

NEWCASTLE INSIGHT

SEPTEMBER 2015



Key Findings

Population growth in Newcastle expected to average 1,770 persons per annum between 2014 and 2031

Gross Regional Product (GRP) was estimated to be \$14.23 billion as at 2014, significantly above other major regional NSW centres

Diverse economy - no single industry contributed more than 12% to GRP. As at 2011, the LGA supported 88,175 jobs, accounting for 44% of total jobs within the Lower Hunter region

Newcastle CBD is set to experience jobs growth of 7,841 over the next 20 years. 60% of these jobs are anticipated in white collar industries, equating to office demand of circa 80,000m²

Office demand has been concentrated in the A Grade market where the vacancy rate is currently 2.7%, making it one of the tightest A Grade markets in the country

Although a thinly traded investment market, the **most recent A Grade office transactions recorded core market yields of sub 8%**

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.

HIGHLIGHTS

Home to a significant and diverse employment base, Newcastle is the strategic and economic centre for the Lower Hunter, accounting for the bulk of the region's white collar and administrative workforce. Its proximity to the broader region through significant road and rail networks including the new Hunter Expressway, coupled with its strong ties with Asia through the Port of Newcastle makes Newcastle a logical choice for economic investment.

The Newcastle economy has undergone significant structural change over the past two decades transitioning from a manufacturing based economy towards higher order service industries such as health care, professional services and education. Subsequently, local office demand has been boosted, particularly within the A Grade office market where the vacancy rate is amongst the lowest in the country at 2.7%, compared with an Australian non-CBD A Grade average vacancy of 8.0%.

Looking ahead, the CBD is entering a period of revitalisation, underpinned by government funding as part of the Newcastle Urban Renewal Strategy, infrastructure development, and a growing population base. This changing CBD landscape will inevitably strengthen demand for employment space. With tenant demand expected to remain focussed within the city's A Grade stock, moderate downward pressure on the vacancy rate is anticipated, as only a limited number of new office projects are planned.

From an investment perspective, only a handful of sales have occurred in recent years, which reflects a lack of available assets being offered to the market rather than weaker demand. With non-CBD assets trading at a large discount in comparison to those positioned in core CBD locations, we expect considerable firming in office yields over the next two years as investors move up the risk curve.

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INTRODUCTION

NEWCASTLE IN CONTEXT

Newcastle is the capital of the Hunter region, the second largest city in New South Wales (NSW) and one of Australia's largest regional economies. Located 160km north east of Sydney the area is home to The Port of Newcastle, which is the economic and trade centre for the resource rich Hunter Valley and for much of the north and northwest of NSW. The Port of Newcastle is the world's largest coal export port and is one of Australia's largest ports by throughput tonnage. Reflecting increasing global demand, a record 164.3 million tonnes of trade was handled by the Port of Newcastle in 2014, an annual increase in port trade of 5.3%.

Accessibility to Newcastle is also increasing with the opening of The Hunter Expressway to traffic in March 2014. The expressway has improved travel times for motorists between Newcastle and the Upper Hunter and has improved journeys across the broader network.

Furthermore, in a boost to Newcastle and the wider Hunter region, Stage 1 of the

Newcastle Airport expansion was completed in February 2015. Having already seen total passenger movements increase by close to an average of 10% per annum over the past 10 years, the 2,600m² extension to the existing terminal building has created a new arrivals hall and provides a dedicated area for permanent customs, immigration, and quarantine facilities in readiness for potential international services. The formal completion of Stage 1 means Newcastle Airport is able to discuss future direct international services to and from Newcastle without infrastructure being a barrier. The entire project is expected to be completed in late 2015.

Visitor expenditure is increasingly important across Newcastle and the Hunter impacting a number of sectors in the economy. According to the *Newcastle Destination Management Plan (2013)* visitors inject \$722 million of direct expenditure into Newcastle's economy contributing to almost \$1.3 billion of indirect expenditure across sectors including retail, transport and education. In Newcastle, the visitor economy directly and indirectly contributes to over 10,000 jobs.

