RESEARCH & CONSULTING

WOLLONGONG INSIGHT

JULY 2017

GROWTH DRIVERS | DEMOGRAPHIC TRENDS | MARKET OUTLOOK

KEY FACTS

With a current population of 211,213 persons, the Wollongong LGA is expected to **grow to 244,400 persons by 2036.**

Gross Regional Product (GRP) was estimated to be **$12.34 billion** as at 2016 **for the Wollongong LGA**, representing 61% of the Illawarra region's GRP.[1]

Off the back of new business entrants and the expansion of existing businesses, **employment growth in the Wollongong LGA measured 1.5% in the year to March 2017,** well above the 0.5% recorded for NSW.[2]

Wollongong CBD is projected to experience jobs growth of 3,773 over the next 20 years. 72% of these jobs are anticipated in white collar industries, equating to office demand of circa 54,280m².[3]

Office demand has been focussed on the A-grade market where the vacancy rate currently measures 5.6%. With the SES moving into their new premises in mid-2017, the A-grade vacancy rate is expected to fall to sub 1% thereafter.

Both office and industrial assets remain tightly held despite significant levels of available capital in the market. Elevated yield metrics when compared to Sydney has been the primary driver behind solid investment demand.

WOLLONGONG IN CONTEXT

Located 80 kilometres south of the Sydney CBD, the major port locale is transitioning to a more diverse industry base from its historic heavy industrial roots. A supportive business environment, underpinned by knowledge services, advanced manufacturing, trade and logistics, alongside increasing infrastructure spend and connectivity improvements, is positioning Wollongong for growth.

The New South Wales economy continues to strengthen, fuelled by the State Government's fiscal management which has recorded a $4.5 billion surplus for 2016-17, with an anticipated budget surplus of $2.7 billion for 2017-18. Infrastructure spend has long been considered a blight on the growth of the State however the NSW State Government's plan to spend $72.7 billion on infrastructure works over the next four years is set to be the catalyst for further economic activity. In addition, the Federal Government has committed to an $18 billion infrastructure package for NSW over the next seven years.

Infrastructure

At an Illawarra-Shoalhaven regional level the NSW government has committed $137 million in 2017-18 for upgrades to the Princes Highway, including $35.5 million to complete the Foxground and Berry bypass and $19 million to start building the upgrade between Berry and Bomaderry, to be complete by 2021. This investment forms part of an overall four-year Princes Highway spend of $789.9 million. The budget infrastructure statement also highlighted $17.3 million in 2017-18 for planning and preconstruction for the Albion Park Rail bypass, in addition to the Commonwealth spend for the Albion Park Rail bypass of $52.5 million over eight years. On top of these projects announced in the various budgets, the 1.3 km West Dapto road link has progressed and is now under construction. Funding for the circa $90 million project has been split three ways, supported by the NSW Government ($22.5 million) and the Federal Government ($10 million), with the remainder funded by the Wollongong City Council. The road link is anticipated to open in 2020.

FIGURE 1
Data Dashboard
Wollongong and the Illawarra in context

Source: ABS, REMPLAN, NSW Ports

Whilst these infrastructure projects will have significant implications on a broad mix of industries and the general population, for real estate markets, these projects will ultimately shape and determine the direction and magnitude of demand for expansion and additional space in key markets, be it office demand in the Wollongong CBD or industrial space across the Illawarra region.

Education Precinct Regeneration and Innovation

Together with the Commercial Core, Health Precinct and connecting neighbourhoods the Education Precinct forms part of an important network of well -connected economies and partnerships across the city. The University of Wollongong (UoW) campus plays an important role in the economic, social, cultural and creative success of the city and provides a major hub for employment in the region. The University generates more than $2 billion in economic activity each year, and has aided the transformation of Wollongong from an industrial town to a university city focused on the knowledge economy.

