

RESEARCH



ADELAIDE

OFFICE MARKET OVERVIEW APRIL 2015

HIGHLIGHTS

The Adelaide CBD vacancy rate, as measured by the PCA, decreased to 13.5% as at January 2015, down from 13.8% in July 2014 but remains above the 25 year average of 12.1%

Institutional investment in the Adelaide CBD has seen resurgent activity, highlighting ongoing disconnect between investment demand and underlying office market fundamentals.

Capital values of older, secondary stock with exposure to leasing risk will be vulnerable to softening. Increased vacancy will trigger refurbishment and capital investment in this sector.

KEY FINDINGS

Average CBD prime gross face rents as at April 2015, were \$495/m² (\$392/m² net) and incentives averaging 22%.

Adelaide CBD recorded negative net absorption of 5,697m² for the six months to January 2015 and -18,703m² over the past year.

Site works have begun on the new building at 115 King William Street. The 25 storey office tower is being speculatively developed.

A Grade assets have led the market with regard to yield compression; there is a greater range of purchasers with an appetite and potential to move up the risk curve.



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SUPPLY & DEVELOPMENT

Vacancy rates decreased for the first time since 2012, but remain above average. As a result of relatively soft demand, projected supply in the Adelaide CBD will continue to be below trend.

Gross supply in the Adelaide CBD has decreased by 45% in the last six months from 6,788m² to 3,706m² (Figure 1). Development activity has slowed as the market catches up with the new additions and backfill refurbished space derived from a “flight to quality”, as tenants relocate to newer buildings.

It is anticipated that any new construction in the short to medium term in the Adelaide CBD will be minimal, unless significantly pre-committed. Current development is concentrated around secondary stock refurbishment. This trend is expected to continue through 2015.

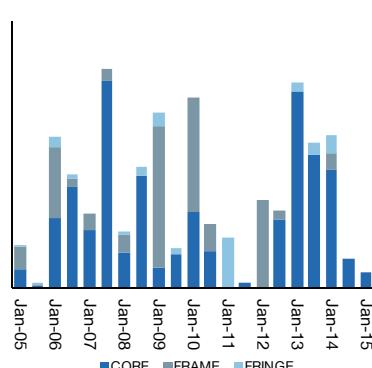
There are a number of staged refurbishment programs underway in the CBD. 1 King William Street will progressively bring back circa 12,500m² from 2016; 167-175 Flinders Street will add 3,095m², with a pre-commitment from Breast Screen SA; 82-98 Wakefield Street will contribute 4,000m² including a pre-commitment from Torrens University (1,500m²) and 169 Pirie Street will provide 8,000m², of which approximately 6,000m² is pre-committed (see map on page 3).

Site works at 115 King William Street have commenced with completion scheduled for mid 2016. The 25 storey office tower has a small footprint of 350m² and will provide 6,900m² of A Grade office space to the market. The

property may be Community Titled and sold on a floor by floor basis. A new building at 185 Pirie Street has been approved and is subject to pre commitments. The eight level building will add 6,000m² to the office market with an estimated completion date of mid 2016.

Site works have also commenced on the University of Adelaide Medical and Nursing Schools site on North Terrace. The 13 storey building will neighbour the new Royal Adelaide Hospital and further add to Adelaide's new medical hub. It's likely that office space in this area will become more attractive for medical oriented businesses as development in this precinct matures.

FIGURE 1
Adelaide Supply Additions
('000m²)



