



RESEARCH



ADELAIDE

OFFICE MARKET OVERVIEW MARCH 2016

HIGHLIGHTS

The Adelaide CBD vacancy rate increased from 13.5% to 14.1% in the six months to January 2016. This was a result of an increase in supply with the completion of the new building at 50 Flinders Street.

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

In December 2015, a one third reduction in stamp duty charges on commercial property came into effect. The second reduction will take effect from July 2017, with full removal by July 2018.

KEY FINDINGS

In the six months to January 2016, CBD prime yields have firmed by 14 basis points and secondary yields have firmed by 24 basis points, despite ongoing weak leasing fundamentals.

Annual net absorption for the total Adelaide market remained positive at 3,444m² as at January 2016, aided by attractive incentives on new leases.

In the 12 months to January 2016, average prime CBD incentives increased from 20% to 28%, placing downward pressure on effective rents.

Sublease vacancy in the CBD has reached a 25 year high, increasing from 1.5% to 2.1% in the six months to January 2016.



RORY DYUS
Research SA

SUPPLY & DEVELOPMENT

Short term supply remains below historic levels as the market moves into a softer period of the supply cycle. It is likely that the next wave of supply will be subject to major tenant pre-commitment.

In the six months to January 2016 the Adelaide CBD recorded an increase in gross supply additions of 27,117m², 43% above the historical average of 15,161m². This is predominantly a result of the completion of the new building at 50 Flinders Street accounting for 20,572m². The remaining supply was split between 3,095m² of refurbished space in 167 Flinders Street and 3,450m² of refurbished space in 1 King William Street.

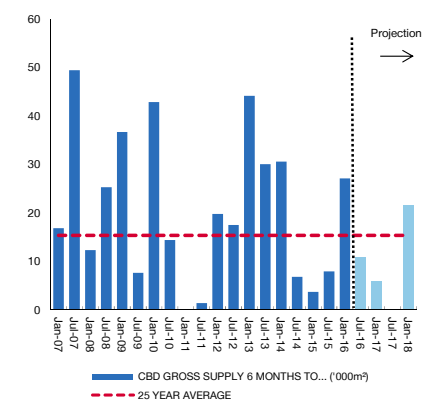
Forecast supply in the CBD office market for the next 12 months is below average as the market falls into a softer period of the supply cycle and absorbs vacant stock. In the six months to January 2016, CBD net supply was 7,193m² after accounting for stock withdrawals. The largest withdrawal being 81-95 Waymouth Street, at approximately 16,378m². The building is undergoing refurbishment works after securing a 63% pre-commitment from the SA Government (DEWNR). The building is likely to be completed by the second half of this year.

Emmett Properties 3,900m² development at 170 Frome Street is nearing completion with a 38% tenant pre-commitment from Grant Thornton. Similarly, construction at 115 King William Street is nearing completion; the 6,775m², 25 level office building will have

small floor plates of approximately 271m². Both buildings are expected to be completed by H2 2016.

The longer term development pipeline will be subject to major tenant pre-commitment with mooted projects providing in excess of 40,000m² post 2018/2019. Developments in early planning of note include Charter Hall's Precinct GPO development which is to include approximately 36,500m² of office space over two towers and the Walker Corporations proposed Festival Plaza / Riverbank Precinct redevelopment which is to include a 24 level, 40,000m² office building adjacent to the Adelaide Casino.

FIGURE 1
Adelaide Gross Supply Additions
('000m²)