A refreshed University Strategic Plan 2016-2020 has been developed to guide the future direction and planning for the University. To achieve the University's goal of being a global top 1% teaching and research university, UoW has set out a strategy to grow student numbers at the Wollongong Campus by 3,000 over the next 20 years. Accommodating this number of students will require approximately 80,000m² of additional floor space. To ensure that the physical environment responds to changing academic and research needs, and a growing student population the Strategic Plan sets out capital expenditure plans which will release in excess of $300 million within the next five years.

Commercial Core and Health Precinct

As part of Wollongong's urban evolution, the commercial core is undergoing a significant transformation. Over the past four years, the city centre has seen in excess of $1.3 billion worth of investment in major development projects either completed or currently under construction, with a further $300 million of development proposed (Source: Advantage Wollongong). Major projects which have recently completed as part of this investment include a $200 million upgrade to Wollongong Central by GPT. The redevelopment included an additional 18,000m² of specialty stores, a new supermarket, department store and 650 car spaces. A further $93 million has been invested by GPT, as it works with department store David Jones in developing the second of their new concept food-halls, scheduled for 2017.

In addition to the major retail investment by GPT, the upgrades of Wollongong Public and Private hospitals, with a combined investment total of $234 million, has added to Wollongong's strength as a medical, health, teaching and specialist referral centre.

Land Releases and Residential Buoyancy

A number of large subdivisions and land releases are currently ongoing within close proximity to Wollongong, which will provide further demand for goods and services. The West Dapto Urban Release Area is about to experience land releases allowing for an additional 19,500 new dwellings, creating around 8,500 jobs. The West Dapto Master Plan has been prepared to guide the development of the release area over the next 30+ years. Calderwood Valley, a 609 hectare land subdivision, is currently underway and is anticipated to provide around 4,800 homes for nearly 12,500 residents. The project will inject an estimated $2.9 billion into the local economy during the 20 year construction period.

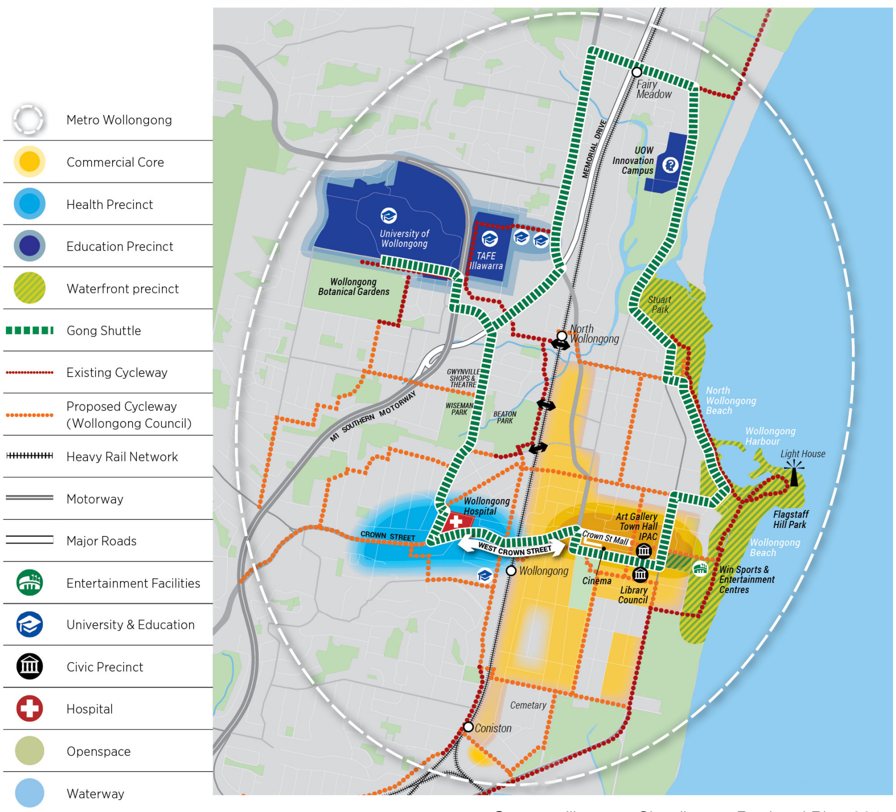
The land releases come off the back of strong house and apartment price growth across the Wollongong suburb (postcode 2500) which encompasses the majority of the above-mentioned precincts. In the four years since May 2013, the median house price has increased by 62% to reach a new peak of $907,000 (Source: Residex). Consistent with the Greater Sydney region, apartments in Wollongong have increased by 55% over the same period, to reach a median value of $570,000. Growth in apartment values coincides with developer confidence, as a number of apartment developments have recently been built or planned within the city centre and wider region.