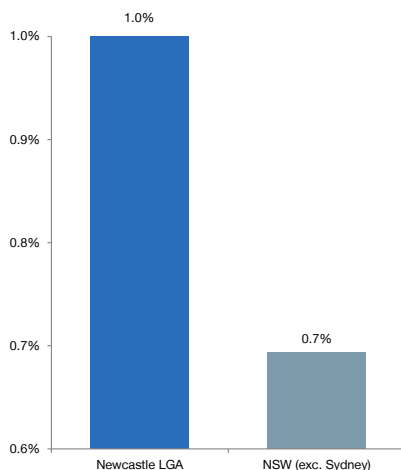
MAP 1

Newcastle's Strategic Location

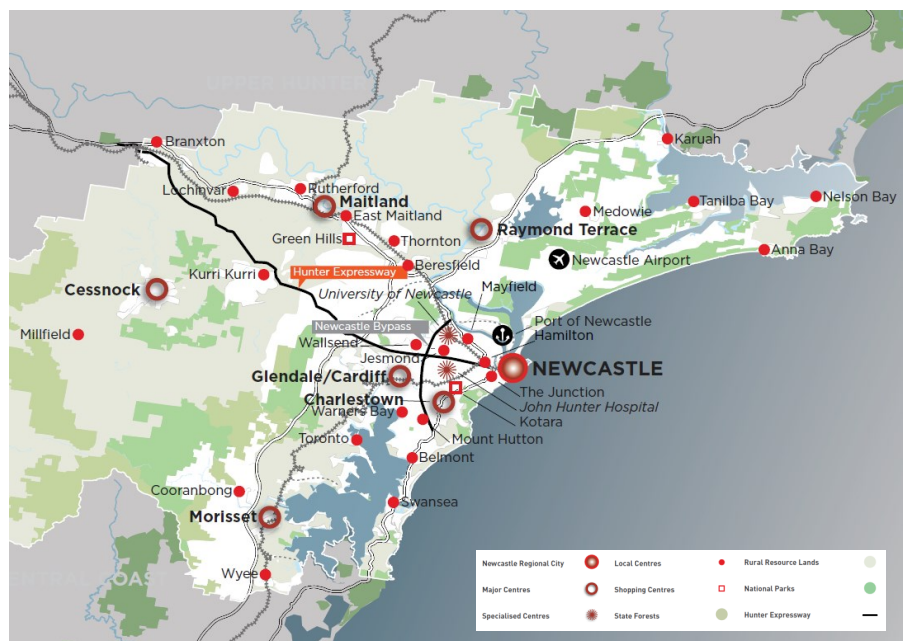
Newcastle's position makes it a natural value-adding, services and distribution point

FIGURE 1
Annual Projected Population Growth Rates

2011 - 2031



Source: NSW DP&E, Knight Frank Research



Source: NSW Government

FUTURE GROWTH DRIVERS

CITY CENTRE REVITALISATION

In 2013, on the basis of the strategic directions outlined in NSW Government's Newcastle Urban Renewal Strategy, the NSW Government committed \$460 million to revitalise the Newcastle city centre. The Newcastle Urban Transformation and Transport Program has been established to deliver this commitment.

This Program seeks to "revitalise the Newcastle city centre by strengthening connections between the city and waterfront, creating employment opportunities and delivering new transport connectivity". This program comprised of three elements:

- The introduction of a new light rail system linking Wickham to Pacific Park
- The activation of Hunter and Scott Streets linked to the delivery of light rail
- The urban transformation of surplus government lands, the delivery of housing, and the delivery of improved public domain, including parks, entertainment precincts and public spaces, consistent with Newcastle City Council's vision for the city centre.

The 2015/16 State Budget reiterated the

State government's plans for Newcastle, with the City securing \$103 million towards the CBD light rail plan.

Light Rail

The existing rail line, originally built to move freight to the harbour, now divides the city centre in half. The decision to replace rail services with bus services from a new transport interchange at Wickham recognises that the commercial core is no longer close to Newcastle Station; the emerging commercial core is at the western end of the city, and the rail line creates a physical barrier between this area and Honeysuckle.

As a result of the changing urban landscape, it is envisaged that the new 2 km light rail route will better serve the main activity areas of the city and improve connections. Once the preferred light rail route is determined (expected in coming months), construction is anticipated to commence shortly after, which will then follow the opening of the Wickham Transport Interchange in 2017.

