

KNIGHT FRANK NEWCASTLE

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Newcastle Market Report.

Q1 2018



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Key Facts



Gross Regional Product of \$48.351 billion

Lowest non-capital city office vacancy rate of 9% nationally



Yield compression continues across all sectors particularly institutional assets and those with long WALE's



Significant investment in infrastructure particularly in the Newcastle CBD

The strong presence of Government and financial services sector tenants, coupled with a diverse and growing economy with linkages to resource, education and infrastructure projects will ensure Newcastle remains the strategic centre and key contributor to the economic wellbeing of the Hunter region.

Newcastle is the capital of the Hunter Region, the second largest city in New South Wales and one of Australia's largest regional economies producing a Gross Regional Product of \$48.351 billion. The Region is rejuvenating due to the New South Wales Government commitment to key infrastructure projects within the Newcastle CBD. The Transport Interchange at Wickham opened in October 2017 and the currently under construction Light Rail is an initiative designed to transform the city centre by providing greater connectivity between the city and waterfront.

In addition, the Federal Government is committed to upgrades at the Williamstown RAAF Base to accommodate the addition of the Joint Strike Fighter Fleet at the base. Projects such as runway extensions, improvements to electrical, sewage, fire and storm water infrastructure, as well as construction of an F-35A squadron headquarters, training and maintenance facilities are expected to be complete by 2021.

Newcastle's Strategic Location.

Newcastle and the surrounding Hunter Region comprises Australia's seventh largest city. The region has and is currently benefiting from unprecedented level of investment across a key number of sectors. Newcastle is recognised as the capital and economic hub of the Hunter Region and thus, the NSW Government is committed to revitalising Newcastle's city centre. The revitalisation will deliver a high calibre of outcomes for Novocastrians including better transport, greater connectivity between the city and waterfront, increased employment and new urban amenity ensuring the city will thrive well into the future.

The Hunter Region's population is in excess of 660,000 and is considered the economically strongest regional centre in Australia, with a Gross Regional Product of \$48.351 billion. The region's close proximity to Sydney makes Newcastle a viable alternative to Sydney over an array of industries.

Newcastle has been named one of the top ten must see destinations of the world by travel publication, Lonely Planet. Newcastle offers some of Australia's best beaches as well as a dynamic cosmopolitan city with rich maritime history, eclectic bars and award winning restaurants as well as a lively arts culture.



Office Markets.