Although the median value for both houses and apartments have grown significantly they still provide an attractive alternative option for residents, especially first home buyers, priced out of Greater Sydney. The NSW Government's July 2017 package to improve housing affordability which focused on helping first home buyers, by abolishing stamp duty on all homes up to $650,000 and giving stamp duty relief for homes up to $800,000, will only intensify the interest in the Wollongong residential market as a Sydney alternative.

MAP 1

Metro Wollongong —Distinct Sector Precinct's

Wollongong comprises distinct precincts – health, education, the commercial core, and the waterfront



Source: Illawarra-Shoalhaven Regional Plan 2015

LOCAL MARKET DEMOGRAPHICS

Once driven by retirees and downsizers from Sydney, population growth in Wollongong has seen a significant turnaround over the past decade. Notably, recent population gains have come off the back of a restructure and expansion of the local economy which has led to jobs growth in key emerging sectors. Historically, population growth in Wollongong was weak as young adults in their late teens and twenties moved to Sydney in search of employment and educational opportunities. However, a more diverse employment base, coupled with the promotion of the University of Wollongong as a top tier university, has stemmed the flow of young adults in recent years.

Population Growth

As at June 2016, the Wollongong LGA had a total resident population of 211,213 persons (Source: ABS, ERP data - official population estimates), making it the most populous LGA in NSW outside of Sydney. From a growth rate perspective, population growth in the Wollongong LGA has increased by 1.0% per annum over the past decade.

In line with a pick-up in apartment construction and continued growth in university enrolments, the central suburbs of Wollongong have experienced the greatest growth in population, increasing 2.1% per annum on average over the past two years. Similarly, residential subdivisions to the west of the Princes Highway has led to population growth of 1.8% per annum over the past two years in the Figtree - Keiraville SA2 region.

Age Structure

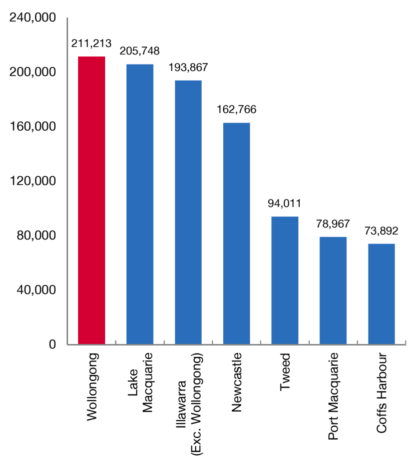
By age, Wollongong's age profile is on par with both state and national averages. With the University of Wollongong being a highly regarded university, population growth amongst the 20-34 year age cohort has been solid, increasing 1.7% over the past year. In 2015, there were 17,739 full-time students enrolled at the University of Wollongong, up 30% over the past decade (Source: Dept. of Education). With 25% of full-time students enrolled at campuses in Wollongong being from overseas, students have provided a key source of Wollongong's population growth.

Similarly, with the region being a popular retiree destination, particularly from downsizers migrating from Greater Sydney, population growth for persons 65+ has been significant. Over the past decade, persons aged 65+ increased by 2.1% per annum on average while more recently has increased to 2.3% over the past 12 months, reflecting a pick-up in downsizer demand and ageing of the local resident base.