University Expansion

In 2015 Times Higher Education ranked the University of Newcastle in the top 3% of all universities across the world, and second in Australia and number 30 in the world for universities under the age of 50.

In February 2015 Minister for Planning, Pru Goward announced planning approval for the University of Newcastle to expand into the city centre, with a \$95 million, education and business precinct. The new campus will be one of the first projects to be completed in the CBD since the NSW Government released the Newcastle Urban Renewal Strategy in 2012.

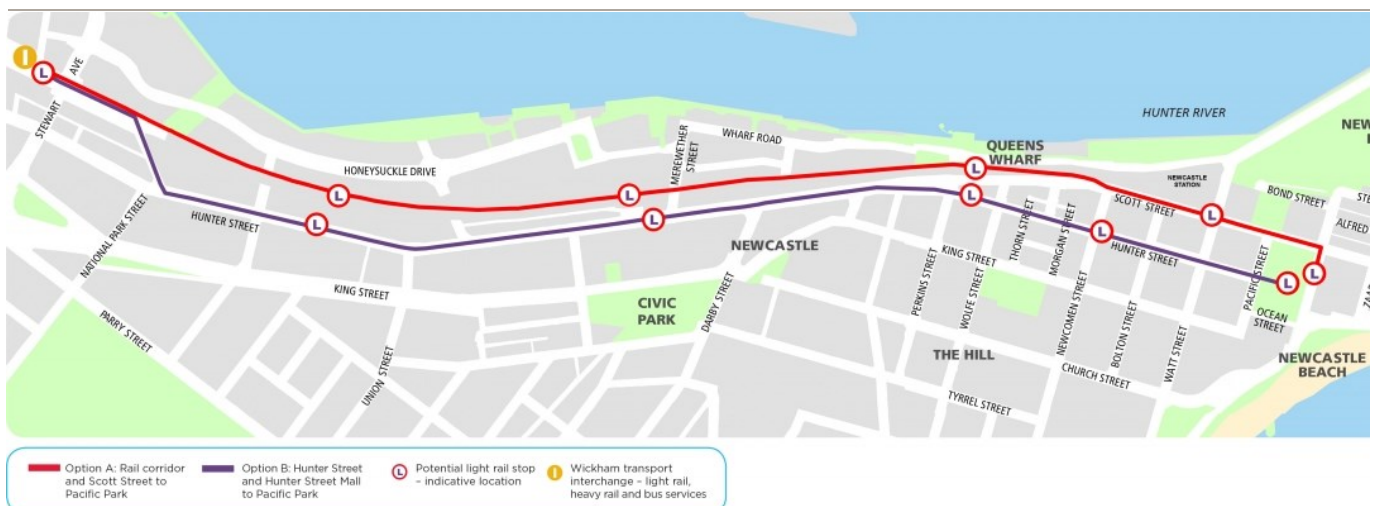
With around 4,000 students, plus staff, starting at the campus in 2017, activity in the CBD will increase helping to stimulate the local economy and accelerating the city's rejuvenation, similar to the recent WSU commitment in Parramatta.

Hunter Street Mall

As part of the City's urban transformation, UrbanGrowth NSW and GPT are working closely with Newcastle City Council in preparing a concept plan for their 20,000m² city centre site that would feature new retail, commercial and residential components. The development proposes high density residential, convenience retail, markets, entertainment, cultural and leisure activities. There are plans for an Eat Street and an entertainment precinct. There is also provision for recreation and open spaces. It is expected a revised development application will be lodged later in 2015.

MAP 2

Newcastle Proposed Light Rail Options



Source: Transport for NSW

GROWTH CONTINUED

Local Market Demographics

Off the back of solid economic conditions, underpinned by mining and transport infrastructure projects, the Newcastle LGA has enjoyed solid population growth over the past decade. At the same time, growth in student numbers at the University of Newcastle has ensured strong population growth in younger age cohorts.

As at June 2014, the Newcastle LGA had a total population of 160,021, making it the 4th most populous LGA in NSW outside of Sydney. Over the past 10 years, population growth has averaged 1.0% per annum, only slightly below the NSW average of 1.2% per annum over the same period.

More recently, national population growth has eased following a slowdown in net overseas migration due to the tapering back of mining related activities. However for Newcastle, a modest uptick in population growth was recorded over the 12 months to June 2014.

