RESEARCH

APRIL 2011

ADELAIDE OFFICE

Market Overview

Knight Frank

HIGHLIGHTS

- The total office vacancy for Adelaide rose from 7.8% to 8.3% in the six months to January 2011. The vacancy rate in the Core precinct experienced a slight increase from 7.0% to 7.3% but this sector still remains well placed on a national scale.
- Vacancy levels in Adelaide's Frame have eased from the high of 12.7% in January 2010 to 11.4% in January 2011. This is still considerably higher than the Core and Fringe markets and is largely the result of three significant new developments at the southern end of King William Street completed last year which are leasing well.
- Prime yields have tightened by as much as 10-15 basis points in the six months to January 2011. Average prime market yields are now in the range of 8.00% to 8.75% in Adelaide's Core Precinct
- Prime market rents have increased slightly across all precincts in the six months to January 2011, largely a result of a relatively tight A-grade vacancy.

ADELAIDE OFFICE OVERVIEW

Economic Snapshot

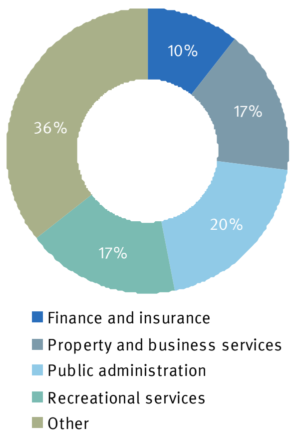
The Australian economy has continued to prove resilient since the global economic downturn in 2008/09, outperforming most other industrialised economies. This remains underpinned by sustained economic growth in China, which has resulted in consistent demand for our mineral resources and a large surge in commodity prices.

However, ongoing concerns about the European debt crisis, Middle East tensions and the resultant volatility in world equity markets threaten the global economic recovery.

Australia has managed to cap its level of unemployment and the underlying inflation outlook is now more moderate than earlier forecast. The RBA sees the level of GDP getting back to its pre-flood levels by mid 2011 with forecast GDP growth of 4% through to December 2012 and June 2013.

Australia is experiencing a two-speed economy with the "commodity boom mark II" enriching the mining states while the traditional manufacturing centres and retail struggles.

Figure 1
White Collar Employment by Sector
Adelaide – March 2011



Source: Access Economics

The South Australian economy faces ongoing challenges including a sluggish manufacturing industry, a significant decline in commercial construction approvals and soft retail turnover figures. Over the past six month's the state's unemployment figures have lagged behind the national average and unemployment reached a high of 5.8% as at February 2011.

The year ahead will see continued volatility as a result of the relationship between debt stricken southern Europe, a delicate recovery in the US and an inflating Chinese economy. Interest rates and the implications of the Australian and Japanese natural disasters are likely to have the greatest direct impact over the next six months and beyond. The cash rate has the potential to increase to 5.25% by year end, helping to keep underlying inflation within the RBA's 2-3% target range, however the market is now pricing no further rises in 2011.

Table 1
Adelaide Office Market Indicators January 2011

Grade	Market	Total Stock^ (m^2)	Vacancy Rate^ (%)	Annual Net Absorption^ (m^2)	Avg. Gross Face Rent ($/$m^2$)	Average Incentive (%)	Average Capital Value ($/$m^2$)	Avg. Prime Core Market Yield (%)
Prime	Core	397,109	4.5	6,570	426	13.0	3,800 – 4,200	8.00 – 8.75
	Frame	70,972	23.1	12,945	409	13.0	3,500 – 3,900	8.25 – 8.75
	Fringe	32,520	12.3	8,963	372	7.5	3,500 – 4,000	7.75 – 8.50
Secondary	Core	614,544	9.2	-9,609	328	14.0	2,400 – 2,700	9.00 – 10.00
	Frame	220,336	7.7	-4,222	308	14.0	2,200 – 2,500	9.00 – 9.75
	Fringe	179,146	8.3	-9.480	304	11.5	2,600 – 2,900	8.25 – 9.00
Total Precincts	Core	1,011,653	7.3	-3,039	370	13.5	2,900 – 3,300	8.50 – 9.50
	Frame	291,308	11.4	8,723	335	14.0	2,700 – 3,100	8.75 – 9.25
	Fringe	211,666	8.9	-517	315	10.5	2,900 – 3,300	8.00 – 8.75
Total Market	**Adelaide**	**1,514,627**	**8.3**	**5,167**	**355**	**13.0**	**2,900 – 3,300**	**8.50 – 9.50**