Source: Knight Frank Research/PCA

TABLE 1
Adelaide Office Market Indicators as at January 2016

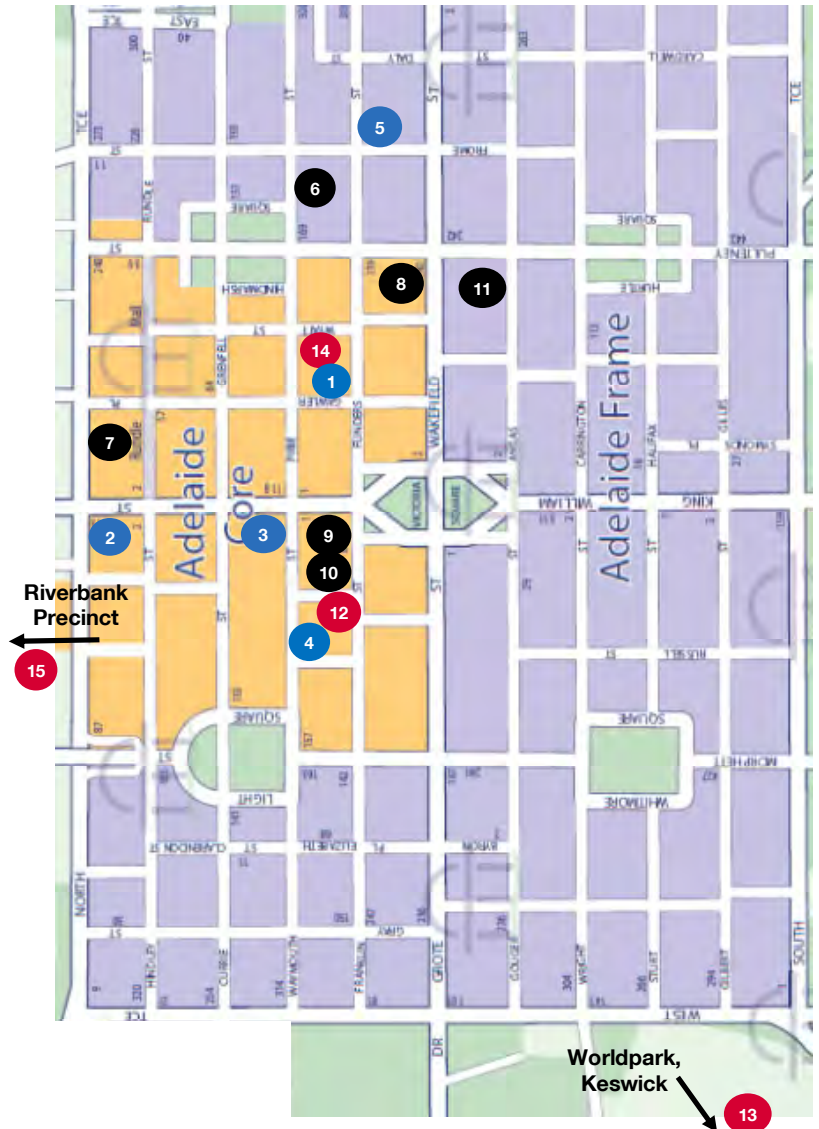
Grade	Market	Total Stock (m ²)	Vacancy Rate (%)	Annual Net Absorption (m ²)	Annual Net Additions (m ²)	Average Gross Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	CBD	573,709	12.5	944	4,194	502	27.6	7.00—7.75
	Fringe	37,297	5.6	0	0	441	18.2	7.25—8.25
Secondary	CBD	812,829	15.2	1,549	8,197	375	28.7	8.00—9.25
	Fringe	178,029	7.4	951	-3,772	340	19.0	8.00—8.75
Total Precinct	CBD	1,386,538	14.1	2,493	12,391			
	Fringe	215,326	7.1	951	-3,772			
Total Market	Adelaide	1,601,864	13.2	3,444	8,619			

Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY

- 1** 50 Flinders St - 20,572m² [People's Choice C.U. & Santos]
Cbus - October 2015 - 82% committed
- 2** 1 King William St # - ~12,500m² (ex Origin) [SA Govt]
Anvil Capital - October 2015 - 55% committed
- 3** 115 King William St - 6,775m²
Brinz Holdings - H2 2016
- 4** 81-95 Waymouth St # - 16,378m² (ex ATO) [SA Govt]
KTS Properties - H2 2016 - 63% committed
- 5** 170 Frome St - 3,900m² [Grant Thornton]
Emmett Properties - 2016 - 38% committed
- 6** 185 Pirie Street - 6,000m²
Palumbo / Pruszinski - 2017+
- 7** 186-190 North Terrace - 5,000m²
Adelaide Development Company (ADC) - 2018+
- 8** 102-120 Wakefield St - 16,500m²
Kyren Group - 2018+
- 9** GPO Plaza (Precinct GPO) - 141 King William St - 12,500m²
Charter Hall/Telstra Super Fund - 2019+
- 10** GPO Tower (Precinct GPO) - 12-26 Franklin St - 24,000m²
Charter Hall/Telstra Super Fund - 2019+
- 11** 130 Angas St (Hospital) - 25,000m²
Commercial & General - 2019+
- 12** 42-56 Franklin St - 21,000m²
Private (Molfetas) - 2018+
- 13** Worldpark - Richmond Rd, Keswick - 22,600m²
Axiom (Stage B & C) - 2018+
- 14** 57-61 Wyatt Street - 4,180m²
Private - 2018+
- 15** Festival Plaza / Riverbank Precinct - 40,000m²
Walker Corp/SA Government - 2019+