Source: Knight Frank/PCA

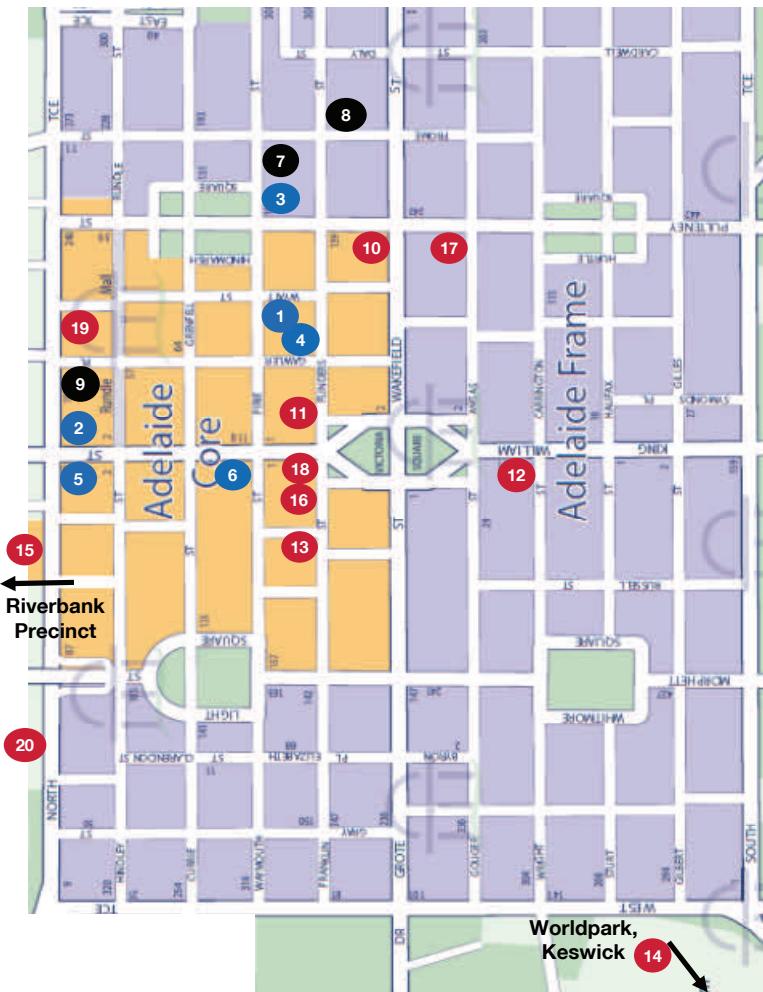
TABLE 1
Adelaide Office Market Indicators as at April 2015

Grade	Market	Total Stock (m ²) [^]	Vacancy Rate (%) [^]	Annual Net Absorption (m ²) [^]	Annual Net Additions (m ²) [^]	Average Gross Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	CBD	569,515	11.9	-7,832	0	495	22	7.25–8.25
	Fringe	37,297	5.6	-460	0	436	15	7.75–8.75
Secondary	CBD	804,632	14.6	-10,871	3,706	369	26	8.50–9.75
	Fringe	181,751	8.8	-1,345	0	337	15	8.25–9.25
Total Precinct	CBD	1,374,147	13.5	-18,703	3,706			
	Fringe	219,048	8.3	-1,805	0			
Total Market	Adelaide	1,593,195	12.8	-20,508	3,706			

Source: Knight Frank ^PCA data as at January 2015

MAJOR OFFICE SUPPLY

- 1** 101 Pirie St - 6,788m² [Health Partners] *
Health Partners Ltd - Apr 2014 - 55% committed
- 2** 2-12 King William St # - 4,820m² [RaboBank, Comm & Gen]
Private - Sept 2014 - 48% committed
- 3** 169 Pirie St (ex BAB) # - 8,000m² [Lucid , Channel 9, Homestart]
Aus Property Developments - mid 2015 - 75% comitmitted
- 4** 50 Flinders St - 21,431m² [People's Choice C.U. & Santos]
Cbus - Q4 2015 - 82% committed
- 5** 1 King William St # - 12,500m² (ex Origin) ~
Anvil Capital - from 2016 - seeking commitment
- 6** 115 King William St - 6,900m²
Brinz Holdings - Q2 2016
- 7** 185 Pirie St - 6,000m²
Pruszinski/ Palumbo- 2016+
- 8** 170 Frome St - 4,000m²
Emmett Properties - 2016+
- 9** 186-190 North Terrace - 5,000m²
Adelaide Development Company (ADC) - 2017+
- 10** 102-120 Wakefield St - 16,500m²
Kambitsis Group - 2017+
- 11** 2-20 Flinders St - 17,500m²
Toga - 2017+
- 12** 301-317 King William St, Adelaide - 26,000m²
Supreme Court Precinct - 2017+
- 13** 42-56 Franklin St - 21,000m²
Private (Molfetas) - 2017+
- 14** Worldpark - Richmond Rd, Keswick - 22,600m²
Axiom (Stage B & C) - 2018+
- 15** Riverbank Precinct
Walker Corp/SA Government - 2018+
- 16** Tower 7 - 12-26 Franklin St - 25,000m²
Charter Hall/Telstra Super Fund - 2019+
- 17** 130 Angas St (Yorke Campus Stg 2) - ~25,000m²
Commercial & General - 2019+
- 18** Tower 4 - 141 King William St - 15,000m²
Charter Hall/Telstra Super Fund - 2019+
- 19** 200 North Terrace - ~17,000m²
Maras/Le Cordon Bleu - 2019+
- 20** University of Adelaide AMNS^ - North Terrace
~12,000m² University of Adelaide - 2016+
- 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 (>5,000m²)