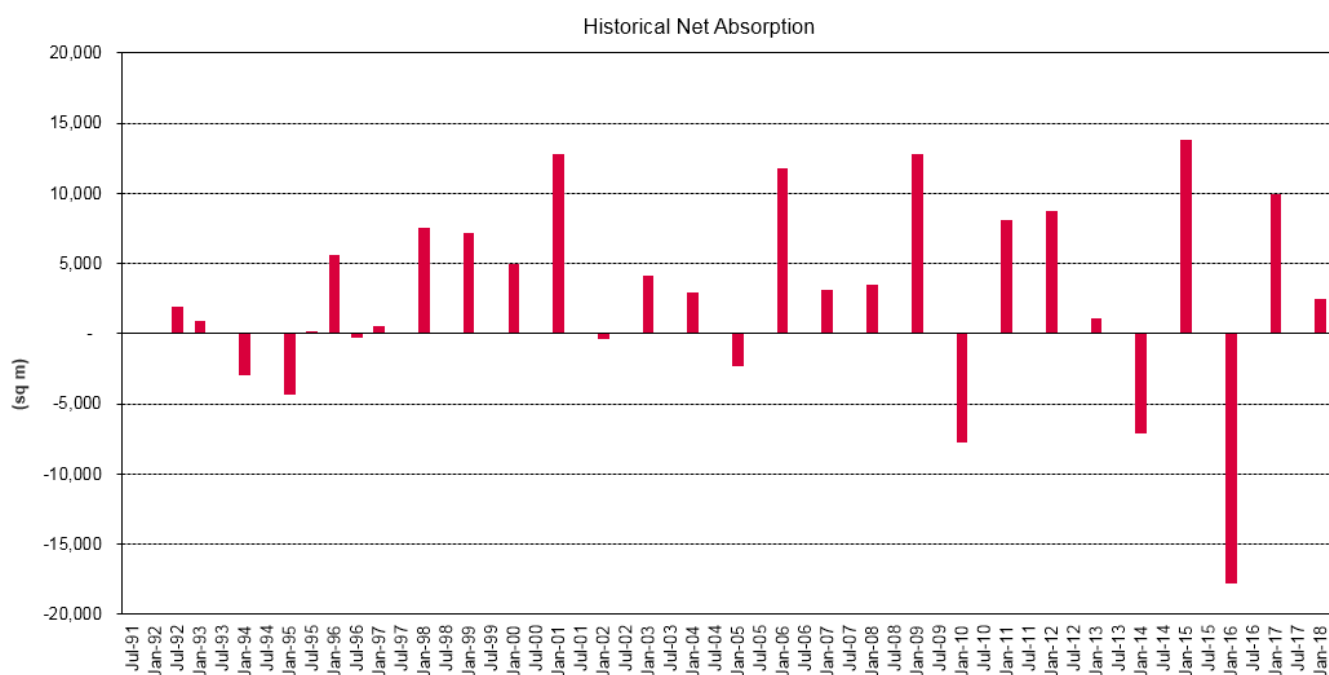
Stock Base

According to the Property Council of Australia (PCA) January 2018 Office Market Report, the Newcastle CBD comprises total stock of 253,956 sqm down from the January 2017 figure of 255,101 sqm. A Grade stock comprises 41% of the market at 105,028 sqm, with the proportion comparing favourably in comparison with some Sydney metropolitan markets including North Sydney at 31% and Crows Nest/St Leonards at 33%. Chatswood (56%), Macquarie Park (74%) and Wollongong (49%) have significantly higher proportions of A Grade stock than Newcastle.

Supply

Since 1992 when the Newcastle Office Market was first surveyed total stock has increased from 163,839 sqm to 253,956 sqm. There is contention that some supply additions in the PCA Stock list were existing buildings that had been refurbished and not new construction, which would slightly skew the analysis.

Historical Absorption & Vacancies



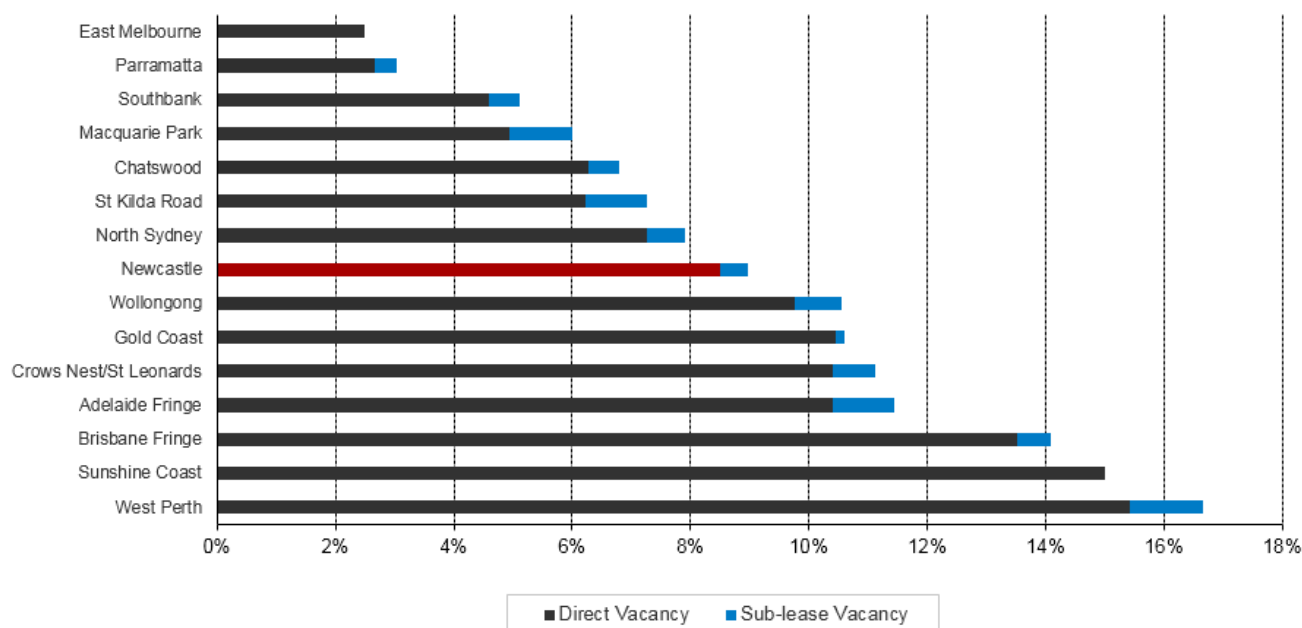
Whilst Newcastle is a relatively large market in comparison to other NSW regional markets (including Wollongong at 157,086 sqm), it is reasonably small in comparison to suburban Sydney markets including North Sydney (823,982 sqm), Crow's Nest/St Leonards (307,731 sqm), Macquarie Park (865,482 sqm) or Parramatta (705,416 sqm). In the 12 months to January 2017 the overall vacancy factor in Newcastle was 9.3% with A Grade at 6.4% down from 7.7% in January 2017.