Source: Knight Frank Research/PCA ^ PCA OMR data as at January 2011 NB. Average Data is on a weighted basis
Definition: Core Market yield: - Abbreviation for analysed equated market yield - Calculated using the assessed Market Rental divided by Purchase Price adjusted for short term risk issues (vacancies, capital expenditure, etc).
Grade: Prime includes Premium & A grade stock whilst secondary includes B, C & D quality grade

Leasing Market & Rents

In January 2011 the office vacancy rate for Adelaide's CBD climbed to a six-year high with total vacant space increasing from 7.8% in July 2010 to 8.3%, however Adelaide continues to be one of Australia's tightest office markets. The highest vacancy level is in the Adelaide Frame market, which recorded a vacancy rate of 11.4%, but this too is a reduction on the previous six month figure of 11.8%. The majority of the increase in vacancy occurred in the lower grade buildings, while Prime space actually showed a fall in vacancy.

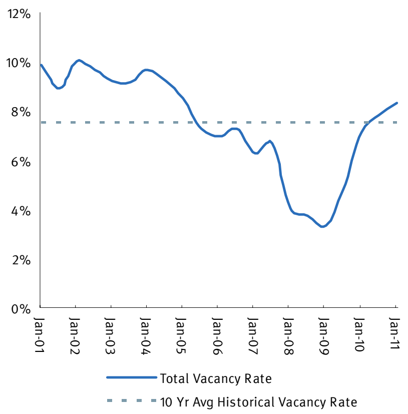
Despite the increased level of vacancy, the Adelaide market is among the most robust in the Asia-Pacific region, along with a number of other Australian markets also recording moderate vacancy rates.

The total vacancy figure can be partially attributed to a softening in demand for space which reflects a cautious approach from businesses.

Figure 2

Vacancy Rates v 10 Year Average

Adelaide Total Market (%)



Source: PCA

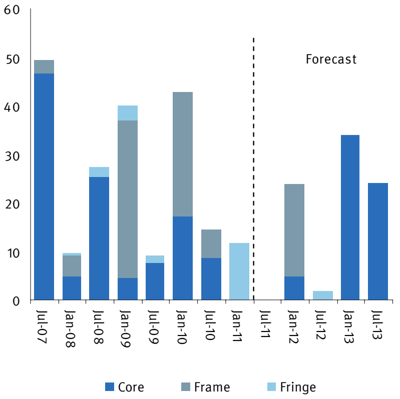
It is anticipated that a large amount of backfill space will come onto the market within the next 12-24 months, which may result in increased vacancy rates by mid 2013, however the city's white collar employment figure has increased by 2.9% in the past 12 months. With further steady growth forecast in the next 12 months office demand is more likely to experience a period of stabilisation rather than a decline. Office demand will be largely driven by business confidence and the state's white collar employment market which remains resilient.

Adelaide's annual net absorption rate of 5,167m² in January 2011 was similar to the figure of 5,951m² recorded in July 2010. This remains below the long term average of 13,318m² and can be attributed to the slow down in demand and conservative business and management practices.

Figure 3

Development Activity

Adelaide Office ('000m²)



Source: PCA

Development Activity

Development activity has stalled in the past six months as lenders continue to demand higher levels of pre-commitment (circa 60%-70%) and more stringent loan to valuation ratios of circa 50-60%. This is reflective of financiers maintaining a conservative policy setting more aligned to those adopted in previous credit squeezes. Despite this, at 93%, Adelaide has the highest level of pre-commitments in the nation.