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

TENANT DEMAND & RENTS

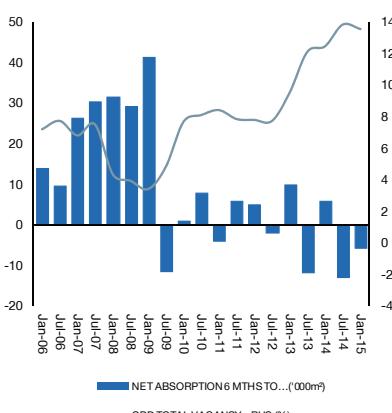
Net Absorption

The Adelaide CBD recorded a negative net absorption figure of -5,697m² for the six months to January 2015 and negative net absorption of -18,703m² over the past year (Figure 2), while the Fringe recorded a positive figure of 2,386m².

Negative net absorption in the CBD office market can be attributed to overall weakened demand and major tenant relocations. One recent significant relocation is Elders vacating 12,000m² at 27 Currie Street and occupying 3,000m² at 80 Grenfell Street under a sub lease from Bendigo and Adelaide Bank.

In addition, there is a continued reduction in the floor area required by tenants as they become more efficient in how they manage their office space. In particular, the South Australian Government are looking to reduce their footprint, as they currently have the largest market share in the Adelaide CBD, occupying around 20% of office space.

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



Source: Knight Frank/PCA

Vacancy

According to the PCA, the Adelaide CBD vacancy rate now stands at 13.5%, which is above the 25 year average of 12.1% and a marginal decrease of 0.3% since the July 2014 result of 13.8%.

The overall decrease in CBD vacancy is a result of decreases in Premium grade vacancy from 11.6% to 10.7% and B grade vacancy decreasing from 14.7% to 10.7%. The remainder of the CBD (A, C and D grade) office space was subject to marginal increases in vacancy (Table 2).

The 18,247m² office building at 1 King William Street remains circa 70% vacant since Origin Energy's relocation to 100 Waymouth Street. The owner is actively seeking commitments to the 12,500m² of backfill space and the building is a significant contributor to the 14,883m² of total stock withdrawn in the Adelaide CBD over the six months to January 2015. The space will be progressively refurbished upon lease commitments.

As at January 2015, there is approximately 185,570m² of CBD office stock recorded by the PCA as being vacant. One of the buildings which contributed a significant proportion of this vacant space is the former ATO building at 81-95 Waymouth Street (17,878m²) which remains 100% vacant.

Other notable vacancies include the recently refurbished 55 Currie Street (approximately 25% vacant), 30 Currie Street (approximately 45% vacant), 108 North Terrace (approximately 27% vacant), 101 Pirie Street (approximately 45% vacant) and 2-12 King William Street (approximately 52% vacant).

Other key tenant relocations that will impact vacancy include 63 Pirie Street which has an imminent vacancy of approximately 65% with the relocation of AON to 91 King William Street. People's Choice Credit Union will vacate 60 Light Square (7,000m²) when their new premises are complete at 50 Flinders Street in the fourth quarter of 2015.

Increased vacancy in lower grade stock will be the likely catalyst for capital investment and refurbishment in this sector to ensure building owners remain competitive. Further contributing to the competition in this sector is the availability of vacant Prime space offering attractive incentives. There is approximately 60,368m² of vacant prime space in the Adelaide CBD with incentives on offer in the vicinity of 20%.

TABLE 2
Adelaide CBD Vacancy Rates (%)

Grade	Jan 2014	Jul 2014	Jan 2015
Premium	6.3%	11.6%	10.7%
A Grade	11.0%	11.2%	12.1%
Prime	10.6%	11.2%	12.0%
B Grade	14.0%	14.7%	10.7%
C Grade	11.5%	14.9%	17.0%
D Grade	17.2%	19.0%	19.2%
Secondary	13.6%	15.6%	14.6%
Total	12.4%	13.8%	13.5%

Source: Knight Frank/PCA

The CBD Fringe experienced a more substantial decrease to 8.3% from 9.9% at January 2015 (Table 3), as a result of new leases at 24-25 Greenhill Road and 103 Fullarton Road. However, the Fringe is a comparatively small market and therefore susceptible to minor fluctuations in vacancy.