The area's population growth has stemmed from a combination of overseas migration and inflows from neighbouring and nearby LGAs. Between the two most recent Census periods (2006 & 2011),

TABLE 1

Population Growth by Age, Newcastle LGA

Age Cohort	2009	2014	2014%	Growth (2009-2014)	% Growth p.a.
0-19	36,063	36,171	22.6%	108	0.1%
20-39	47,080	49,865	31.2%	2,785	1.2%
40-54	29,768	30,852	19.3%	1,084	0.7%
55-64	16,216	18,124	11.3%	1,908	2.2%
65+	22,768	25,009	15.6%	2,241	1.9%
Total	151,895	160,021	100%	8,126	1.0%

Source: ABS, Knight Frank Research

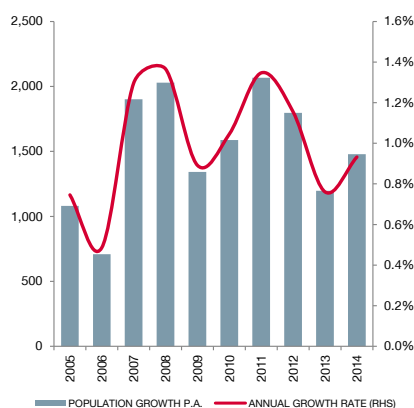
overseas migration to the Newcastle LGA totalled 5,303 persons, in addition to a large inflow of residents from the LGAs of Port Macquarie-Hastings, Greater Taree and Tamworth Regional. At the same time, Newcastle has enjoyed a solid net gain of 1,194 persons from Sydney between the two most recent Census periods.

By age, Newcastle has a young demographic structure with 53.8% of residents aged 39 or below, reflecting the area's connection to the University of Newcastle. From a population growth perspective, persons aged 55-64 and 65+ experienced growth rates of 2.2% and 1.9% per annum respectively over the five years to June 2014. This rate of growth is considerably above the broader average for Newcastle, however below the state average recorded over the same period.

Looking ahead, population growth is expected to remain strong (see Figure 4), underpinned by growth in all age cohorts. According to the NSW Department of Planning & Environment, the Newcastle LGA is set to encompass a population of approximately 190,100 persons by 2031, indicating growth of around 1,770 persons per annum from 2014.

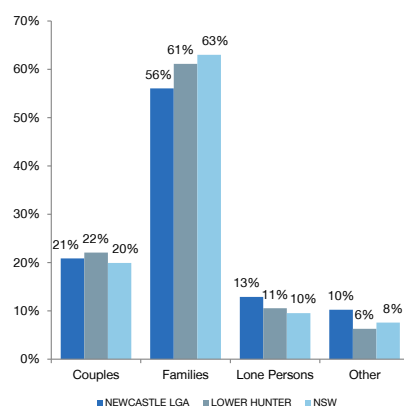
In line with current trends, population growth is expected to be greatest within persons aged 65+, increasing by an average annual rate of 2.3% to 2031. Similarly, population growth in the dominant working age group (20-64) is expected to remain strong at around 740 persons per annum to 2031. The area's ageing demographic is likely to present employment opportunities to younger age cohorts as persons aged 65+ begin to retire from the local workforce.

FIGURE 2
Newcastle Historical Population
Growth
Population Number and Growth Rate



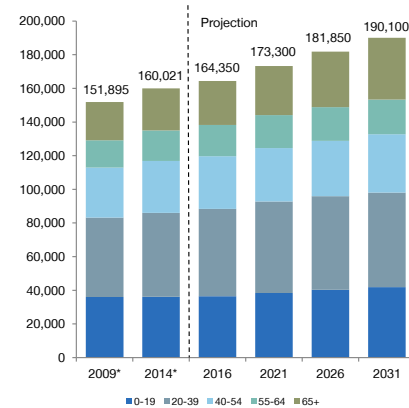
Source: ABS, Knight Frank Research

FIGURE 3
Household Composition, Newcastle
vs. Lower Hunter & NSW
June 2014



Source: ABS, Knight Frank Research

FIGURE 4
Newcastle Population Growth
Projections by Age
2009-2031



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

OFFICE MARKET

Economy

Newcastle is not only a large urban centre, but it is also the key contributor to the Lower Hunter region's wealth, employment and economic stability, accounting for just under half (48%) of the region's economic output (GRP). The LGA's employment diversity coupled with its strong linkages with mining related activities through the Port of Newcastle ensures further business growth and investment will follow.