Over the year prior to January 2018, overall net absorption within the Newcastle market place was 12,504 sqm with A Grade stock representing 2,236 sqm. Looking forward, there is 10,236 sqm of A-Grade office supply due to come online in 2018. This space comprises the fully precommitted Gateway 2 Project of Newcastle West. Newcastle City Council have committed to approximately 64% of this new development, reinforcing Newcastle West as the new office hub of the city.

Office Vacancy – non-CBD snapshot

The PCA report indicates Newcastle has the strongest performing office market of outside of Australia's capital cities, even outperforming several capital city CBD and fringe office markets. Newcastle's office market vacancy rate firmed to 9.0%, down from 10.3% in 2017, and is slightly stronger than the national average of 9.6%.

Non-CBD Total Vacancy Factor: January 2018



Stock withdrawals has helped bolster lower vacancy rates across C & D grade buildings, as many of these buildings have been or are in the process of being converted into residential developments. C-grade vacancy has 100 basis points to 10.4% as at January 2018, whilst D-grade vacancy has followed a similar trend reducing from 25% at January 2016 to 8.3% as at January 2018.

Comparison of Prime Office Rentals

The table below provides a comparison of Prime Office Rentals (defined as Premium Grade and A-grade stock) between non-CBD Sydney markets and regional markets including Newcastle and Wollongong:

Market	Average Net Face Office Rental (\$/sqm)	Average Net Incentive (%)
Parramatta	\$515	18.4%
Chatswood	\$480	21.9%
Crows Nest/St Leonards	\$525	24.6%
Macquarie Park / North Ryde	\$369	24.3%
Newcastle	\$375	15.0%
Wollongong	\$355	10.0%

*Knight Frank Research

Rental levels across the Newcastle market show a significant discount to their metropolitan counterparts. Average net face rentals across the Macquarie Park/North Ryde market are similar to that of Newcastle, however it must be noted that there is a large concentration of campus style office accommodation in this market.

Office Sales



7 Smith Street, Charlestown

Split level commercial building with good office fit-out and on-site parking for 16 vehicles. The property was taken to auction with a 5 + 5 year leaseback to Property NSW. The asset was purchased by a local private investor.

Tenure	Date	Price	NLA	Rate	Initial Yield	Core Yield
5 + 5 year leaseback to State Government	October 2017	\$2,425,000	557.3 sqm	\$4,351.33 per sqm	6.43%	6.43%



Cooks Hill Commercial Centre - 235 Darby Street, Cooks Hill

Cooks Hill Commercial Centre is anchored by Genesis Gym and is complimented by an additional 11 tenancies, occupying a mix of retail and commercial suites.

The property was marketed by Knight Frank Newcastle via a national Expressions of Interest campaign. The purchaser, a local syndicator, will extensively refurbish the accommodation to medical use.

Tenure	Date	Price	NLA	Rate	Initial Yield	Core Yield
Commercial and retail tenancies with 76.5% occupancy	Oct 2017	Circa \$22 mil	16,613 sqm	circa \$1,300 per sqm	6.6%	N/A



18 Honeysuckle Drive, Newcastle

Ground floor office suite within a new nine level twin tower, mixed use commercial / residential building constructed over a single podium.