FIGURE 4

Population by Major Non Sydney LGAs

June 2016



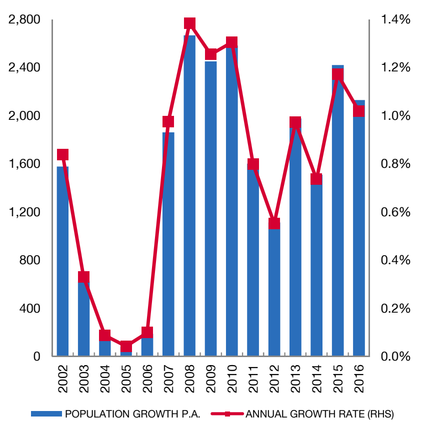
Source: Knight Frank Research, ABS

Looking ahead, strong population growth is expected to continue, underpinned by a greater volume of Sydneysiders relocating to the area in search of more affordable accommodation and sustained growth in students attending the University of Wollongong. Utilising NSW Government projections, the population of Wollongong is expected to grow by 16% between 2016 and 2036, at which point 244,400 persons are expected to reside in the Wollongong LGA.

FIGURE 2

Wollongong LGA Historical Population Growth

Population Number and Growth Rate

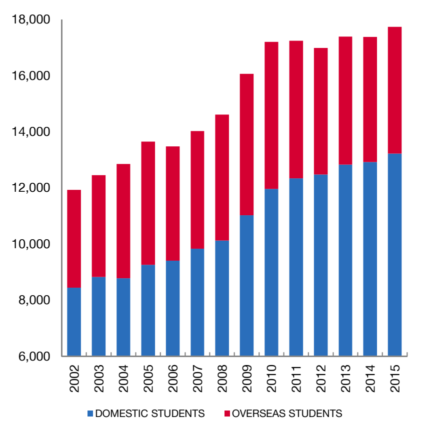


Source: Knight Frank Research, ABS

FIGURE 3

Wollongong Full-time Student Enrolments

Wollongong Campus, 2002-2015

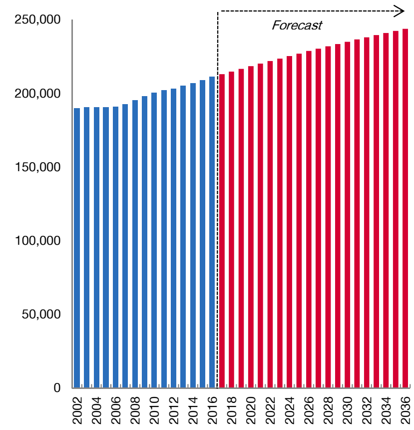


Source: Knight Frank Research, Dept. of Education & Training

FIGURE 5

Wollongong LGA Population Growth Projections

2002-2036



Source: Knight Frank Research, NSW DP&E, ABS

OFFICE MARKET

Office Market Fundamentals

Notwithstanding economic headwinds to the broader Australian economy and volatility in financial markets, New South Wales continues to experience favourable economic conditions underpinned by elevated housing and infrastructure investment and a buoyant labour market. The latter has been the catalyst behind the marked improvement in the Wollongong office market which has led to the entry of new businesses and expansion of existing office tenants.

In the 12 months to March 2017, employment growth in the Wollongong LGA totalled 1.5% (Source: Dept. of Employment), triple the rate recorded for NSW over the same period (0.5%). However, over the past six months employment growth in Wollongong has eased in line with the NSW labour market. On a longer term basis, the total number of jobs in the Wollongong LGA has increased by 18.0% over the past five years, more than double the 7.6% recorded for NSW over the same period.

Reflecting the improved employment fundaments has been local business confidence. As per the Illawarra Business Survey (IRIS) for March 2017, trading conditions for businesses within the Illawarra were up a net 23%. Similarly, a net 6% of local businesses reported high levels of profitability - the best result in a decade. With expectations that local businesses will experience improved trading conditions over the next 12 months, higher employment levels are anticipated which will continue to flow through the Wollongong office market.