As at the 2011 Census, Newcastle accounted for 44% of total jobs within the Lower Hunter region, significantly above the next largest LGA (Lake Macquarie at 26%). At the same time, the area is the hub for commercial and administrative activity, accounting for 47% of the region's white collar workforce (63,164 jobs), with just under half of these workers living outside of the LGA boundaries, highlighting the economic importance of Newcastle.

For the LGA itself, the local economy is significant with its 2014 Gross Regional Product (GRP) estimated at \$14.23 billion, considerably above other major NSW regional economies (see Figure 5). The diversity of the local economy is reflected in the value added by industry with no single industry contributing more than 12% to Newcastle's GRP

(see Figure 6). Given this diversity, Newcastle is well placed to capitalise on emerging growth sectors, namely being healthcare, education and information technology. At the same time, its proximity and ease of accessibility to the region's key tourism assets including the wine district via the new Hunter Expressway ensures the area has the opportunity to capitalise on the growing tourism market.

Employment

The labour market within Newcastle has undergone significant structural changes over the past two decades, transforming the once dominant manufacturing centre into one of the most diverse employment centres in NSW. The closure of the BHP steelworks in 1999 forced the local economy to evolve, with a significant shift towards financial and services sectors underpinning recent growth.

As at the 2011 Census, the Newcastle LGA supported 88,175 jobs, of which 63,164 or 72% were within a white collar capacity (those who require office space). As mentioned earlier, Newcastle accounts for 47% of the Lower Hunter region's white collar workforce, with just under 30,000 white collar workers traveling from outside the LGA for work.

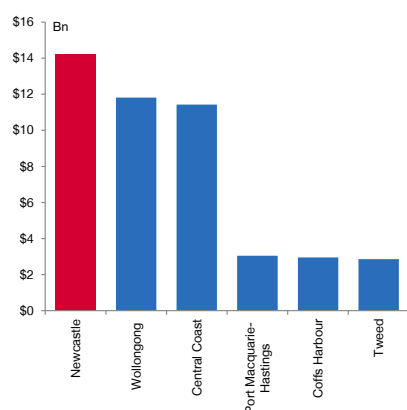
Over the five years to 2011, employment growth in the LGA totalled 7,043, with health care (+2,046 jobs), professional, scientific and technical services (+1,192 jobs) and education and training (+919 jobs) experiencing the largest growth. Over the same period, jobs growth of 4,375 was recorded in the dominant white collar industries (see Figure 7).

While private sector employment in Newcastle provides the dominant source of jobs, representation from the Government sector is significant. Behind the City of Sydney and Parramatta LGAs, Newcastle has the highest level of Government employment in NSW with 18,840 employees working across Local, State and Federal agencies, representing 21% of total jobs. By tier, the bulk of Newcastle's Government jobs are located at the State level (67%), while a further 28% are at the Federal level.

What Businesses are Located in the CBD?

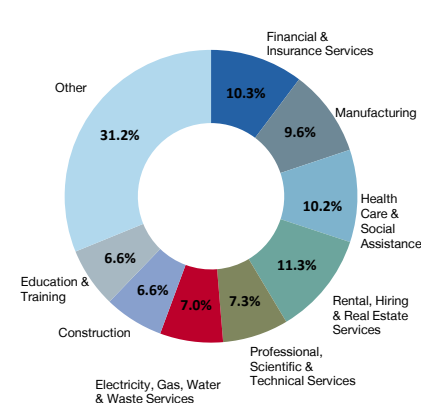
As at June 2014, there were 2,600 businesses trading within the Newcastle CBD (Newcastle - Cooks Hill SA2 region), 55% of which were sole trading/non employing businesses while a further 28% only employed between 1 and 4 workers. This represents growth of 169 businesses over the two years to June 2014.