Construction of the new SA Police (SAPOL) headquarters at 100 Angas Street is due for completion in late 2011, with SAPOL pre-committing to the entire NLA of the building (18,935m²). Construction of the Aspen Group's $200 million Tower 8 building on Franklin Street is expected to be completed in late 2012 adding 34,000m² to the Core office stock base.

The only major development scheduled beyond 2012 with a firm commitment is the development which will occur at the Harris Scarfe site at 80 Grenfell Street. The 24,000m² development is fully committed by Bendigo & Adelaide Bank and is due for completion in mid 2013.

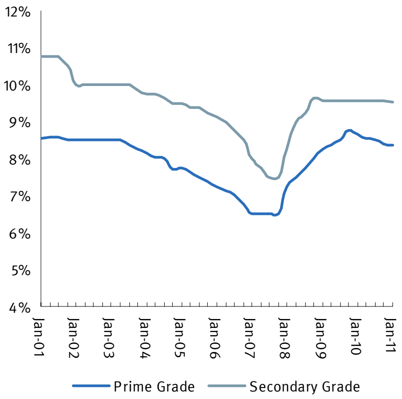
Sales & Investment

There has been subdued sales activity in the Adelaide office market in the past six months. It would appear that investors are taking a more cautious approach and are looking more closely at our business environment before investing. The typical buyer profile for investment property continues to be mainly private, comprising high net worth individuals, families and syndicates.

Figure 4

Average Core Market Yields

Adelaide Office – Core Precinct



Source: Knight Frank

There has been significant consolidation between REIT's, Funds and Institutions and some are now ready to acquire again, however the high $AUD has kept overseas investors largely at bay.

Over the past six months transactional activity has been most prevalent in the City Fringe where a number of assets have changed hands. The Core and Frame have been more subdued.

APRIL 2011
ADELAIDE OFFICE
Market Overview

CORE

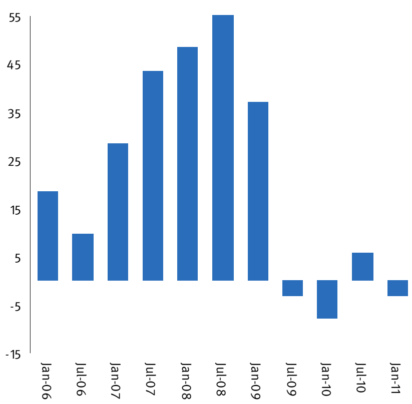
Leasing Market & Rents

After surpassing one million square metres of net lettable area last year, the Adelaide Core office market remains at 1,011,653m², having experienced no supply additions in the six months to January 2011.

Despite a slight rise in vacancy rates office vacancy in Adelaide's Core remains low in comparison to other markets across the nation. Total vacancy in the Core has increased from 7.0% in July 2010 to 7.3% in January 2011, with sub-lease vacancy accounting for 0.9% of this total vacancy.

Much of this increase can be attributed to vacancy levels in the secondary market increasing from 8.1% in July 2010 to 9.2% in January 2011. This was led by strong demand for prime stock as tenants seek to upgrade. Another contributing factor has been the tightening of residency laws, attributing to a drop in international student applications and the resulting closure of a number of colleges which had occupied lower grade stock in the Core.

Figure 5
Net Absorption – Core precinct
12 month rolling ('000m²)



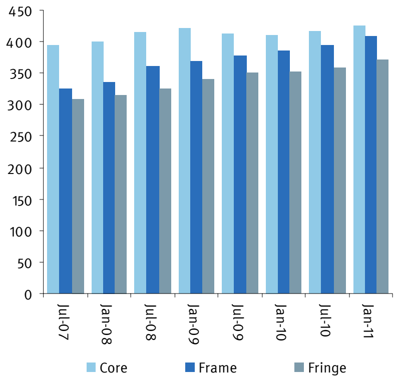
Source: PCA

The largest fall in vacancy came from Premium stock which fell from 6.4% in July 2010 to 3.8% in January 2011. This is largely a result of several leasing deals which took place at 91 King William Street.

The Adelaide Core market experienced annual negative net absorption of 3,039m² to January 2011, which was a decline on the positive figure of 5,654m² recorded to July 2010.