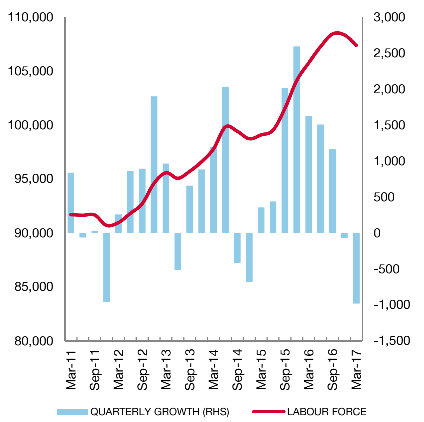
Local Business Profile

Reflective of the local economy, the Wollongong CBD is characterised by a diverse range of business types. As at June 2016, there were 3,338 businesses operating in the Wollongong CBD (Wollongong East & West SA2s), 59% of which were in industries which require office space.

Of the white collar businesses, 62% are small to medium enterprises and underpins the demand for smaller office suites in the CBD. For those white collar businesses which employ workers, professional services represents 35%, followed by health care (25%) and financial and insurance services (14%).

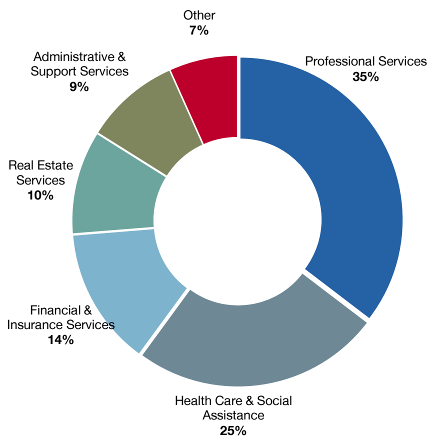
Notably, the number of office based businesses in the Wollongong CBD has increased 4.4% over the past two years. It has been this growth that has led to a improving fundamentals in the office market as additional businesses require office space.

FIGURE 6
Employment & Employment Growth
Wollongong LGA, Smoothed Data



Source: Knight Frank Research, Dept. of Employment

FIGURE 7
Wollongong Business Profile
Employing and White Collar Businesses, June 16



Source: Knight Frank Research, ABS

Wollongong has a significant presence of Government departments and spans across all tiers of Government. By LGA, Wollongong has the fourth largest presence of Government workers in NSW at 14,042 (2011), only behind the Sydney CBD, Parramatta and Newcastle and represents 19% of all jobs in the LGA. By tier, the bulk of Wollongong's Government jobs are located at the State level (61%), while a further 31% are at the Federal level. Government representation in the Wollongong includes NSW Office of Fair Trading and the Australian Electoral Commission at 43 Burelli Street, Office of State Revenue at 90 Crown Street and the ATO at 45-53 Kembla Street.

Office Stock & Supply

Office space in the Wollongong CBD is provided through a number of dedicated stand alone office buildings and shared main street office formats in conjunction with retail and other uses. As at January 2017, Wollongong had 154,119m² of office space, almost half (48%) of which was A-grade office space.

Over the past 12 months there has been no new office supply added to the Wollongong office market which has begun to place downward pressure on the availability of vacant office stock over the period. The latest office building to be constructed in the market was the completion of the ATO building at 45-53 Kembla Street in late 2013 (6,660m²).

With recent evidence suggesting gross face rents have started to push $520/m² in a selected basket of buildings, developer interest in the area is expected to increase as new projects become more feasible.

Over the next two years, the supply pipeline across Wollongong is limited with additions expected to stem solely from mixed use developments. In the longer term pipeline there are numerous projects which have the potential to be added to the market, however, their timing remains unknown and are dependent on pre-commitments. Notably these projects include 134-148 Keira Street (5,200m²), 29 Denison Street (20,000m²) and a recently mooted project at Langs Corner (Cnr Crown and Kembla Streets) for a 13,000m² office tower.

