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21 November 2013

Stephanie Bashford
Manager - Strategic Planning
Lane Cove Council
48 Longueville Rd, Lane Cove
Sydney NSW 2066

Dear Stephanie,

Re: Planning Proposal for 472 – 520 Pacific Highway & 95 Nicholson St, St Leonards

I write with reference to the above referenced sites (hereafter referred to collectively as the Subject Site) to provide independent economic advice to Council. More specifically our advice relates to the Proponents statement that "*Notwithstanding an uplift in development potential, commercial redevelopment of the land is not viable"*[1].

We have broken our advice into three key areas as follows:

1. A discussion regarding the current and prospective commercial office market in St Leonards and whether the proponents statements regarding existing and future demand can be supported;
2. A review of the potential impacts to job targets in the St Leonards and Lane Cove LGA; and
3. An assessment of the impacts to the planning proposals development viability as a result of varying levels of commercial office floorspace and car parking.

In preparing this advice we have reviewed the documents[2] submitted by the Proponent[3]. We have also undertaken market research, spoken directly with commercial office developers and industry experts in the locality and prepared a financial feasibility model. To set out our findings and advice concerning the planning proposal we have structured this letter as follows:

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[1] Planning Proposal dated October 2013 Page 58

[2] Planning Proposal dated October 2013; Economic Assessment dated October 2013; Urban Design Report October 2013

[3] Charter Hall and Leighton Properties

Section 1.1 An overview of the Subject Site and Planning Proposal

Section 1.2 A review of the St Leonard's / Crows Nest Office Market

Section 1.3 A discussion of potential impacts to job targets

Section 1.4 A summary of the feasibility modelling results

Section 1.5 Conclusions and recommendations

To set out our research and methodology in greater detail we also include the following attachments:

Attachment 1 – Commercial office market research

Attachment 2 – Retail and residential market research

Attachment 3 – Feasibility modelling methodology and assumptions

Attachment 4 – Summary sheets from the Estate Master Financial Model

1.1 The Subject Site and Planning Proposal

The Subject Site is located within a commercially zoned precinct (B3 Commercial Core) located on the southern side of the Pacific Highway to the east of the railway line. The Subject Site is divided into four parcels of land located at 472 -520 Pacific Highway and 95 Nicholson Street, St Leonards as follows:

1. 504 -520 Pacific Highway and 95 Nicholson Street - ten and four storey commercial office building;
2. 500 Pacific Highway - a six storey commercial office building in single ownership;
3. 486 Pacific Highway - a six storey strata commercial office building in single ownership; and
4. 472 Pacific Highway - a six storey commercial office building in single ownership.

Combined the Subject Site is estimated to provide 24,332sqm of commercial floorspace.

The planning proposal seeks to rezone the Subject Site to B4 Mixed use to provide 4,000sqm of office floorspace; 2,100sqm of ground floor retail space and 76,305sqm of residential floorspace (910 units). This translates into approximately 7.4% of the Subject Site's GFA being provided as employment generating uses with 4,000sqm (5% of GFA) proposed as office[4]. With respect to the latter, the planning proposal identifies the potential to provide the office space at sub-market rent (i.e. 20% below) to support start-up businesses for a five year period.

1.2 The Commercial Office Market

A review of the planning proposal documentation identifies that there are two key economic cases that are being made by the Proponent with respect to commercial office space in the St Leonards Specialised Precinct:

1. There is a lack of market and investor demand to substantiate a new commercial office building; and

[4] Details provided in Table 5, Planning Proposal dated October 2013

2. Owing to poor demand redevelopment without a large component of residential would not be feasible[5].

This section identifies and responds to the key issues raised in relation to the first point. It is based on the more detailed analysis provided in Attachment 1.