Average gross face rental rates in the Core have increased by approximately 2.0% over the previous six months with Prime rents averaging $426/m² and Secondary rents averaging $328/m².

Figure 6
Prime Gross Face Rents
Adelaide Office ($/m²)



Source: Knight Frank

Development Activity

Construction of the Aspen Group's Tower 8 building on Franklin Street as the new headquarters for the Australian Taxation Office in SA is expected to be completed in late 2012. The building will have an NLA of 37,000m² (office component of circa 34,000m²), which includes some retail and storage space leased to Australia Post, and an end value of around $200 million. This will result in 18,000m² of A-grade backfill space coming onto the market at the ATO's current Waymouth Street location. Another 12,000m² of backfill space at Rundle Mall will also come onto the market.

Further backfill space will come onto the market when SAPOL relocates from its main headquarters at 30 Flinders (14,000m²) Street and its other location at 60 Wakefield Street (6,400m²) into their new headquarters on Angas Street in the Frame precinct.

It is anticipated that A-grade and B-grade backfill space is likely to be taken up in preference to lower grade space. This could continue to put upward pressure on vacancy rates and incentives for both C-grade and D-grade stock.

The only development activity in the Core market scheduled beyond 2012 will occur at the Harris Scarfe site at 80 Grenfell Street. The 24,000m² development is fully committed by Bendigo & Adelaide Bank and is due for completion in mid 2013. Mooted developments for the Core include 42-56 Franklin Street (17,000m²), 58-78 Franklin Street (26,900m²), 102-120 Wakefield Street (18,000m²) and 135 Pirie Street (16,000m²), all unlikely to occur before 2013.

Sales and Investment

There has been a notable lack of major sales transactions in the Core market in the six months to January 2011. The exception being "Tower 2" at 121 King William Street which settled in September 2010 having been contracted in May 2010. The building sold for $75 million which reflects a core market yield of 7.49% and a building rate of $5,978/m². This is a notable sale as the building has a 5-star Green Star rating and was sold with a Weighted Average Lease Expiry of 6.6 years.

121 King William Street sold for $75 million reflecting a core market yield of 7.49%.

The lack of sales evidence has made it difficult to accurately determine the level of change in Core yields. Average yields in the Core experienced a slight tightening in the previous six months and range between 8.00% and 8.75% for prime with secondary yields ranging between 9.00%-10.00%.

FRAME

Leasing Market & Rents

The Frame market continues to have the highest vacancy rate of the three Adelaide office markets. It was less than two years ago that this market was the tightest nationally in July 2009 at 2.3%. This increase is directly a result of an increase in supply due to the completion of 400 King William Street (22,000m^2) and “The Edge” at 420 King William Street (5,000m^2).

The vacancy rate in the Frame of 11.4% in January 2011 represents a slight tightening on the July 2010 figure of 11.8%.

The annual net absorption of rate of 8,723m^2 was an increase to that of 3,029m^2 in July 2010 and the largest figure since July 2009, prior to the two King William Street developments.

The most significant leasing transaction in the Frame is the SAPOL lease at 100 Angas Street. A rent of circa \$510/m^2 gross was negotiated for a 15 year lease commencing upon the completion of the new building.

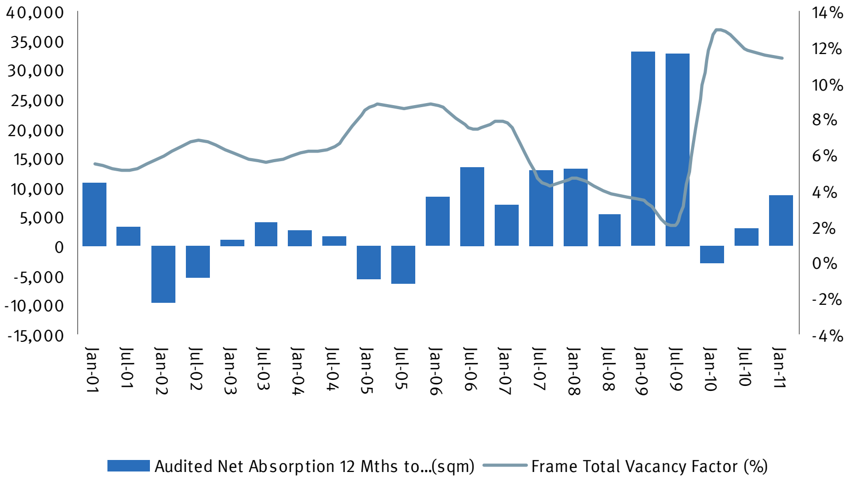
Construction of the new SAPOL headquarters at 100 Angas Street is due for completion in late 2011.