- Under Construction/Complete
- DA Approved / Confirmed
- Mooted / Early Feasibility



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
 ~ note total NLA is 18,247m²
 Office NLA quoted (>3,000m²)

TENANT DEMAND & RENTS

Net Absorption

The pending closure of General Motors Holden, Australian Defence Force manufacturing and mining projects in South Australia continues to challenge the states' economy and unemployment levels. These are likely contributors to continued inconsistent demand for office space in the CBD.

In the six months to January 2016 the Adelaide CBD leasing market remained subdued, recording a negative net absorption of -1,577m² (see Figure 2) and 2,493m² over the past 12 months. In trend terms, net absorption has experienced minor fluctuations in comparison to the consistent demand recorded pre GFC and as a result vacancy has increased.

Negative net absorption is a result of tenant contractions outweighing demand and new leasing being led by existing tenants rather than new tenants entering the market. As tenants relocate, their space requirements can change and typically floor space requirements have decreased as a result of efficiency gains.

In the six months to January 2016, tenant movements of note include the Commonwealth Government Department of Human Services expanding by 2,582m² at 55 Currie Street, Peoples

Choice Credit Union relocating from 60 Light Square into 9,000m² in the recently completed 50 Flinders Street, the South Australian Government Ministerial Office taking up 2,300m² in the recently refurbished building at 1 King William Street and the South Australian Government Department of Environment, Water and Natural Resources (DEWNR) pre-committing to approximately 10,318m² at 81-95 Waymouth Street.

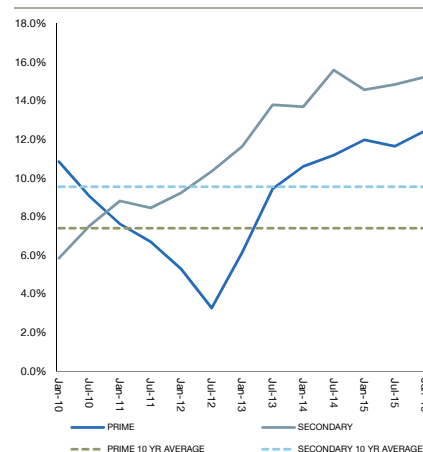
Vacancy

The Adelaide CBD vacancy rate increased from 13.5% to 14.1% in the six months to January 2016 and remains above the historical average of 12.2%. Both the prime and secondary vacancy rates continue to trend upwards, reaching 12.5% and 15.2% respectively as at January 2016 and both remain above the 10 year historical average (See Figure 3).

Sublease vacancy has reached a 25 year high increasing from 1.5% to 2.1% in the six months to January 2016, or approximately 28,910m² of vacant space. One of the significant contributors to this includes Elders 11,800m² tenancy in 27 Currie Street, after relocating to 80 Grenfell Street.

Tenants which sign sublease agreements in prime space often benefit from a new fit out with attractive incentives or below average rental rates. An example of this is the Australian Health Practitioner

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

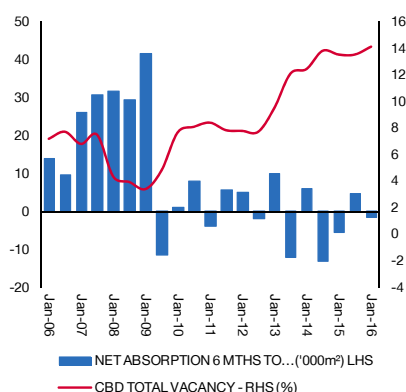


Source: Knight Frank Research/PCA

Regulation Authority (AHPRA) which are leasing Level 14 from Bendigo and Adelaide Bank at 80 Grenfell Street. The deal was reportedly struck at a rate that is circa \$90/m² below the head lease rent, plus an attractive incentive of circa 30%.

