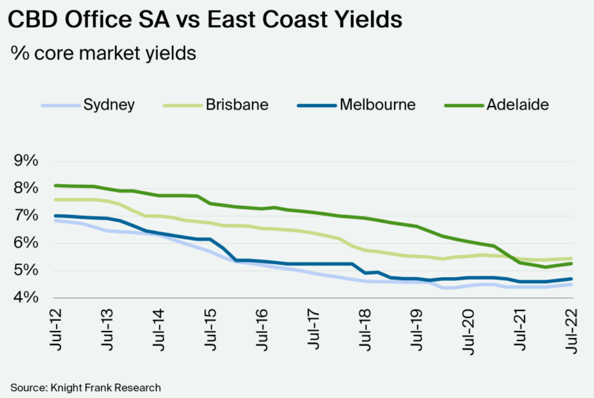
Notable settled sales include a 12 level, A grade office tower at 91-97 Grenfell Street purchased by Cromwell for $81.3 million, and L5-9 131-139 Grenfell Street purchased by Sentinel for $20.9 million. Both sales were brokered by Knight Frank Australia.

Several major campaigns are yet to gain traction or have been withdrawn from the market, likely due to current inflationary pressures, rising interest rates and uncertainty surrounding the wider economic climate. Given the large increase in funding costs, purchasers risk/reward profiles are under review. Evidently, the institutional buyer pool for Adelaide is currently bifurcated. There are still buyers showing strong interest in core well located trophy assets that provide certainty and liquidity, with the remaining pool of buyers showing interest in core plus, value add or opportunistic assets where the increased cost of capital can be offset with enhanced returns from active management initiatives.

Yields in Adelaide CBD begin to soften

Average prime yields softened for the first time since Q4 2016, rising 13 basis points from 5.13% to 5.26% from February 2022. Adelaide continues to offer a compelling value proposition due to the yield spread between the eastern seaboard and lack of stamp duty on commercial transactions. Adelaide's current yield spread with Sydney is 73bps, compared to the 10 year average of 176bps. The yield spread has converged since mid 2018, unlike Adelaide's yield spread with Perth, which has diverged over this time. Yields in Adelaide are currently 116bps firmer than Perth, well above the 10 year average of 14bps. This highlights investors growing confidence in Adelaide's CBD office market.





Recent significant sales

PROPERTY	PRICE $M	CORE MARKET	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
63 Pirie Street, Adelaide	Confidential	c6.50	11,211	TBA	4.0	Confidential	Raptis Group	U/C
99 Gawler Place, Adelaide	c70.00	c6.00	c10,537	c6,643	c3.0	Marprop	BlackRock & Fortius	U/C
210 Grote Street, Adelaide	50.00	7.10	11,587	4,315	1.5	Cedar Pacific	Centennial Property Group	U/C
Level 5-9 131-139 Grenfell Street, Adelaide	20.90	7.66	4,020	5,199	3.1	Sentinel	Centuria	May-22
91-97 Grenfell Street, Adelaide	81.35	5.62	11,142	7,301	6.1	Cromwell Funds Management	Harmony Investments & Arc Equity Partners	Apr-22
139 Frome Street, Adelaide	11.40	6.50	3,306	3,448	0.1	Local Private	Local Private	Feb-22

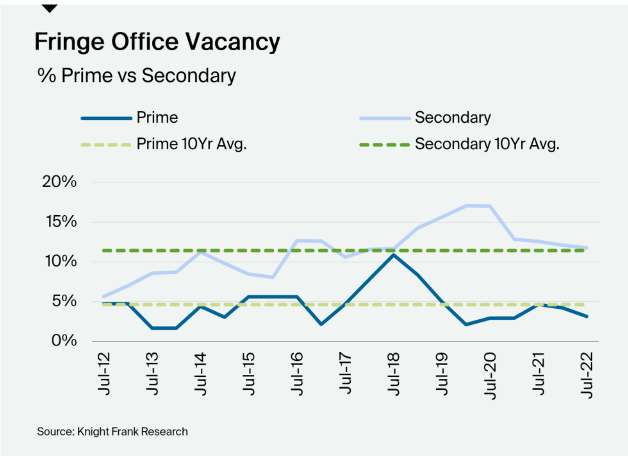
c Circa *Not Settled ^Knight Frank Assessment

INVESTMENT POTENTIAL IN THE FRINGE

Opportunity with secondary stock refurbishment

In the six months to July 2022, Adelaide City Fringe recorded a marginal increase in vacancy, from 10.1% to 10.4%. The prime vacancy rate rose by 2.8% to 5.9% while the secondary vacancy rate fell by 0.4% to 11.8%. A breakup of the secondary vacancy rate identified that although there was an addition of 2,086sqm of B grade stock, the withdrawal of 2,700sqm of C grade stock resulted in an overall decrease in the secondary grade vacancy rate. Due to the size of the fringe market, changes in occupancy have a greater impact on the vacancy rate as compared with Adelaide CBD.

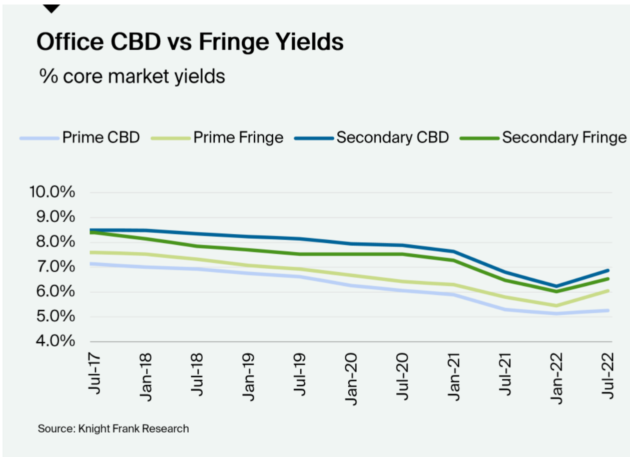
Properties located along the Fringe benefit from high traffic volume, corporate exposure, with ease of accessibility and car parking availability near a city presence. A recent negotiation is SPAA Conveyancing occupying 191 Fullarton Road on a 5 + 3 year term, commencing at $400/sqm per annum net face.



Rent decreases resulting in softening yields.

In the six months to July 2022, prime gross effective rents in the Fringe decreased from 371/sqm to $355/sqm while secondary gross effective rents rose from $265/sqm to $275/sqm. Similarly, incentives increased for prime assets from 22.50%to 24.50%, whilst decreasing from 26.25% to 25.00% for secondary assets. During this time, average outgoings for both prime and secondary assets increased slightly, up $2/sqm to $106/sqm and up $4/sqm to $101/sqm, respectively. This is largely due to statutory re-valuations and above average inflation.

Average prime yields within the Fringe have softened by 60bps to 6.05% as at July 2022, and softened 50bps to sit at 6.53% for secondary assets. A notable sale is 209-211 Fullarton Road, Eastwood which transacted at $4.4million, reflecting a core market yield of 6.02%, for a secondary office with a short term WALE of 0.50 years.



Recent significant tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	FACE RENT $/SQM	TERM YRS	START DATE
Telstra	60 King William Street	Core	4,500	540n	7	July 2023
NAB	60 King William Street	Core	3,000	*700g	7	July 2023
Cyber CX	95 Grenfell Street	Core	950	525g	5	May 2022
Optus	108 North Terrace	Core	5,670	480g	7r	April 2022
Department of Education	108 Wakefield	Core	1,445	560g	7	April 2022

g Gross n Net *approximate (r) renewal

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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