In the 12 months to January 2011, gross face rents have increased by around 6.1% for prime space in the Frame. Gross face rents are achieving on average \$409/m^2 for prime, increasing from the January 2010 figure of \$385/m^2. This can be attributed to the large amount of newly developed stock coming into a relatively small market. Leases are being negotiated for newly developed space upwards of mid \$400’s/m^2 gross face. There was little change in secondary rental rates which are averaging \$308/m^2 as at January 2011.

Figure 7

Vacancy Rate v Net Absorption

Frame Office Market – 12 months rolling



Source: PCA

The most significant lease negotiated in the six months to January 2011 occurred at 400 King William Street where 2,036m^2 was leased to Health Workforce Australia at a rate of \$425/m^2 gross for a term of 5+5 years commencing October 2010.

Another significant lease negotiated occurred at “The Edge” at 420 King William Street where 1,882m^2 was leased to BDO at a rate of \$370/m^2 net for a term of 15+5+5 years commencing January 2011.

Development Activity

Construction of the new SA Police (SAPOL) headquarters at 100 Angas Street is due for completion in late 2011, with SAPOL pre-committing to the entire 18,935m^2 of net lettable area.

Further speculative development potential for the Frame beyond 2012 includes 37-45 Wakefield Street (23,000m^2) and Yorke Campus Stage 2 at 130 Angas Street (25,000m^2), with both unlikely to occur before 2014. Activity will remain largely dependant on tenant pre-commitments.

Sales & Investment

As at January 2011, prime yields in the Frame average 8.55% with secondary yields at around 9.40%. There has been minimal transaction activity in the six months to January 2011 with no major sales transactions recorded. This makes it difficult to gauge the level of change in yields over this period, however there appears a gradual strengthening in investor demand, with limited quality investment stock available.

Optus House on the corner of South Terrace and King William Street remains on the market. It is understood that the vendor was seeking circa \$40 million, which would constitute a significant sale for the City Frame sector.

The average prime yields in the Frame precinct range between 8.25% and 8.75% with secondary yields ranging between 9.00% and 9.75%.

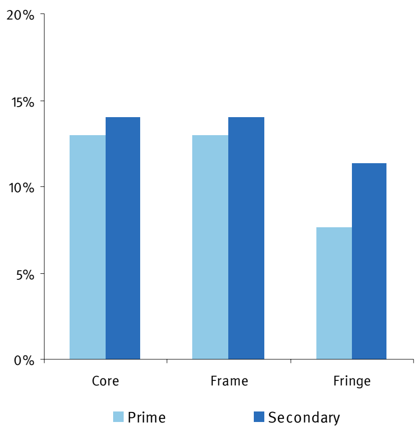
FRINGE

Leasing Market & Rents

The Fringe market experienced the largest increase in vacancy of Adelaide's three markets with the vacancy rate increasing from 5.6% to 8.9% in the six months to January 2011.

Vacancy now totals 18,913m² with sub-lease space accounting for 2.9% of the total vacancy. The current vacancy rate is the highest experienced by the Fringe market in more than a decade due to significant supply additions. Much of this increase can be attributed to 3,420m² of vacant A-grade space at 1 Richmond Road, Keswick. This space was vacant as at January but has been leased and will be occupied as at April 2011.