Vacancy & Demand

A return to more favourable economic conditions and a more buoyant labour market has placed downward pressure on the Wollongong vacancy rate. As at January 2017, the office vacancy rate in Wollongong measured 11.2%, down from 12.2% a year prior. Tenant demand across the market over the 12 months to January totalled 1,610m². Notably, tenant demand stemmed solely from the A-grade market (2,170m²), while a flight to quality saw tenant demand within the secondary market contract (-560m²).

With tenant demand being focussed on the A-grade market as tenants take advantage of favourable rental and incentive metrics, the divergence in vacancies between the A-grade and secondary market within Wollongong has widened to its highest level since 2012. At January 2017, the vacancy rate in the A-grade market measured 5.6%, down almost 3% from 12 months prior and well below the 16.4% recorded for the secondary market. Historically, the A-grade vacancy rate has been extremely tight, averaging 0.7% in the six years to January 2013. However, the completion of the current ATO building (45-53 Kembla Street) in 2013 and their subsequent backfill space at 93 Burelli Street led to a sharp rise in the vacancy rate thereafter. With the State Emergency Services (SES) occupation of the former ATO building in mid-2017, the A-grade vacancy rate is expected to return to sub 1% levels by January 2018.

The outlook for the vacancy rate in the secondary market is less encouraging. However, new tenants seeking space will be directed to secondary buildings to secure space given the lack of A-grade stock available for lease. An accelerated recovery could occur if a number of underutilised secondary buildings are withdrawn for alternative uses.

From a tenant demand perspective, jobs growth in industries which utilise office space is set to total 2,714 within the Wollongong CBD over the next 20 years (source: BTS). Based on an office density ratio of 20m² per worker, this equates to 54,280m² of office space demand over the next two decades.

Rents and Incentives

The lack of available leasing options in the Wollongong A-grade market is beginning to flow through to rents with a select basket of buildings achieving rents approaching $520/m² gross. More broadly however, A-grade gross face rents in Wollongong average $445/m² ($400-$480/m²).

Although being very asset and owner specific, incentive levels range between 5% and 15% with A-grade space being at the lower end of this range.

Even with recent upward pressure on rents in Wollongong, they remain well below major non-CBD Sydney office markets. With these markets experiencing significant rental growth over the past two years, coupled with a tight A-grade market in Wollongong, a pick-up in rental growth is forecast over the next two years and should prompt the progression of new developments, if tenant pre-commitments are secured.

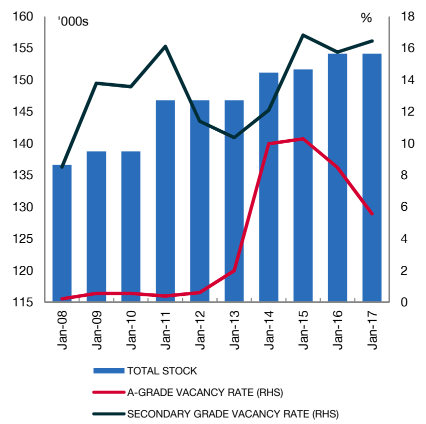
Sales and Investment Activity

With an increasing number of buyers becoming priced out of the Sydney and major metro markets, a growing number have turned their attention towards non-metro and large regional markets, attracted by the higher yields metrics on offer. Investor demand in the Wollongong office market remains strong, albeit volumes have been restricted as a result of assets being tightly held. In 2016, office sales in Wollongong totalled $58.9 million and represented the highest annual total since 2013.

The largest sale to occur in 2016 was the August acquisition of 90 Crown Street for $43.9 million. Purchased by Castlerock Property Group from Centuria, the sale represented a record high price for an office asset in Wollongong and a premium to the $30.7 million it sold for in 2005. Anchored by the Department of Human Services and Roads & Maritime Services, the 7,468m² building was sold on a passing yield of 8.3%.