- The St Leonards / Crows Nest office market has experienced higher vacancy rates and weaker demand for commercial office floorspace over the past decade. We agree with the Proponent that this has in part resulted from strong competition from locations such as Macquarie Park / Ryde and Norwest Business Parks that offer larger campus style floorplates, lower build costs and greater car parking provision. Furthermore this competition is not likely to abate in the short to medium term as there is still sufficient capacity in Macquarie Park / Ryde to accommodate commercial demand.
- Notwithstanding this historical trend, fluctuations in tenant demand form part of the office market cycle. Our research finds that investor confidence is growing as the "office demand cycle is beginning to turn"6. This confidence aligns with forecasts for industry growth in a range of sectors including legal services, accounting, other business services, technology, health and education. According to Dexus "White collar employment will grow much faster than total employment, supporting office demand"7. In accordance with this job growth Sydney experienced its best quarter of commercial tenant demand since FY12. However as there are no new buildings to add to Sydney's core stock until FY16 "vacancy is expected to trend downwards in FY14 and FY15 as demand outstrips supply"8.
- With vacancy rates declining in Sydney CBD for higher grade floorspace and rents increasing in higher order commercial centres, there will be increasing interest and demand within more suburban locations to provide a more affordable office product whilst maintaining reasonable proximity to Sydney CBD and the executive housing belt. To this effect recent office transactions show that "Buyers have been attracted to the suburban office markets due to higher yields and anticipated future cap rate compression".9
- Growing interest in North Sydney and associated rental increases are likely to have a positive flow on effect to other centres in the hierarchy such as St Leonards / Crows Nest. The optimism specific to the St Leonards / Crows Nest market can be exemplified by comments from CBRE Richard Ellis to the effect that *"Vacancy levels are currently at their peak and have stifled rental growth. Although demand remains patchy, we anticipate that there will be a take up of A grade supply. Development activity is likely to restore strong dynamics to the Market"*.[10]
- This optimism may also be exemplified by the declining vacancy rates in St Leonards / Crows Nest from 15% in 2010 to 12% in January 2013. Although it has experienced a temporary fluctuation in trend to 13.8% in July 2013, it is anticipated that vacancy rates will continue to decline to 9.4% as shown in

[5] Planning Proposal dated October 2013 Page 5

[6] Australian Real Estate Quarterly Review – Whats Next for Property in 2014? Q4/2013

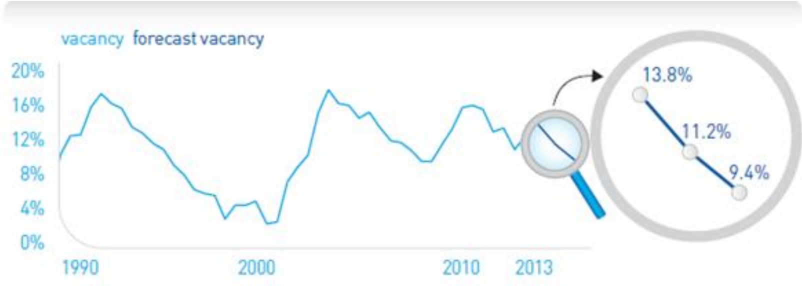
[7] Australian Real Estate Quarterly Review – Whats Next for Property in 2014? Q4/2013 Page 6

[8] Australian Real Estate Quarterly Review – Whats Next for Property in 2014? Q4/2013

[9] Australian Real Estate Quarterly Review – Whats Next for Property in 2014? Q4/2013

[10] PCA Office Market Report 2013

the figure below sourced from the PCA July 2013 Commercial Office Market Report. For context, these rates compare to an existing vacancy rate of 11.4% for Sydney CBD[11].