The Fringe recorded the lowest vacancy rate of all office market sectors in Adelaide at 7.1%, decreasing from 8.0% over the six month period. However this is mostly due to a stock withdrawal of 1,975m² from 127 Greenhill Road which is receiving extensive upgrade and refurbishment works. The Fringe market is comparatively smaller than the CBD at approximately 16% of the size by NLA. As a result, this market is more sensitive to small scale tenant movements.

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



Source: Knight Frank Research/PCA

TABLE 2
Adelaide CBD Vacancy Rates (%)

Grade	Jan 2015	Jul 2015	Jan 2016
Premium	10.7%	9.4%	7.7%
A Grade	12.1%	11.8%	12.8%
Prime	12.0%	11.6%	12.5%
B Grade	10.7%	11.1%	11.1%
C Grade	17.0%	17.2%	17.9%
D Grade	19.2%	19.7%	20.6%
Secondary	14.6%	14.9%	15.2%
Total	13.5%	13.5%	14.1%

Source: Knight Frank Research/PCA

TABLE 3
Adelaide Fringe Vacancy Rates

Grade	Jan 2015	Jul 2015	Jan 2016
A Grade	5.6%	5.6%	5.6%
Prime	5.6%	5.6%	5.6%
B Grade	8.8%	8.7%	5.6%
C Grade	8.5%	8.3%	7.9%
D Grade	16.9%	9.6%	9.6%
Secondary	8.8%	8.5%	7.4%
Total	8.3%	8.0%	7.1%

Source: Knight Frank Research/PCA

Tenant Demand

Leasing market fundamentals remain weak, with net absorption continuing to fluctuate post GFC. In the short term, tenant demand will likely continue to fluctuate until there is some certainty around some broader economic drivers in the state. As a result, short term gross supply forecast is below average for prime space until the next wave of mooted development, post 2018 / 2019.

In the six months to January 2016, leasing deals of significance include Peoples Choice Credit Union occupying 9,000m² in the recently completed office building at 50 Flinders Street. The deal was struck on a 12 year term and accounts for approximately 47% of the building's NLA. Santos Limited also leased 7,040m² (33% of NLA) within 50 Flinders Street on a seven year term. Santos have subsequently placed this space on the market for sublease.

Demand for secondary stock remains inconsistent. C and D grade office space accounts for 32% of the total CBD stock and has a combined vacancy of 19%. As a result, opportunities exist for building owners who can reposition these assets to improve building appeal and environmental performance to attract tenants.

Examples of buildings that have been recently repositioned include 81-95 Waymouth Street, securing a pre-commitment from the South Australian Government (DEWNR) for a circa 10 year term and 169 Pirie Street in the CBD Frame. The 7,900m², 5 level office building has undergone extensive upgrades and refurbishment works. As a result, the building has attracted quality tenants on long term leases including the Nine Network Australia on a 15 year term, Homestart Finance and HAMB Systems Limited on 10 year terms.

Redundant secondary stock in the CBD Frame is also providing the opportunity for residential redevelopment. As at January 2016, there is in excess of 1,700 apartments mooted, under construction or for sale within the CBD.

Rental Levels

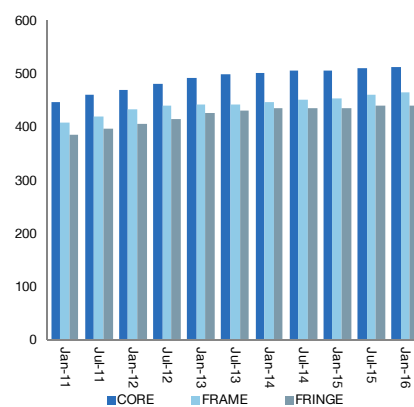
Leasing opportunities in the CBD are favourable for prospective tenants due to a combination of factors. Above average vacancy and competition between landlords has resulted in an increase in incentives. At the same time marginal growth in face rents has resulted in an overall reduction in gross effective rents.