Figure 8
Adelaide Office Incentives
Average % of Net Lease Value



Source: Knight Frank

The Fringe precinct recorded a 12 month negative net absorption of -517m² following the July 2010 low of -2,732m². The Fringe hasn't experienced positive net absorption since July 2009, reflecting the fact that some tenants are seeking a move to the Frame where greater levels of contiguous space over 1,500m² are available. Small private tenants however, represent a large portion of the Fringe market and are more reluctant to relocate because they are most susceptible to the economic uncertainty and lack the capital required to shift.

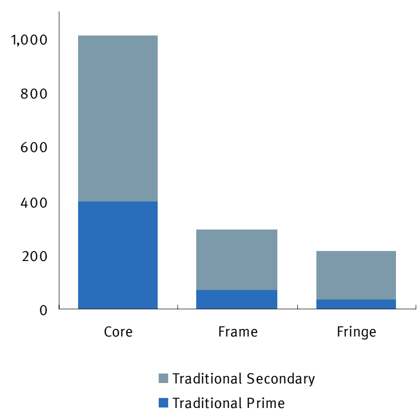
In the 12 months to January 2011, face rents have increased around 5.7% for prime space in the Fringe. Gross face rents are achieving on average $372/m² for prime, increasing from the January 2010 figure of $352/m². This can also be attributed to the large amount of newly developed stock coming onto the market. Secondary rental rates increase 4.0% over the same period and are averaging $304/m² as at January 2011.

Development Activity

The most significant development in the past six months in Adelaide's Fringe market was World Park at 31-33 Richmond Road, Mile End South. The construction of the 11,835m² project was completed in late 2010. The building is fully pre-committed with 4,447m² being leased by the SA Government and 7,233m² to Coffey International, who are now subleasing some of this space.

A supply addition of 1,800m² is expected to enter this sector via a two storey development at 57 Greenhill Road, which is currently seeking finance.

Figure 9
Adelaide Office Market Stock
Size of market by grade ('000m²)



Source: PCA

Sales & Investment

Over the past six months transactional activity has been most prevalent in the City Fringe where a number of assets have changed hands in comparison to Core and Frame markets which have been more subdued.

Building A - World Park, Mile End South sold for circa $46.5 million reflecting a core market yield of 9.01%.

The sale of Building A at 31-33 Richmond Road, Mile End South (World Park), which settled in January 2011, represents the most significant commercial sale in the past six months. The property was purchased by Growthpoint for circa $46.5 million from Axiom. The sale price reflects a core market yield of 9.01% and an improved rate of $3,929m². The asset is fully leased to the S.A Government and Coffey International.

The other significant sale recent sale that occurred in the Adelaide Fringe market transacted in November 2010 being 226 Greenhill Road, Eastwood which sold for $22.65 million reflecting a market yield of 8.54%. This showed an improved rate of $4,247/m². AGL occupies approximately 75% of the building on a 7 year lease. The average prime yields range between 7.75% and 8.50% with secondary yields ranging between 8.25% and 9.00%.

226 Greenhill Road, Eastwood sold for $22.65 million reflecting a core market yield of 8.54%.

OUTLOOK

The uncertainty surrounding global markets is likely to impact the Australian economy in the year ahead. Further volatility can be expected as a result of the European debt crisis, a delicate recovery in the US and a strong Chinese economy. The natural disasters in both Australia and Japan will also have a significant impact on the Australian economy.

The Reserve Bank has judged that the current mildly restrictive stance of monetary policy remains appropriate in view of the general macroeconomic outlook in Australia and abroad. It would appear that the cash rate will remain unchanged in the short term as Australia continues to experience the effects of a 'two speed economy', with the strong resources sector being offset by weakness in the manufacturing sector and retail market.

Although building activity remains subdued, it is expected to increase around 2013/14 as general economic activity strengthens. Despite the number of destabalising influences affecting the general economy, it is expected that confidence levels will improve in the next 6-12 months.