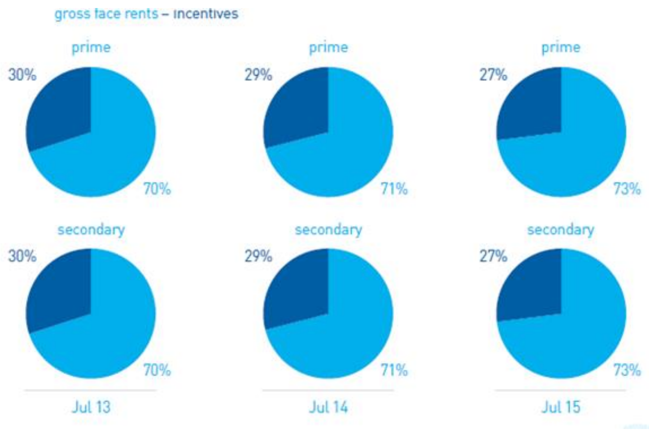
- The planning proposal makes the case that the reductions in the St Leonards / Crows Nest vacancy rate has been skewed by the redevelopment of office space in the centre for mixed use development in the second half of 201312. We do not disagree that this would have had some affect however our research shows that in the 6 months prior, total office stock had increased by +18,000sqm of which the majority was A Grade space.
- The planning proposal also has a distinct lack of information concerning the nature or level of occupancy experienced in the existing commercial buildings on the Subject Site. The only reference to this is by way of Figure 5 that indicates 486 Pacific Highway has less than 5% vacancy and the lease for 500-520 Pacific Highway expires within 1 year (a likely reflection of the Proponent's intent concerning the planning proposal). The figure does not clarify the occupancy level or leasing arrangements for the existing commercial building at 472 Pacific Highway.
- We agree with the Proponent that the St Leonards / Crows Nest market has a greater proportion of C and D grade office floorspace. Our research finds that this space is more affordable and thereby attractive to smaller specialist medical uses and local professional firms when compared to the new commercial space surrounding the hospital. The existing C and D grade space therefore meets a specific market need however it would not support the growing demand for high quality commercial space.
- The approved 32,600sqm development at 88 Christie Street represents an example of a new A Grade office development that seeks to capitalise on the growing demand for higher quality space and the lack of existing supply in St Leonards. Whilst the Proponent cites the lack of pre-commitments on this site as evidence that the commercial office market is poor, our research indicates that the Winton Group have secured pre-commitments for this building thereby inferring quite the opposite.
- The demand for larger floorplate, green-star rated, commercial office space was also strongly made by Knight Frank on behalf of the Proponent of the Gore Hill Technology Park that sought to rezone existing industrial land to provide additional A grade commercial space on the centre's fringe.
- As referenced above, the commercial office market is cyclical resulting in periods of net absorption and others of net loss with respect to commercial office space. Over the past 10 years there has been net

[11] Page 6 Australian Real Estate Quarterly Review – Whats Next for Property in 2014? Q4/2013

[12] Planning Proposal dated October 2013 Page 23

absorption or demand within the North Shore Market13 of 65,000sqm of office space14. However in the more buoyant market between July 2004 and 2007 net absorption was close to 80,000sqm over the four year period. In any case these figures show that should the entire planning proposal (approximately 82,000sqm) be provided as commercial floorspace, it would represent a notable portion of overall supply. This would in turn represent over 10 years of demand on the North Shore (excluding North Sydney) based on past absorption rates. Whilst the market is improving, this would still represent significant financial risk for the Proponent and is therefore a highly unlikely proposition to be realised (please see section 1.4 for further evidence based on development feasibility).

- Conversely residential is a financially attractive option a more ready demand for owner / occupiers. Residential also has significantly greater sale rates on a per square metre basis than commercial (close to double) making it a more financially attractive option (please see section 1.4 for further evidence based on development feasibility).
- There are however potential economic implications to the broader locality as a result of the introduction of residential within commercial cores. Evidence of such implications can be provided by both Chatswood and Milsons Point Centres following the introduction of residential uses. In both cases mixed use / residential development helped to undermine the prestigious commercial character of the precincts and in turn to raise land owner expectations for higher value returns. This in turn increased land values to the point where stand lone commercial buildings were / are no longer a viable option. Consequently should the planning proposal proceed, it could set a strong precedent for other commercial sites in the core to be redeveloped as predominantly residential mixed use.
- As a final point for consideration, the Planning Proposal incorporates a 20% discount to market rent over a 5 year period with the intent to support start-up businesses in the precinct. As shown in the figure below (sourced from the PCA Office Market Report July 2013), a 20% to 30% discount over a 5 year lease is not an uncommon commercial incentive for a tenant in St Leonards at present.



1.3 Commercial Demand and Job Targets

The planning proposal makes a case that with the redevelopment of the Subject Site, based on the Metropolitan Strategy's employment target of 8,000 jobs by 2031, there would be sufficient supply of floorspace in the St Leonards Specialised Precinct. Investigating this concept further, we have identified a number of factors:

[13] Please note the North Shore Market excludes North Sydney and Macquarie Park but includes Chatswood and St Leonards / Crows Nest.