TABLE 3
Adelaide Fringe Vacancy Rates

Grade	Jan 2014	Jul 2014	Jan 2015
Prime	4.4%	3.1%	5.6%
B Grade	11.5%	14.8%	8.8%
C Grade	7.6%	10.1%	8.5%
D Grade	13.3%	13.3%	16.9%
Secondary	8.7%	11.3%	8.8%
Total	8.0%	9.9%	8.3%

Source: Knight Frank/PCA

Tenant Demand

Overall tenant demand in the CBD is weak at present. This is highlighted by negative net absorption for both prime and secondary space. B grade space has showed the strongest demand over the past 12 months to January 2015, the only grade to record a positive net absorption of 6,795m². However, secondary space has been weighed down by C grade stock which holds the weakest demand and a negative net absorption of -13,814m².

Weak demand is encouraging building owners to refurbish space and focus on building presentation and stronger environmental credentials. 2 King William Street is an example of how a quality refurbishment is attracting corporate tenants with Commercial & General and Rabobank each leasing a floor or approximately 530m². However, it is noted that five floors, or approximately 2,500m², remains available.

There has been minimal development in the Fringe as a consequence of soft demand. Demand in the CBD Fringe market was modest over the six months to January 2015 with net absorption of 2,386m² recorded. However over the past 12 months to January 2015 the Fringe recorded negative net absorption of -1,805m². Fluctuations can be attributed to the small market size.

The small level of growth in face rents which currently exists in the leasing market is being led by those few tenants actively seeking greater efficiencies through consolidation of their space. This impacts building owners trying to secure tenants for smaller areas, in comparison to a single, large floor plate.

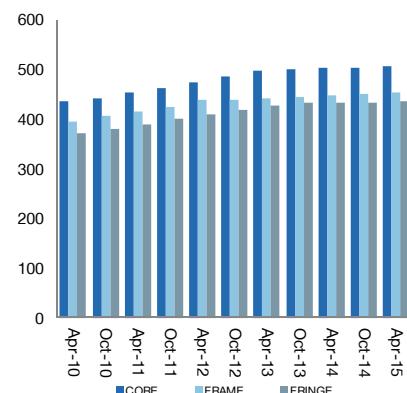
Rental Levels

Rental levels in the office market have remained static with marginal increases over the past 12 months to April 2015. This is evidence of the overall soft demand in the office market.

Average CBD prime gross face rents (Figure 3) as at April 2015 have increased slightly to \$495/m². On a gross effective basis (\$388/m²) rents have fallen by 2%

over the past year, with gross incentives rising to 22%. Average CBD secondary gross face rents are \$369/m² (\$274/m² gross effective) an annual decrease of 5.7% on an effective basis, with average incentives increasing to 26% from 21% a year ago.

FIGURE 3
Adelaide Prime Gross Face Rents
By precinct (\$/m²)

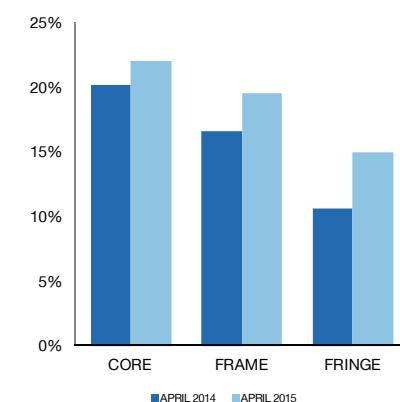


Source: Knight Frank

largely unchanged and demand is mostly active in the 600m² to 1,000m² range. Average Fringe prime gross face rents as at April 2015 are \$437/m² (\$371/m² gross effective—an annual decrease of 4.4%), with gross incentives rising to 15% from 10.5% a year ago. Average secondary gross face rents as at April 2015 are \$337/m² (\$286/m² gross effective - an annual fall of 2.8%), with gross incentives increasing to 15% from 12% a year ago.

The outlook for face rental growth over the next 12 months is forecast to be modest compared with historic average rates. Whilst face rents are not expected to show any significant decline in the better quality buildings, incentives are increasing as the level of competition increases, placing further downward pressure on effective rents.

FIGURE 4
Adelaide Prime Incentives April 2014 – April 2015
By precinct (%)



Source: Knight Frank

Over the 12 months to April 2015 there has been an increase in both prime and secondary incentives (Figure 4). Prime incentives for new leases in the CBD now range between 20%-25%, while incentives on lease renewals, which have also risen, continue to trade in a slightly lower range between 15%-20%. This is a result of the available space on the market and the level of competition that exists. Fringe incentives remain well below that of the Core and Frame (CBD).