FIGURE 5
Gross Regional Product
By Major Regional NSW Centre (2014)



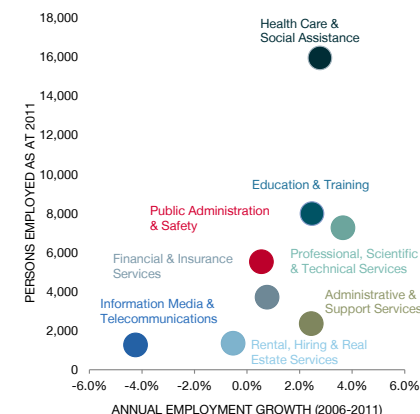
Source: ABS, REMPLAN, NIEIR

FIGURE 6
Gross Regional Product
By Major Industry (2014)



Source: ABS, REMPLAN, NIEIR

FIGURE 7
Employment & Employment Growth
White Collar Industries (2006-2011)



Source: ABS, Knight Frank Research

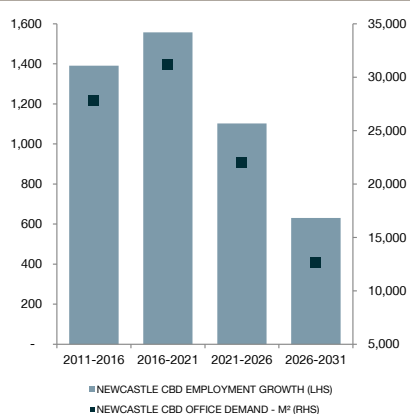
From an office space perspective, there were 1,601 businesses located within the dominant white collar industries accounting for 62% of total businesses. By size, 87% employed four or less workers, indicating solid demand for smaller office provisions.

Demand Projections

Newcastle is expected to experience significant employment growth over the next 20 years, underpinned by service industries, reflecting a strong link between population growth and employment opportunity. Over the 20 years to 2031, an additional 19,200 jobs are expected to be created (960 per annum). Industries which are forecast to experience the largest growth are professional, scientific and technical services (+3,470 jobs), health care (+2,482 jobs) and accommodation and food services (+2,436 jobs).

For the Newcastle CBD (Newcastle - Cooks Hill SA2), employment growth of 7,841 is expected over the 20 years to 2031, 4,681 of which is anticipated within white collar industries (those who require office space). Based on these projections and a conservative office density ratio of 20m² per worker, office demand in the Newcastle CBD is expected to total 93,600m² over the next 20 years. Given that a share of this demand is expected to be absorbed in existing office provisions through reduced densities and absorption of vacant stock, we estimate office demand to be in the order of 80,000m².

FIGURE 8
Newcastle CBD Employment Growth & Office Demand
White Collar Industries (2011-2031)



Source: BTS, Knight Frank Research

Office Market Fundamentals

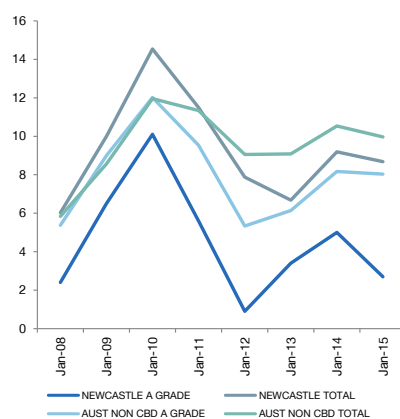
The Newcastle Office precinct is generally known as being the area bounded by Newcastle Harbour to the north running from Pacific Street in the east to just past Tudor Street to the northwest. The Property Council define the CBD into the following three zones (see Map 3):

- City East;
- City West;
- The Honeysuckle Precinct

Whilst Newcastle is a relatively large market in comparison to other NSW regional markets it is reasonably small in comparison to suburban Sydney markets. The Newcastle office market is fairly typical of a regional location in that there are a number of larger established office buildings generally occupied by the various levels of Government and also semi-Government agencies or corporations. Beneath these buildings there are a number of good quality, investment office buildings and at the lowest level of this hierarchy is office accommodation above shops and in small one and two storey buildings.

The commencement of construction of the \$94 million court complex on land adjacent to Newcastle City Council's main office is likely to see renewed interest in the Civic precinct from legal, professional and allied services providers. The Civic Precinct adjoins the Newcastle West precinct of the city. The development is due for completion in October 2015.