Initial passing rental at \$191,062.50 per annum net being in addition to a concurrent, separate agreement for eight basement spaces at \$22,000 per annum net. Annual rental is reviewed at the greater of 3.25% or CPI.

The property was on the market for sale by Auction with the agent advising that there were four bidders participating in the Auction. We have been advised that the under bidder was fractionally below the final knock down price, also a local investor.

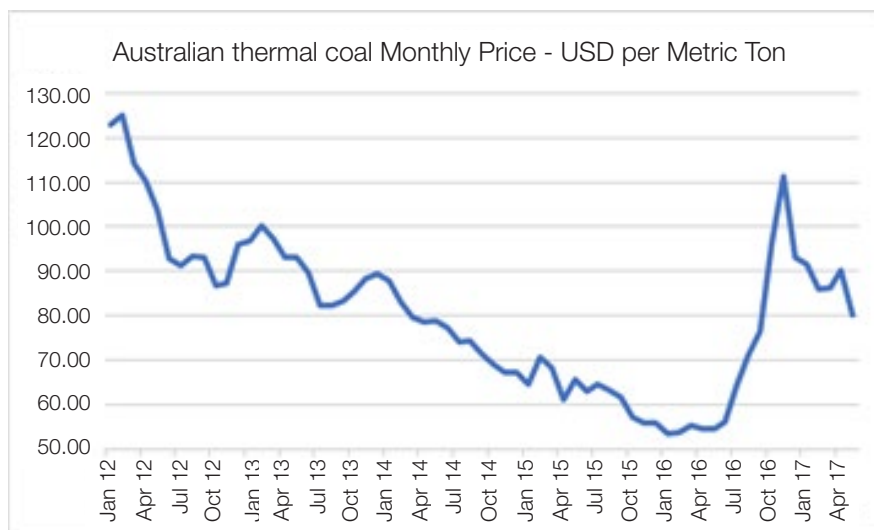
Tenure	Date	Price	NLA	Rate	Initial Yield	Core Yield
10 + 5 + 5 year lease to Colliers International	October 2017	\$4,600,000	509 sqm	\$9,037 per sqm	4.63%	4.63%

It has been reported that the Australian Taxation Office building at 98 Georgiana Terrace, Gosford has sold for \$47 million. This property is 97% leased to the Australian Taxation Office, and it is understood that the vendor will provide a five year rental guarantee over the remaining 3% of the accommodation which is currently vacant. The overall WALE of the property is 10 years. At a sale price of \$47 million this shows both an initial and core market yield of 6.44%, an IRR of 6.94%, and rate \$/sqm NLA of \$6,369 per sqm.

Industrial Market.

Record levels of investment in infrastructure, coupled with an uplift in commodity prices and residential construction has seen renewed confidence in the Newcastle industrial Property market.

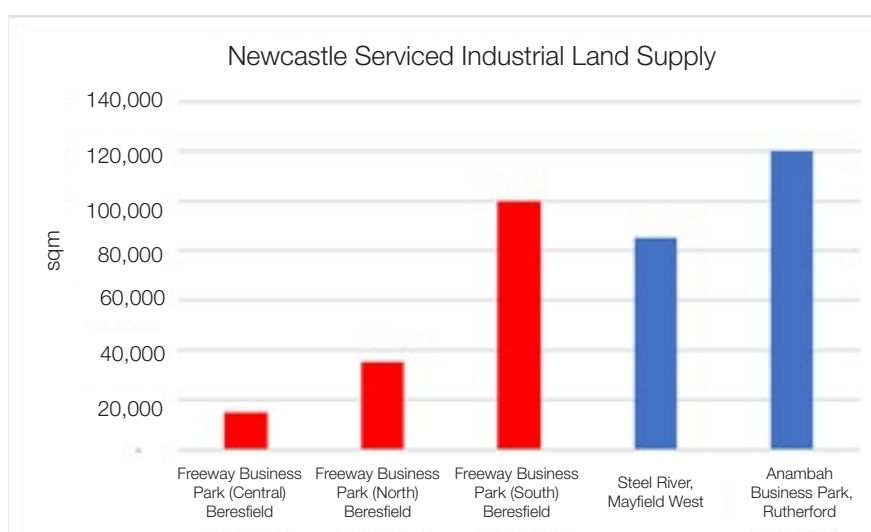
The significant surge in spot prices for coking coal as well as an improvement in thermal coal prices has markedly improved the profitability of existing Hunter Valley mines leading to growth and demand in leasing and sales activity in the first half of 2017.