Average prime gross face rents in the CBD increased from \$499/m² p.a to \$502/m² p.a in the six months to January 2016 with average prime incentives increasing from 24% to 28%. This translates to over 18 months rent free on a standard five year lease. As a result there has been a 4% decrease in gross effective rents from \$379/m² p.a to \$364/m² p.a.

FIGURE 4

Adelaide Prime Gross Face Rents

By precinct (\$/m²)



Source: Knight Frank Research

TABLE 4

Recent Leasing Activity Adelaide CBD and Fringe

Address	NLA m ²	Face Rent \$/m ²	Term yrs	Incentive (%) [*]	Tenant	Start Date
225 Greenhill Road*	753	270n	10	10.0	P&Q Assoc SA	Mar-16
1 King William Street	2,300	495g	12	26.5	SA Government	Jan-16
1 King William Street	1,124	535g	8	N/A	WSP	Jan-16
80 Grenfell Street	2,835	500g	10	30.0	Elders Ltd	Jan-16
83 Currie Street	518	330g	5	N/A	AIMET	Nov-15
91 King William Street	551	525g	5	N/A	AICD	Oct-15
80 King William Street	1,363	350g	5	N/A	DMAW Services	Oct-15
86 Pirie Street	632	315g	3	N/A	Risk Insure P/L	Aug-15

^{*}estimated incentive calculated on a straight line basis g Gross n Net *Fringe

Source: Knight Frank Research

As at January 2016, average secondary gross face rents were \$375/m² with incentives at 29% resulting in a gross effective rental rate of \$268/m² p.a.

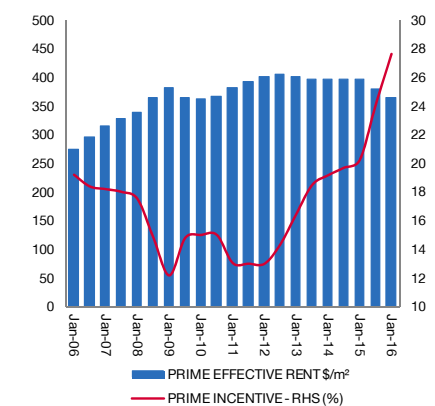
Rental levels in the Fringe have remained stable for both prime and secondary space. In the six months to January 2016, average Fringe prime gross face rents remained unchanged at \$441/m² and secondary gross face rents remained unchanged at \$340/m².

Fringe incentives have increased marginally, placing downward pressure on effective rents. Incentives on prime space increased from 17% to an average of 18% and incentives on secondary space also increased from 17.5% to an average of 19% over the same six month period.

FIGURE 5

Adelaide CBD Prime Incentives vs. CBD Gross Effective Rents

Jan 2006—Jan 2016 (\$/m² LHS, % RHS)



Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

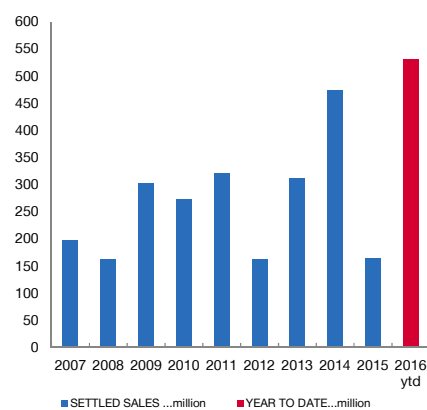
The first quarter of 2016 has provided record breaking sales activity. To date there is approximately \$531.45 million worth of settled sales, more than tripling the entire 2015 sales result of \$164.80 million (see Figure 6).

The increased investment activity began in December 2015 when Singaporean based investor Norleco Holdings purchased 100 Weymouth Street for \$73 million from Cromwell Property. The property sold fully leased to Origin Energy and Beyond Bank on a core market yield of 6.57% and a WALE of 8.0 years (income weighted).