FIGURE 9
CBD Office Vacancy, 2008 – 2015
By Grade (%), at January



Source: PCA, Knight Frank Research

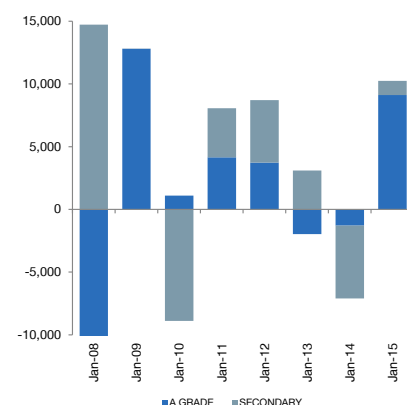
The most recent Property Council of Australia (PCA) data as at January 2015 recorded 255,166m² of total office space across the Newcastle CBD. Even though A Grade stock represents a third of the total market (87,786m²) a lack of vacancy shows higher quality stock is in demand.

In the 12 months to January 2015 the overall CBD vacancy rate in Newcastle was 8.7% with A Grade at 2.7% (see Figure 9), making it one of the tightest A Grade markets in the country. In comparison, the combined A Grade vacancy rate across Australian non-CBD markets was 8.0% at the same period in January 2015.

Being a relatively small market Newcastle is susceptible to volatility and whilst it is a market which hasn't seen a lot of speculative development, any completions that occur without being fully leased, can lead to spikes in the vacancy rate, as apparent in 2010. A Grade vacancy levels inflated in January 2010 to 10.1%, however, this was a result of increasing stock levels rather than decreasing demand. A Grade stock increased by 26,289m² during 2008 and 2009, with no withdrawals.

Over the year to January 2015, overall net absorption within the Newcastle office market was 10,238m² with A Grade stock representing 9,120m² (see Figure 10). This was a positive change given the negative net absorption experienced for A Grade stock throughout 2012 (-1,293m²) and 2013 (-1,974m²).

FIGURE 10
Newcastle CBD Total Net Absorption, 2008 – 2015
By Grade (m²), 12 months to January



Source: PCA, Knight Frank Research

Rents and Incentives

Similar to the vacancy rate, rents vary considerably by grade in Newcastle, where at present, A Grade net face rents currently range from \$320-\$400/m² (see Figure 11).

Newcastle has traditionally been a market where minimal incentives have been provided to tenants. With the wave of construction in the Honeysuckle Precinct and supply additions during 2006 - 2009, owners had been offering incentives up to 15%, whilst trying to maintain face rental levels. Now that surplus stock has largely been absorbed, there has been a corresponding reduction in incentives, where they currently average 10% for A Grade stock.

Development Activity

A moderate increase in office supply is anticipated over the next few years and follows 11,090m² of new stock added to the market during 2014. Imminent office supply will stem from 168 Parry Street (4,720m²) and the refurbished 266 King Street (14,157m²) office building, both of which are expected to be completed towards the end of 2015.

Further potential supply in the medium term includes the DA approved projects of 18 Honeysuckle Drive (7,000m²) and 291 King Street (9,600m²). While both projects are being actively marketed, timing remains uncertain with pre-commitments

TABLE 2

Mooted Office Development Sites—See Map Below

ID & Project Address	Development Stage	Owner	NLA (sqm)	Office Levels	Floorplate Size	Car spaces
1. 168 Parry Street	Construction	Spartohori	4,720	5	1,080	78
2. 18 Honeysuckle	DA Approved	Doma	7,000	5	1,300	112
3. 291 King Street	DA Approved	Mesimo	9,600	4	2,400	160
4. 12 Stewart Avenue	Planning	Spartohori	c.10,000	n/a	n/a	n/a

Source: PCA, Knight Frank Research c. Circa

necessary prior to commencement. Beyond this, 12 Stewart Avenue (adjacent to 168 Parry Street) has the potential to add a further circa 10,000m² to the market, however the project has not yet sought a DA, but has gained Government architecture approval.

General and Justice) and sold with a 10 year WALE. The other notable recent transaction was the May 2014 sale of the Hunter Water Corporation headquarters at 36 Honeysuckle Drive for \$25.825 million (7.9% core market yield).