Table 2
Major Leasing Activity Adelaide Office market

Address	Area (sq m)	Estimated Rental ($/m²)	Term (yrs)	Tenant	Date
420 King William St	1,882	370n	15+5+5	BDO	Jan-11
Gd & Pt1, 151 South Tce	1,616	N/A	5+5	Transfield Services	Nov-10
22 King William Street	1,546	425g	1+5	Minister for Infrastructure	Nov-10
400 King William St	2,036	425g	5+5	Health Workforce Australia	Oct-10
100 Angas St	18,935	510g*	15+5+5	S.A Police	UC

Source: Knight Frank g gross n net *circa UC Upon Completion

Table 3
Major Investment Sales Activity Adelaide Office market

Address	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	Purchaser	Sale Date
121 King William Street	75.00	7.49	12,409	5,978	State Government Body	Sep-10
31-33 Richmond Road, Mile End South	46.50*	9.01	11,835	3,929	Growthpoint	Jan-11
226 Greenhill Road, Eastwood	22.65	8.54	5,333	4,247	Local Private	Nov-10
5 Cooke Terrace, Wayville	5.20	8.40	1,393	3,733	Local Private	Sep-10
45 Greenhill Road, Wayville	4.61^	VP	1,275	3,616	Chamber of Commerce	Feb-11

Source: Knight Frank * Circa VP Vacant Possession ^Under Contract

IT IS EXPECTED THAT CONFIDENCE LEVELS WILL IMPROVE IN THE NEXT 6-12 MONTHS

South Australia has navigated its way through the economic challenges in reasonable condition. With strong prospects of mining and defence expansion, the medium term outlook for South Australia remains positive.

The main issue relating to the Adelaide CBD market will be the amount of backfill space coming onto the market in the next 12-24 months, particularly in the Core precinct. It is anticipated that demand will be strong for higher-grade backfill space, with A-grade and B-grade vacancy rates already being low.

Prime rental rates across all Adelaide sectors are anticipated to experience modest levels of growth in the next 12 months with vacancy rates expected to remain tight.

It is uncertain how quickly C-grade and D-grade space will be taken up, however any potential negative impact could be mitigated should Adelaide's white collar employment market continue to grow steadily as anticipated. The possible increase in C-grade and D-grade vacancy is unlikely to have a large impact on face rents but is likely to keep upward pressure on incentives.

Global volatility and potentially higher interest rates have resulted in a higher level of risk in the commercial real estate market. However, the positive outlook for the South Australian economy and relatively attractive yields will continue to present opportunities for value add investors, capitalising on the low point in the cycle.

Notwithstanding this, it is anticipated that investors will continue to take a more cautious approach and look more closely at the business environment before investing, which could see the level of transactional activity remain moderate in the short term.

RESEARCH

Americas
USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia
Australia
New Zealand

Europe
UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
The Netherlands
Ukraine

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

The Gulf
Bahrain
Abu Dhabi, UAE

Knight Frank Newmark Global

Knight Frank Research

Matt Whitby
National Director – Research
+61 2 9036 6616
Matt.whitby@au.knightfrank.com

Matthew Mason
Research Analyst –SA
+61 8 8233 5232
Matthew.mason@au.knightfrank.com

Jennelle Wilson
Associate Director – Research QLD
+61 7 3246 8830
Jennelle.wilson@au.knightfrank.com

Nick Hoskins
Research Manager - NSW
+61 2 9036 6766
Nick.Hoskins@au.knightfrank.com

Justin Mahnig
Research Manager - Vic
+61 3 9604 4713
Justin.Mahnig@au.knightfrank.com

Alison Smith
Research Analyst - WA
+61 8 9225 2434
Alison.Smith@au.knightfrank.com

Commercial Agency Contacts

Peter McVann
Managing Director
+61 8 8233 5210
Peter.mcvann@au.knightfrank.com

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

Martin Potter
Director, Leasing
+61 8 8233 5208
Martin.potter@au.knightfrank.com

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

Valuation Contacts

James Pledge
Managing Director
+61 8 8233 5212
James.pledge@sa.knightfrankval.com.au

Nick Bell
Director
+61 8 8233 5242
Nick.bell@sa.knightfrankval.com.au

Knight Frank Research provide strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, financial and corporate institutions. All recognise the need for the provision of expert independent advice customised to their specific needs.

Knight Frank Research reports are also available at www.knightfrank.com.