14 PCA Office Market Report, July 2013

- The draft Metropolitan Strategy's targets are largely based on the Bureau of Transport Statistics forecasts (BTS). The BTS have been challenged as they reflect / extrapolate past trends as opposed to future market trends and thereby demand. This difference becomes relevant when using past trends to determine demand for floorspace and job growth in a fluctuating industry such as the office market that has been suppressed for over a decade as discussed in Section 1.2 above.

- The revised draft Metropolitan Strategy's targets are now considered a minimum rather than a maximum or an absolute number. Furthermore as recognised by the Proponent the revised targets represent "3,000 extra jobs to be facilitated in 10 less years"15 than prior targets. Accordingly making the case that there would be sufficient floorspace to just accommodate the 8,000 minimum target would not facilitate any improvement on the minimum target. This is also an important consideration in light of the growing number of residents in the Precinct as well the pending preparation of the draft Subregional Strategy.

- The Proponent has multiplied the number of jobs likely to result from the minimum target of 8,000 jobs (3,882 jobs) using a ratio of one job per 15sqm to identify demand for 58,000sqm. This ratio relates to higher density space for new office space, however it is also applied across existing lower C and D grade commercial space. Based on our industry experience older space would not be able to achieve these ratios and accordingly we would recommend the use of a higher ratio in the order of 1 per 20sqm or even 1 per 25sqm in a suburban office market such as St Leonards. As a consequence by using this alternative range yet the same methodology, demand for floorspace could increase to between 77,640sqm and 97,050sqm.

- The planning proposal makes the case that the existing 44,231sqm of vacant floorspace would be available to meet this demand despite competing arguments that this floorspace is largely dated C and D grade floorspace that is not attractive to prospective tenants. Consequently it may be argued that the loss of existing floorspace on the Subject Site and the retention of lower grade stock would further undermine the attractiveness of the St Leonard's Specialised Precinct to prospective tenants and employment generating uses as the expense of the minimum job target.

- This approach also places a strong reliance on the 32,600sqm of commercial office space approved for 88 Christie Street. In the case that this one development did not proceed, or be entirely tenanted, using the Proponents methodology there would be a significant undersupply of floorspace in the Precinct to meet job targets.

- It is also important to note that the planning proposal would result in the net loss of 18,232sqm of commercial office space on the Subject Site. Using the Proponents job yield ratios for consistency, this would represent a potential loss of over 1,200 jobs in Lane Cove LGA. Whilst the development at 88 Christie Street has the potential to generate an additional 2,170 jobs[16], this would only represent a net increase of 960 jobs for Lane Cove LGA across all five sites in the commercial core. This net increase would however be reliant on the development getting sufficient demand to be built and fully tenanted which the Proponent contends is unlikely.

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[15] Planning Proposal dated October 2013 Page 45

[16] Based on a higher ratio of 1 job per 15sqm as it is new and thereby likely to be more efficient office space

- As a final matter, we also note that the policy analysis on Page 39 of the planning proposal concerning Ministerial s117 Directions does not address Section 1.1. that relates to Business and Industrial Zones. This is an important consideration as the three objectives in particular seek to:

  a. encourage employment growth in suitable locations,

  b. protect employment land in business and industrial zones, and

  c. support the viability of identified strategic centres.

  Based on our analysis, the planning proposal fails to support these objectives.

1.4 Financial Viability

As outlined above, through the preparation of the Lane Cove LEP 2009, the Proponent received a notable uplift in development density in order to facilitate the viable redevelopment of the Subject Site for commercial uses. The proponent now proposes to rezone the Subject Site to a financially more attractive use yet retain the same quantum of floorspace and to increase building heights to reflect a more suitable built form for residential uses.

In recognition of the potential value that would be gained by this change in use, the Proponent has stated that:

"In addition, the proposal incorporates an offer from the proponents to enter into VPAs incorporating a monetary contribution that recognises the change in building forms that come with a change of use from commercial to mixed use residential for Council to use at its discretion on capital works projects such as the St Leonards bus interchange project".[17]

To better understand the degree of benefit that could be gained by the Proponent as a result of the planning proposal and to substantiate claims that it would not be viable to redevelop the Subject Site as commercial alone, we have tested the financial viability of a range of scenarios that may be summarised as follows:

1. The current planning proposal with variations to car parking rates; and
2. The current planning proposal with variations to the quantum of commercial floorspace provided.