Rental levels in the Fringe market remain

TABLE 4
Recent Leasing Activity Adelaide CBD and Fringe

Address	NLA m ²	Face Rent \$/m ²	Term yrs	Incentive (%) ^a	Tenant	Start Date
169 Pirie Street	2,700	450n	15	25#	Channel 9	Feb-15
169 Pirie Street	1,000	365n	7	N/A	Lucid Consulting	Jan-15
108 North Terrace	20,112	470n	7	16	Optus	Jan-15
149 Flinders Street	314	380n	5	N/A	Confidential	Dec-14
100 Waymouth Street	9,135	465g	10	N/A	Origin Energy	Nov-14
121 Greenhill Road	2,278	350g	7	15	GPA Engineers	Oct-14
129-130 Greenhill Road	379.5	316g	2	12	Duke Services	Sep-14

^aestimated incentive calculated on a straight line basis g Gross n Net #circa

Source: Knight Frank

INVESTMENT ACTIVITY & YIELDS

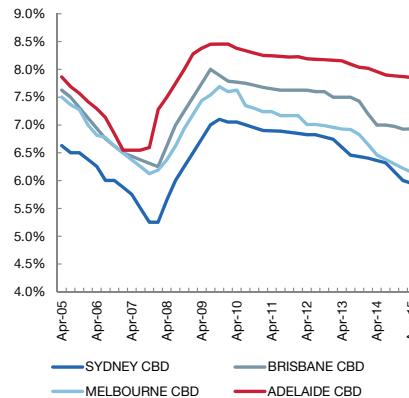
A Grade assets have led the market with regard to yield compression however, there is now a greater range of purchasers with an appetite and capacity to move up the risk curve. The latter part of 2014 saw high transaction activity in assets over \$10 million, with a total \$515.23 million worth of sales. Investment activity in the first quarter of 2015 has been headlined by the sale of 60 Wakefield Street and 21 Divett Place, 81 Flinders Street and 49-51 Pirie Street totalling almost \$100 million.

Investment activity in the latter part of 2014 was defined by a few major transactions, the most significant being the SachsenFonds portfolio which was purchased by Lend Lease APPF Commercial for \$175.2 million. 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 major transactions included the September 2014 purchase of a 50% interest in the Westpac building at 91 King William Street, one of Adelaide's two Premium Grade buildings, for \$74 million. In February 2015, a local private syndicate purchased 81 Flinders Street

**FIGURE 5
Adelaide CBD vs Eastern States
CBD Prime Yields**

% Analysed Core Market Yield



Source: Knight Frank

for \$41.3 million. The 11 storey office building sold on a core market yield of 8.18% and a WALE of 4.6 years by income. In March 2015, a private syndicate purchased 60 Wakefield Street and 21 Divett Place for \$37.5 million. The six-level office building at 60 Wakefield Street and the 10-level State Forensic Centre at 21 Divett Place sold on a core market yield of 7.56% and a WALE of 12 years by income. Both properties have

new 12 year leases in place to the South Australian Police.

The sale of 151 Pirie Street in September 2014 is noteworthy as it indicated a high level of institutional competition and firmer yields. 151 Pirie Street sold after an intensive Expressions of Interest Campaign, with submissions from 12 parties. The prospective purchasers included Australian and overseas funds, Institutions, high net worth individuals (domestic and offshore) and local syndicates. The property was contracted to a local private investor for \$72 million. The property has a WALE of 5.7 years by income and the sale price reflected an analysed core market yield of 7.32% (fully leased initial yield of 7.07%). We have seen an increased level of demand for these types of assets.

These recent sales indicate that Adelaide is now an established target for interstate and offshore investment. This level of demand is not being driven by the underlying office market fundamentals, as these are quite weak at present. The demand is a result of the shift of money from lower yielding investments such as term deposits, due to a record low cash rate, in order to chase higher yielding long term investments, such as property.