Sales volumes in 2016 have been skewed up by Blackstone's purchase of the Rundle Place development for \$400 million, Adelaide's largest CBD transaction to date. Located in the CBD Core precinct, the interconnected development comprises a 14 level 23,472m² A grade office tower at 80 Grenfell Street fully leased to Bendigo and Adelaide Bank, the adjoining Rundle Place Shopping Centre and a 506 bay, seven level car park at 90-100 Grenfell Street. The sale reflected a core market yield of circa 6.50%.

In March 2016, a private investor purchased the 11 level office building at 30 Flinders Street for \$63.5 million. The property sold fully leased to multiple

FIGURE 6
Adelaide CBD Sales Transactions
2007 to 2016 year to date (\$million)



Source: Knight Frank Research

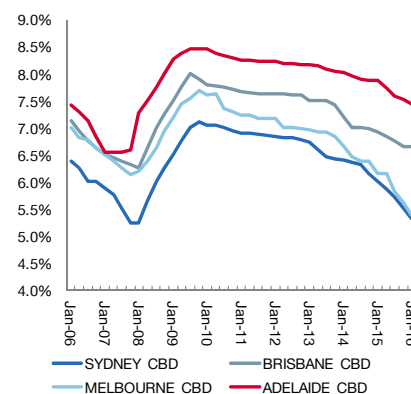
tenants including the SA Government and Jacobs, representing a core market yield of 7.30% and a WALE of 4.4 years (income weighted).

Other sales of note includes, Shakespeare Property Group's purchase of 30 Currie Street in January 2016 for \$28.75 million representing a core market yield of 8.22% and WALE of 1.1 (income weighted). The property sold with a total vacancy of approximately 46%. The groups second acquisition, 19 Grenfell Street was purchased for \$39.2 million representing a core market yield of 8.86% and WALE of 2.1 years (income

weighted). The property sold with multiple tenants and a total vacancy of approximately 20%.

The heightened investment activity has come from a range of purchaser groups including local and private investors, syndicates and offshore institutional investors, typically for prime assets with secure tenancy profiles. Although the past 12-18 months have shown steady firming, prime yields in Adelaide remain approximately 150-200 basis points above that of the east coast of Australia, making Adelaide a comparatively attractive investment opportunity (on a yield basis).

FIGURE 7
Adelaide CBD vs East Coast Yields
2006-2016



Source: Knight Frank Research

TABLE 5
Recent Sales Activity Adelaide

Address	Price \$ million	Core Market Yield %	NLA m ²	\$/m ² 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	#6.50	~46,635	8,664	9.8	epc.Pacific	**Blackstone	Jan-16
100 Weymouth Street	73.00	6.57	12,305	5,933	8.0	Cromwell Property	Norelco Holdings	Dec-15
60 Wakefield St & 21 Divett	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

Source: Knight Frank Research *Sale of a mixed-use asset comprising office building, retail centre & car park **Blackstone Singapore Pte. Ltd #Circa
~Combined lettable area of office & retail components Shakespeare Property Group <Finance Mutual Australia

In the six months to January 2016 CBD prime yields firmed by 14 basis points to 7.45% well below the 25 year average of 8.50% with the average yield range for prime assets tightening by 25 basis points to 7.0%-7.75%. If more quality investment stock is brought to the market it is likely that further firming will be solidified.

Investment activity in the secondary market remains inconsistent where purchasers have continued to show a mixed tolerance for risk. Average CBD secondary yields have firmed by 24 basis points to 8.72% with a wider yield range of 8.0%-9.25%. Purchasers with the ability to reposition secondary assets and secure tenants have the opportunity to benefit from steady investment demand in the short term.

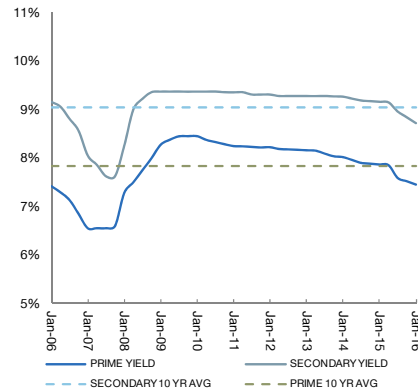
Investment yields in the Fringe office market have firmed modestly, following trend with the CBD investment market. However, being a tightly held market, most of the sales activity has been below the \$10 million price point. In the six months to January 2016. Average prime yields firmed 12 basis points to 7.73% and average secondary yields firmed 18 basis points to 8.50%.