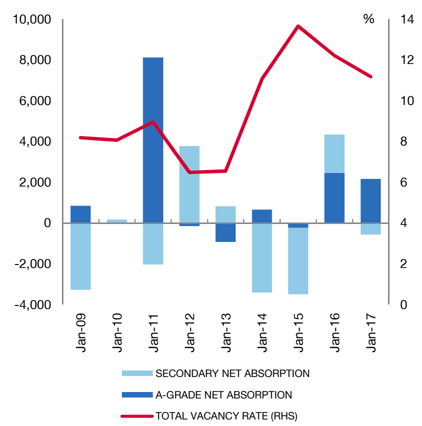
In light of recent transactions, average core market yields have firmed by an estimated 50 basis points over the past 12 months depending on the quality of the building and leasing covenants attached. On average, core market yields broadly range from 8.0% to 8.75% for prime and 8.75 to 9.5% for secondary assets.

FIGURE 8
Wollongong Office Stock & Vacancy Rate by Grade
2008-2017



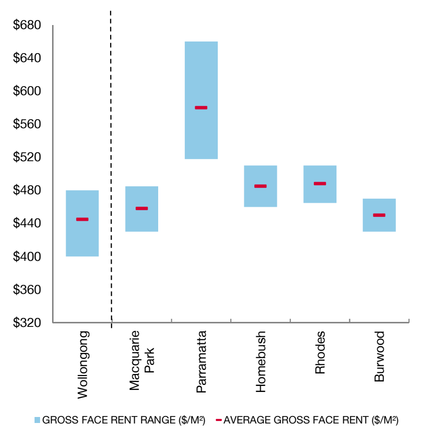
Source: Knight Frank Research, PCA

FIGURE 9
Wollongong Net Absorption by Grade & Total Vacancy
12 months to January, 2009-2017



Source: Knight Frank Research, PCA

FIGURE 10
Average A-Grade Gross Face Rents
Wollongong Vs Selected Major Non-CBD Sydney Office Markets ($/m²), January 2017



Source: Knight Frank Research
*Ranked in terms of office market size

INDUSTRIAL MARKET

The regional NSW industrial market is currently experiencing a period of growth. Heightened by the favourable conditions currently being experienced in the Sydney industrial market, a growing number of buyers are looking further afield for investment opportunities.

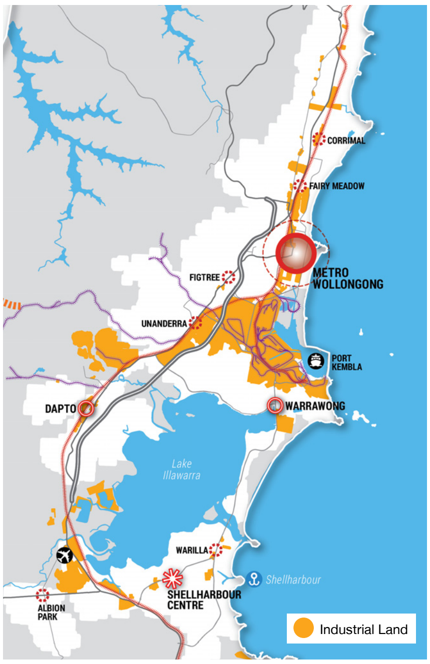
Across the Illawarra manufacturing is one of the largest sectors in the region employing over 11,600 people, with around 75% based in Wollongong. With industrial take-up and locational preferences for businesses heavily influenced by port related activities, industrial space in the Wollongong region is primarily located around Port Kembla, Unanderra and Wollongong (see Map 2). Outside of these areas, industrial activity is scattered, although with a focus along the Princes Highway, to the west and south west of Lake Illawarra.

Development & Port Related Activities

Most of the industrial development activity in the Wollongong regional market has been driven by small bay warehouse and business park style complexs dominated by self managed super fund (SMSFs) purchasers and owner occupiers.