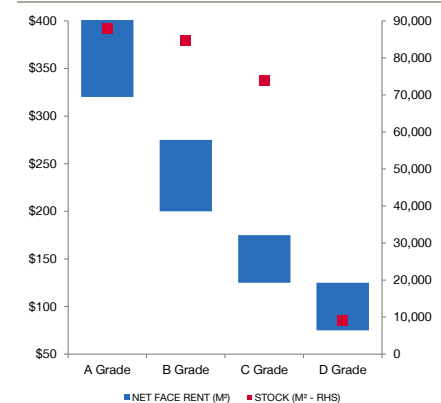
Sales and Investment Activity

While no Newcastle CBD commercial transactions have been recorded in 2015 as assets have become more tightly held, investor demand has remained strong. The last major deal to occur was the government sale and lease back of 237 Wharf Road, situated on Newcastle Harbour, in December 2014. The three storey A Grade building (2,598m² office NLA) sold at auction for \$14.855 million, reflecting a core market yield of 7.27%. The building was 100% leased to NSW Government (occupied by Transport for NSW, RailCorp NSW and Attorney

FIGURE 11

Newcastle CBD Office Net Face Rents & Stock

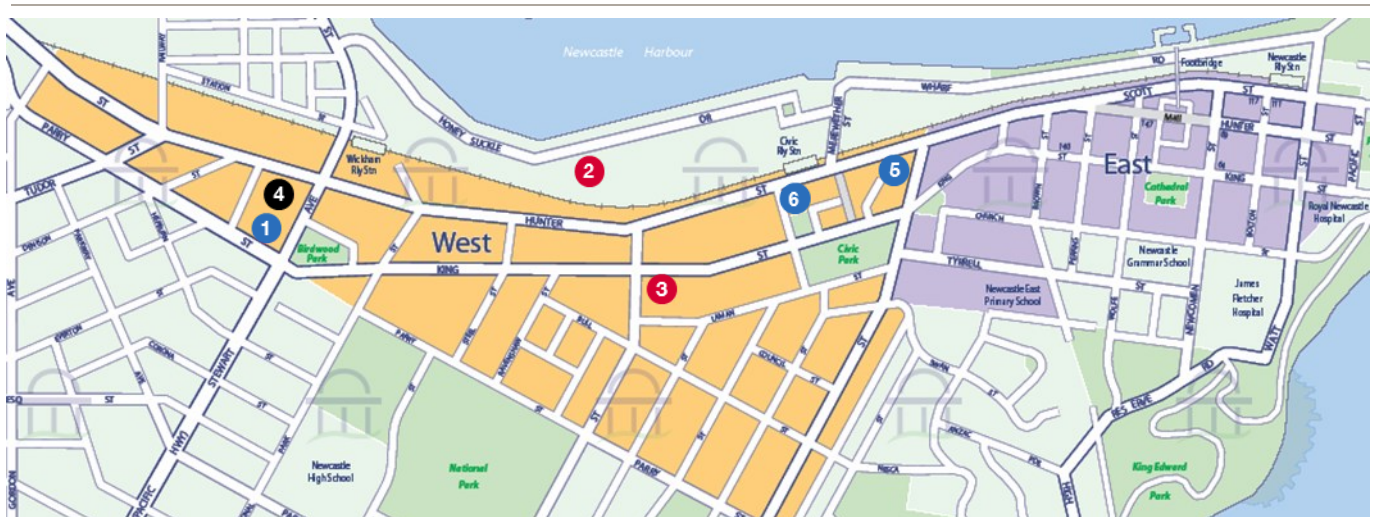
By Grade of Stock, September 2015



Source: Knight Frank Research

MAP 3

Property Council of Australia CBD Boundary and Mooted Office Development Sites



Source: PCA, Knight Frank Research

Note number 5 indicates the location of the Newcastle Law courts complex & number 6 indicates the location of University of Newcastle's under construction City campus

● Under Construction ● DA Approved ● Planning



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The Lower Hunter includes the five local government areas (LGAs) of Newcastle, Lake Macquarie, Port Stephens, Maitland and Cessnock.

Abbreviations & Glossary:

WSU: Western Sydney University (formerly the University of Western Sydney)

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.)

NSW DP&E: NSW Department of Planning & Environment

ABS: Australian Bureau of Statistics

NIEIR: National Institute of Economic and Industry Research

BTS: Bureau of Transport Statistics

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