In undertaking this analysis we have used the Estate Master Development Feasibility Model and applied a range of assumptions as set out in Attachment 3 to this letter. It is important to note that owing to the initial stages of the planning proposal, our modelling has been undertaken at a high level of detail. This modelling should be refined in line with the development of the scheme and the identification of any additional matters of relevance to the Subject Site such as contamination, variations to parking rates or contributions[18].

[17] Planning Proposal dated October 2013 - Executive Summary.

[18] There are indications that the Subject Site may have some level of contamination. As this is yet to be verified, the additional cost of remediation has not been factored into the assessment. It would however have an impact on the overall degree of viability.

The full details of the models and their results are provided in Attachment 4. In summary however our modelling found the following.

Option 1: The planning proposal in its current form[19] achieved a financial return well in excess of the targeted 20% development margin and consequentially could afford a significant monetary contribution as part of VPA for a change in use.

Option 2: The planning proposal with an alternative car parking rate[20] achieved a slightly lower return but would still be a significantly attractive development option that could provide a monetary contribution for the change in use.

Option 3: Amending the planning proposal so that Tower 1 and Tower 3 remain as proposed but Tower 2 (23 levels – 20,365sqm) was entirely commercial[21]. This option provides a return that was marginally financially attractive (17% IRR) indicating potential further feasibility analysis and consideration.

Option 4: Amending the planning proposal so that it was 100% commercial office. This option resulted in a Development Margin of -5% and an IRR of 3.75%. This demonstrated a full commercial option is not viable.

Our financial modelling based on industry knowledge and research therefore shows that Option 1 and 2 are financially viable and attractive development options. Option 3 is however marginal in its viability and therefore represents the 'tipping point' of commercial floorspace within the overall mixed use scheme. Accordingly Option 4 (which was 100% commercial office) across the Subject Site was found not be financially viable in the current market.

1.5 Conclusion and Recommendations

In summary, we do not disagree that over the past decade, commercial office uses have been a less desirable land use in St Leonards and in the broader Sydney market resulting in reduced demand for development. Over the past few years the St Leonard's office market has however been improving with decreasing vacancy rates and a number of proposed commercial developments, some with pre-commitments.

Notwithstanding these improvements in the St Leonard's office market, residential uses continue to represent the more financially attractive development options. Furthermore the office market has not improved to such a point that a substantial increase in commercial office space could be supported. To exemplify this point, should the entire planning proposal be developed as commercial office floorspace (even in the case that it is not financially viable) it would represent 15 years of supply in the North Shore market based on historic trends.

Notwithstanding this, a smaller component of new, higher quality office space has the potential to be attractive to the market, particularly in conjunction with other developments and public domain improvements that would

[19] Using a car parking rate of 0.75 space per residential unit and 1 car spot for 110sqm of retail / commercial floorspace.

[20] Using a car parking rate of 1 space per residential unit and 1 car spot for 110sqm of retail / commercial floorspace.

21 This represents less commercial floorspace on the Subject Site but subject to building design, a new building could achieve an improved job density

reinvigorate the Precinct. Furthermore an increase in the component of commercial office space as part of the proposal would help to minimise the net loss of employment generating floorspace across the Subject Site as a result of the planning proposal.

As a consequence, based on our analysis, we have identified three potential scenarios and their implications that may be considered by Council as follows:

1. **Rejection of the current planning proposal** – this option would encumber the supply of new residential dwellings on the Subject Site and the associated benefits. This option would however retain the existing occupied 24,332sqm of commercial space and the associated 1,200 – 1,600 jobs it generates whilst protecting the commercial character of the Precinct.
2. **Amendment to the current planning proposal** – this option could seek to minimise the loss of jobs generated on the Subject Site by increasing the quantum of commercial floorspace provided either at the podium level or within one standalone Tower. The greater the quantum of commercial floorspace insisted upon on the Subject Site, the less attractive the option becomes from a financial perspective, running the risk of redevelopment not being achieved. In the case that it did proceed however, the introduction of 2+ towers of residential could have an adverse knock on affect to the commercial character and value of the existing commercial core.
3. **Accept the current proposal as it presently stands** – this option would generate 900+ additional residential dwellings in the LGA, provide a notable contribution to public improvement's by way of a VPA and be a catalyst for change. As referenced under option 2, it would however set a precedent that could lead to the erosion of the commercial core and the further net loss of jobs in the LGA.