The emergence of a two tiered market is now evident with a growing gap between capital markets and occupancy markets as yields continue to firm whilst leasing market fundamentals remain weak. Contributing to the demand for investment in commercial property is the recent volatile performance of the share market, low cost of finance and poor performing returns from lower yielding investments such as term deposits and bonds (See figure 9).

In December 2015 the South Australian Government commenced the first (one third) reduction of stamp duty on commercial property transactions, the next (one third) reduction is scheduled for July 2017 and full abolition of the tax will take effect from July 2018. This should help attract further investment in the CBD office market. 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 8
Adelaide CBD Core Market Yields

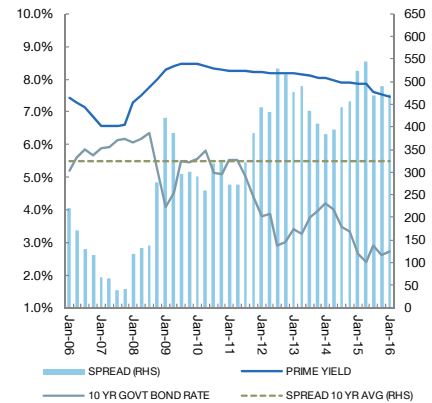
Yields and Averages by Grade



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 the proposed Festival Plaza / Riverbank Precinct redevelopment and Charter Hall's Precinct GPO development providing in excess of 40,000m² of new space.
- 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, 1 King William Street, 167 Flinders Street and 169 Pirie Street.
- Tenant demand is likely to remain subdued in the short term, led mostly by existing tenants relocating especially with attractive incentives on offer and projected modest growth in face rents.
- Vacancy is likely to remain stable in the short term. Its likely that it will take some time for tenants to absorb any new or refurbished space brought to the market.
- Any additional significant sales will add to the strong results recorded so far in Q1 2016. The spread between Adelaide CBD and East Coast CBD yields will likely support Adelaide's appealing investment value proposition.
- 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.



COMMERCIAL BRIEFING

For the latest news, views and analysis of the commercial property market, visit knightfrankblog.com/commercial-briefing/

RESEARCH

Matt Whitby

Group Director
Head of Research and Consultancy
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

Rory Dyus

Research Analyst—SA
+61 8 8233 5230
Rory.Dyus@sa.knightfrankval.com.au

CAPITAL MARKETS

Peter McVann

Managing Director - SA
+61 8 8233 5210
Peter.Mcvann@au.knightfrank.com

Guy Bennett

Director, Institutional Sales
+61 8 8233 5204
Guy.Bennett@au.knightfrank.com

Tony Ricketts

Director
+61 8 8233 5259
Tony.Ricketts@au.knightfrank.com

OFFICE LEASING

Martin Potter

Senior Director
+61 8 8233 5208
Martin.Potter@au.knightfrank.com

Andrew Ingleton

Associate Director
+61 8 8233 5229
Andrew.Ingleton@au.knightfrank.com

VALUATIONS

James Pledge

Managing Director Vals - SA
+61 8 8233 5212
James.Pledge@sa.knightfrankval.com.au

Nick Bell

Director Vals - SA
+61 8 8233 5242
Nick.Bell@sa.knightfrankval.com.au

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS



Australian Residential Review March 2016



Australian CBD & Non CBD Office Top Sales Transactions 2015



Foreign Investment in Residential Property Australian Market Insight 2015/16



Australian CBD Office Supply and Development Maps December 2015

Knight Frank Research Reports are available at KnightFrank.com.au/Research

© Knight Frank 2016 This report is published for general information only. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no legal responsibility can be accepted by Knight Frank Research or Knight Frank for any loss or damage resultant from the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank in relation to particular properties or projects. Reproduction of this report in whole or in part is not permitted without prior consent of, and proper reference to Knight Frank Research.