The Yancoal purchase of Rio Tinto's Hunter Valley coal, rail and port assets for \$US2.45 billion (\$3.25 billion) signals improving conditions for the coal mining sector, the traditional engine of the Newcastle and Hunter economy.

Industrial Supply

The supply of serviced industrial land is limited in the Newcastle market. The vast majority of existing supply is concentrated in the Freeway Business Park Precinct (~150,000 sqm) with a further approximately 120,000 sqm of industrial land available in the Anambah Business Park at Rutherford.



The general shortage of large scale developed industrial land in the Newcastle area is anticipated to continue with only the Hunter Economic Zone (HEZ) precinct, Beresfield and Tomago having large tracts of zoned but undeveloped land. HEZ is located in the Cessnock LGA, near the small village of Pelaw Main, approximately 40 kilometres west of the Port of Newcastle. This development is still constrained by environmental aspects and development within the area has been protracted and was sold by receivers to a Sydney based developer who is looking to sell and develop large industrial facilities. The remainder of Tomago, being a very large holding offers the greatest flexibility to meet demand for industrial sites, is within a flood liable area and requires substantial fill and services to permit development.

Industrial Demand

The demand for industrial Property is largely being led by owner-occupiers due to the historically low interest rate environment, improved confidence in the region and the ability for self-managed superannuation funds to invest into industrial Property. This activity has largely been concentrated to the sub \$1.5m price bracket, however it has also been prevalent across assets above \$2m. Thus, the market has witnessed an uplift in values for properties sold with vacant possession.

Similarly, investor demand for industrial Property has strengthened. A lack of supply of assets with good quality lease covenants has seen yields compress, as evidenced by the recent sale of 16 Channel Road, Mayfield West which was sold on a yield 7.9% (\$3.65m) with an 5 year lease Instant Access Australia Pty Limited. The institutional investment market for industrial assets has also been strong with the acquisitions by Industria REIT of the Westrac facility and Sentinel Property Group of the Austube Site.

Industrial Rents

Improved confidence in the mining sector, coupled with strong residential construction activity has seen enquiry and transaction volumes increase in the leasing market. In a reversal of trend from 18-24 months ago, there is very little available stock of >1,000 sqm available for lease in the current market. Landlords are now only experiencing leasing downtime periods of 3-9 months whereas in 2014/15 vacancy periods were much longer for larger facilities, generally between 18-36 months.

On the back of this strengthening leasing activity, the market has witnessed increased construction activity for industrial buildings with new purpose-built facilities recently constructed for Mainfreight, Hardy Spicer and FLSmith.

Precinct	Warehouse Net Rent \$/m ² pa (>500m ²)	Office Component Net Rent \$/m ² pa
Beresfield/Thornton	\$95 - \$120	\$125 - \$175
Cameron Park	\$100 - \$125	\$150 - \$200
Mayfield West	\$100 - \$125	\$150 - \$200
Cardiff	\$100 - \$125	\$150 - \$200
Rutherford	\$85 - \$100	\$120 - \$150

*Knight Frank Research

Industrial Sales



15 Kilcoy Drive, Tomago

A modern freestanding industrial building comprising ground floor office, mezzanine, high clearance warehouse with 3 x roller doors and concrete on-site parking. GBA of 1,980 sqm on a site of 4,316 sqm.

The property was sold after auction to a Sydney based private investor.

Tenure	Date	Price	GLA	Rate	Initial Yield	Core Yield
Sold with 3 year lease in place	November 2017	\$2,200,000	1,980 sqm	\$1,111 per sqm	8.86%	8.68%



4 Channel Road, Mayfield

Comprises a modern industrial facility with a warehouse and two level office facility. The warehouse has multiple roller doors, covered loading areas and high clearance. The property has exposure to Industrial Drive, providing a high profile.