We trust that this advice is of assistance and should you have any questions concerning our advice, please do not hesitate to contact me in our Sydney office on 02 9252 8777.

Yours sincerely,

Sarah Hill

Sarah Hill
Director
Hill PDA

ATTACHMENT 1 - OFFICE MARKET RESEARCH

Hill PDA has undertaken market research to inform our analysis as outlined in section 1.2. Research sources included the Property Council Office Market Report (PCA), research reports completed by Colliers and Jones Lang LaSalle, interviews with office leasing agents and commercial real estate sales agents and information provided by developers.

By way of context, the PCA identifies the St Leonards / Crows Nest office market as part of the North Shore office market. The St Leonards market consisted of 363,928sqm of floor space as of July 2013 with a vacancy rate of 13.8%[22]. This compares to Chatswood with 279,228sqm and a vacancy rate of 9.8% due to a significant tightening of vacancies in the market, with North Sydney with 860,461sqm and a rate of 10.6%. Over time the vacancy rates of these office markets has been changing with St Leonards/Crows Nest. With St Leonards/ Crows Nest market forecasted to be 11.2% July 2014 and 9.4% in July 2015 based on the PCA benchmark.

Further afield, Macquarie Park is now recognised as being the third largest commercial centre in Australia providing over 834,445sqm of floor space and a vacancy rate of 7.1%[23]. Norwest Business Park maintains 272,474sqm of office floorspace and a vacancy rate of 15.1%[24]. These two centres are considered relevant as their significant growth over the past decade is recognised as having affected the St Leonards / Crows Nest, North Sydney and Chatswood markets. The impact posed by North Ryde/Macquarie Park is not likely to abate in the short-term, with tenants citing competitive prices and flexibility offered by the space therein along with improved amenity and transport accessibility. Although Macquarie Park is a cheaper alternative, offering tenants flexibility for large requirements, the flurry of development activity is likely to continue albeit at a slower pace in the short-term, until it is fully developed over the next 10-15 years.

More specific to the Crow's Nest and St Leonards office market, the PCA Office Market Report dated January 2013 states that in the Specialised Centre:

''total Market total stock in the six months to January 2013 has increased by 14,970sqm from 353,626 to 368,596sqm. The supply of stock was due to A Grade and B Grade office space with A Grade accounting for 14,100sqm of supply due to the completion of a project by Growthpoint Properties Australia Ltd situated at 219-247 Pacific Highway which brings total office space for A Grade to 102,699sqm & B Grade accounting for 2,220sqm due to a full refurbishment of 25-27 Chandos Street, which brings total office space for B Grade to 69,288sqm''.

Furthermore the PCA Office Market Report stated that:

''With D Grade & Premium Grade remaining unchanged, C Grade did record a withdrawal of 1,350 sqm from the market. The majority of the Crow's Nest & St Leonards Office Market comprises of C Grade office Space with 49.10%, followed by B Grade with 27.90%, A Grade with 18.80% and D Grade with 4.20%. As of January 2013, Premium Grade office space is non-existent in the Crow's Nest & St Leonards Office Market.''

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[22] Property Council Office Market Report July 2013

[23] Ibid.

3 Property Council Office Market Report July 2012

St Leonards has a strong presence of a commercial office market in suburban market. The area use to consist of older commercial office buildings comprising of 8-20 storey commercial buildings, while the new stock is 15-30 storeys. The stock comprises of a mix of A grade to D grade office space. It has been stated in the Colliers International market report date second half of 2013, that St Leonards over the past three years has had a loss of -4,312sqm of office space. This loss of office space is due to the mixed uses developments comprising of residential, retail and commercial components constructed surrounding the St Leonards Commercial Core Precinct and Train Station. The redevelopment occurring around this area means amenities for the workers is being provided and making it a more attract place to have a business. It is also said to believe that in redeveloping the commercial office buildings into mixed use will in turn provide high quality office space by replacing all the C and D grade office space.