**TABLE 5
Recent Sales Activity Adelaide**

Address	Price \$ million	Core Market Yield %	NLA m ²	\$/m ² NLA	WALE yrs	Vendor	Purchaser	Sale Date
60 Wakefield St & 21 Divett	37.50	7.56	12,660	2,962	12	SA Government	Private Syndicate	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 Funds	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	German Fund Real I.S.	Private Investor	Sep-14
22-28 King William St	41.80	8.22	9,640	4,350	7.2	Quintessential	Southern Cross Equity	Jun-14
100 Pirie St	28.63	9.39	9,022	3,171	2.1	Melis Developments	Private Investor	Jun-14
108 North Terrace #	69.10	8.33	20,061	3,445	4.4	Commonwealth (CPA)	DEXUS	Apr-14
11-29 Waymouth St #	160.10	8.25	31,003	5,164	3.5	Commonwealth (CPA)	DEXUS	Apr-14

Source: Knight Frank

#corporate transaction - part of DEXUS acquisition of CPA

^purchase of 50% interest

In addition, Adelaide offers a compelling value proposition when compared to Melbourne, Sydney and Brisbane. Average prime yields in Adelaide's CBD are currently around 150-200 basis points higher than other states (Figure 5), making Adelaide's CBD office assets an attractive investment opportunity.

Figure 6 shows that post GFC, yields softened sharply before stabilising and remaining reasonably static for five years before showing signs of firming again in 2014. Further investment activity from Australian and overseas funds, institutional groups, domestic syndicates and private investors will drive this trend which is likely to continue through 2015 and over the short term.

As a result, assets with strong income streams and long term lease covenants are anticipated to experience further yield compression. Demand for CBD property is expected to remain healthy if more quality assets are brought to the market, with the RBA predicted to further cut interest rates in 2015.

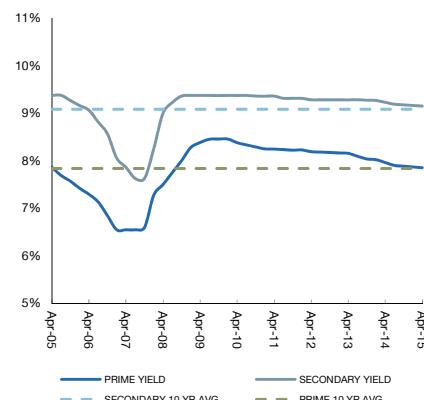
Adelaide prime CBD indicative yields as at April 2015 have shown some firming since July 2014, ranging from 7.25% to 8.25%, with secondary yields ranging from 8.50% to 9.75%. It is likely that transaction activity in the short to medium term will operate in the lower part of the range, particularly if more quality stock is brought to the market.

Adelaide prime Fringe indicative yields as at April 2015 remain unchanged with yields ranging from 7.75% to 8.75%, with secondary yields ranging from 8.25% to 9.25%.



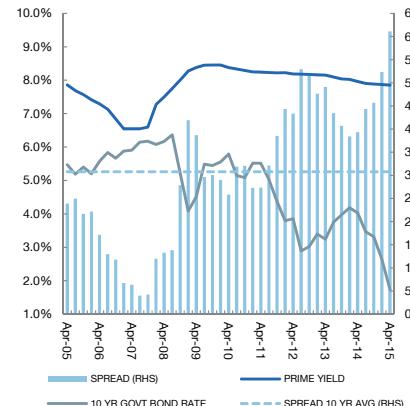
KPMG Building 151 Pirie Street

FIGURE 6
Adelaide CBD Core Market Yields
Averages by Grade



Source: Knight Frank

FIGURE 7
Adelaide CBD Yields & Spreads
Core Market Yields vs 10 Yr Govt Bond Rate



Source: Knight Frank/RBA

Outlook

- The outlook for face rental growth over the next 12 months is forecast to remain modest compared with historical average rates.
- Incentives are likely to rise, particularly in the lower B and C Grade stock, where there is a significant amount of available space.
- The limited face rental growth which currently exists in the leasing market is being led by those few tenants seeking efficiencies through the consolidation of space.
- Construction is underway on 115 King William Street. The 25 storey office tower will contribute an additional 6,900m² of un-committed space in the CBD.
- A new building at 185 Pirie Street has been approved and is subject to pre commitments. The eight level building will add 6,000m² to the office market with an estimated completion date of mid 2016.
- It is expected that additional lower grade stock will become available as tenants move to better quality space with attractive incentives.
- Demand for prime investments is strong nationally and there is potential for further firming of prime yields in the short term.
- The strongest demand, and firmer yields, continues to be for Prime core assets, which are the well presented and well located, office buildings subject to long term leases offering attractive cash flow.



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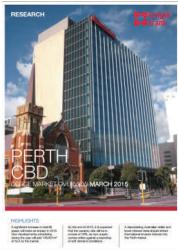
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