Property sold with 8 year lease to Bulbeck Holdings Pty Ltd. Rent advised to be at \$460,000 pa net and commencing at settlement of the sale.

Tenure	Date	Price	GLA	Rate	Initial Yield	Core Yield
Sold with 8 year lease in place	July 2017	\$6,140,000	3,789 sqm	\$1,620 per sqm	7.49%	7.49%



16 Channel Road, Mayfield West

Positioned within the Steel River Industrial Estate, the subject property benefits from direct access to major arterial roads leading to Sydney, the North Coast and the Upper Hunter Valley.

The property is leased to Instant Access Australia Pty Limited on a five year lease due to expire in 2022.

The property was sold via Private Treaty to a Sydney based private investor.

Tenure	Date	Price	GLA	Rate	Initial Yield	Core Yield
Sold with a 5 year lease in place	January 2018	\$3,650,000	3,042 sqm	\$1,199 per sqm	7.9%	7.9%

Retail Market.

Stockland Green Hills has recently completed a \$414 million redevelopment which will see the centre more than double in size from approximately 33,000 sqm to 72,000 sqm.

The redevelopment features David Jones, Target plus Big W, Coles and Woolworths, 12 mini-majors including Harris Scarfe, Best & Less and JB Hi-Fi and over 210 specialty and kiosk retailers as well as international fashion retailer H&M. The centre also comprises a dining and entertainment precinct featuring a 7 screen 900 seat HOYTS Cinema with 2 Xtremescreens, a strong fresh food offer and a refreshed fashion and retail services mix.

Total car parking in the redeveloped centre has increased from 1,500 spaces to over 3,100 spaces.

[Stockland Greenhills fly-through](#)



There has been limited institutional transactions (>\$10m) in the local market with the exception of Elmore Shopping Centre, a Convenience Centre located in the western suburbs of Newcastle, in close proximity to John Hunter Hospital. The Centre is anchored by a Ritchies IGA Supermarket (2,448m²), supported by some 17 specialties, 4 ATMs and a pad site car wash. Adjoining the site to the west are two detached freehold parcels (currently leased on monthly agreements), each improved with a basic residential dwelling. A signed AFL is issued over these adjoining parcels for the construction and operation of a service station (subject to achieving council consent). The IGA gross rent reflects \$330/sqm per annum with the Centre currently reporting a passing net annual income of \$1,179,622 per annum. Overall the asset sold 91% leased and reflecting a WALE of 5.7 years by income and area.

Investment activity in the large format retail sector continues to remain strong as favourable underlying fundamentals encourages a weight of capital into the sector. Similarly, in recent years owners of large format retail centres have diversified their tenancy mixes to accommodate a broader range of retailers including those not normally associated with large format centres including gyms and child care centres. As a result, this has reduced leasing risk given the larger pool of prospective tenants once vacancies arise.

On the Central Coast, Tuggerah Central - a modern, single storey Large Format Retail complex, comprising three freestanding buildings, transacted in October 2017 for \$10.8m. This asset previously traded for \$7.54 million in early 2016 with significant vacancy of approximately 40%. Ozdesign and Tuggerah Tiles have since committed to the complex, boosting the passing income to \$720,334 pa.



Elmore Shopping Centre, Elmore Vale

We understand the Centre was in Due Diligence with another party at a higher purchase price prior to this transaction, however failed to proceed to execution. Discussions with the selling agent indicate the original offer reflected a core market yield ~7.25%.

Date	Price	GLA	Initial Yield	Core Market Yield	IRR	Rate
September 2017	\$17,375,000	4,049 sqm	6.79%	7.68%	8.61%	\$4,291 per sqm



Tuggerah Central, Tuggerah

The Property was sold via an Expressions of Interest campaign with the purchaser being a Sydney based private investor.

Date	Price	GLA	Initial Yield	Core Market Yield	IRR	Rate
October 2017	\$10,800,000	4,118 sqm	6.67%	6.67%	7.69%	\$2,622 per sqm

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