It is anticipated that future industrial development will be centered on the Port as its strategic significance grows alongside activities related to logistic industries. According to the NSW Ports *Navigating the Future Master Plan* report over the next 30 years, Port Kembla's role in supporting NSW's mining, agriculture, manufacturing and construction industries is forecast to grow and strengthen. The report expects Port Kembla to continue to be NSW's largest motor vehicle import hub and bulk grain export port over the next 30 years and will handle an increasingly diverse range of dry and liquid bulk products over this time period. Resulting from increased activity the Port will become NSW's second container port, due to its connectivity to regional NSW and proximity to major growth areas in Sydney's south-west.

MAP 2
Wollongong Major Industrial Precincts



Source: Illawarra-Shoalhaven Regional Plan 2015

Rental Levels

Over the past 12 months the rise of online retailing has boosted demand for warehousing, transport and logistics facilities across Sydney and in other pockets of NSW. Leasing demand is expected to gain further momentum during 2017 resulting from local employment growth and the positive overflow demand from Sydney, where vacancy is at the lowest levels on record, as at July 2017, and where Prime and Secondary net rents have increased by 9% (total growth) over the past three years. At present, industrial net rents in Wollongong broadly range between $115-$140/m² for A-Grade premises and $80-$115/m² for secondary options.

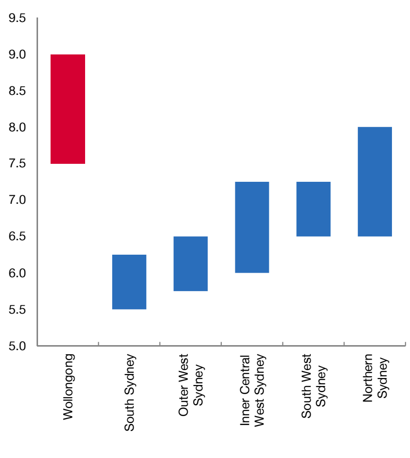
Investment & Yields

Investor demand for industrial assets across the Wollongong region has remained strong over the over the past 12 months, with the low interest rate environment, improving economic confidence and high yield metrics on offer in comparison to Sydney real estate being the primary drivers. This is underpinned by the most recent $22.632 million July 2017 sale of 9 Durgadin Drive, Albion Park Rail. The complex, located on a site of 31,500m² was acquired by a private investor from Sydney, on a sale and leaseback basis, reflecting an initial passing yield of 8.5%. The 13,800m² prime industrial complex built in 2009, was sold with a WALE of 8 years (by income).

Another significant deal which reflected the demand from private investors was the June 2016 sale of 185 Berkeley Road, Unanderra for $7.625 million. This 100% leased 1.56 ha site, which comprised a mix of logistics, industrial, bulky goods and office tenancies across three modern buildings, and anchored by StarTrack Express and Lawrence & Hanson and Global Coffee, being the largest sale transacted in Unanderra.

At present, average core market yields range from 7.5% to 9.0% for A-Grade assets, however, upper prime assets with long WALEs are trading below this range as investors are still principally focused on assets with long term rental security and by strong lease covenants. Secondary assets are requiring an elevated risk premium and average core market yields currently range from 9.0% to 11.0% depending on location and quality.

FIGURE 11
Average A-Grade Industrial Core market Yields (%)
Wollongong Vs Sydney Industrial Regions, June 2017



Source: Knight Frank Research

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The Illawarra-Shoalhaven area includes the four local government areas (LGAs) of Kiama, Shellharbour, Shoalhaven and Wollongong.

Abbreviations & Glossary:
Core Market Yield: The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc.)

Sources:
[1] Remplan Economy—Wollongong City Council Economy Profile
[2] Department of Employment—Small Area Labour Market Publication
[3] Bureau of Transport Statistics (BTS)

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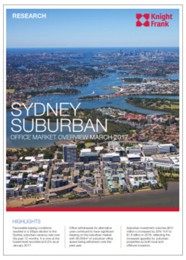

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