In conjunction with the mixed use developments, our research has shown that there is demand for smaller office space in the St Leonards precinct for medical uses and smaller professional firms, however construction of full commercial building bears a few development risks, this being the constructions costs of office space outweighing the overall development profit that in turn makes the commercial office space less attractive to a developer.

Our research and discussions with local agents has informed the following:

- The office market in St Leonards has started to slow, with larger tenants relocating to Macquarie Park
- There is a larger demand for smaller office space around 50-250sqm
- Large office floor plates(300sqm-1,000sqm) usually have pre committed leases
- Sales for new quality office space <250sqm range from $4,000/sqm-$5,800/sqm plus $30,000 for a car spot
- Sales for secondhand office space under < 250sqm $3,000/sqm-$4,000/sqm
- Typical buyers are owner occupiers with some interest coming from investors who have self-serviced superfunds who buy sub $1 million dollars as the capital growth is strong
- Examples such as 460 Pacific Highway and 11 Chandos Street, St Leonards are examples of refurbished office space and are asking $3,500-$4,500/sqm for office space < 250sqm
- Typical businesses that occupy smaller floor plates include IT firms, accountants and medical uses
- Rentals that are being achieved for office space < 250sqm is approximately $350/sqm net + $75 for outgoing
- Good quality small (50-250sqm) office space is in demand and will lease within 3 months, whereas low quality grade small office space take up to 6months to lease
- Parking is essential to any commercial building. If parking is not provided, office space will take a longer time to lease. By way of example 205 Pacific highways has been on the market for a few months although there has been a lot of interest, no leases have been achieved due to the lack of parking provided onsite
- Good quality and layout of commercial office space is vital in the centre
- Commercial office space can work well in mixed use developments; however separate entrances should be provided.

Sale and Lease Evidence

Table 3 below demonstrates sale values for both old and modern office space in St Leonards (referred to as secondhand and refurbished respectively).

The evidence shows sale values for small units (<500sqm) ranging from $3,690/sqm to $6,670/sqm and larger (>500) units ranging from $2,807sqm to $5,875/sqm. It should be noted that the large range of sale values is due to the variation in age, location and quality of stock referenced above.

Table 1 - Commercial Office Sale Transactions for St Leonards (2012- 2013)

Address	Sold Date	Sale Price	Building Area (sqm)	Analysis $/sqm	Comments
48 Albany St	11/5/2013	$2,400,000	708	$3,390	Secondhand Strata Office
6-12 Atchison	14/12/2012	$9,791,000	2,873	$3,408	Secondhand Office
13-19 Atchison	10/7/2012	$400,000	70	$5,714	Modern strata titled office
30 Atchison	4/12/2012	$1,133,000	173	$6,549	Secondhand Strata Titled Office
33-35 Atchison St	10/1/2013	$6,000,000	1,763	$3,403	Secondhand Strata Titled Office
58 Atchison	25/3/2013	$3,150,000	813	$3,875	Secondhand Strata Titled Office
60 Atchison	27/3/2013	$2,000,000	550	$3,636	Secondhand Strata Titled Office
1a Berry Rd	30/5/2013	$185,000	28	$6,607	Secondhand Strata Titled Office
28 Chandos St	4/10/2013	$3,750,000	1,336	$2,807	Secondhand Strata Titled Office
1-5 Albany St	19/7/2013	$703,000	154	$4,565	Modern office.
75-77 Chandos St	5/42013	$2,650,000	462	$5,736	Secondhand Office building
69 Christie St	25/2/2013	$390,000	86	$4,535	Secondhand Strata titled office
110-112 Christie St	20/6/2013	$8,675,000	1,608	$5,395	Refurbished office building
6-8 Herbert St	17/5/2013	$720,000	108	$6,670	Modern Strata office suite
66 Pacific Hwy	6/6/2013	$107,000	29	$3,690	Secondhand strata Tiled office
130-134 Pacific Hwy	11/7/2013	$298,000	74	$4,027	Modern Strata titled office
402/156 Pacific Hwy	16/2/2013	$1,000,000	209	$4,785	Secondhand Strata Tiled Office

Source: PIMS & Hill PDA Research, 2013

Recent discussions with local agents indicated that older office stock would sell between $3,000-$4,000/sqm, while modern office stock could achieve from $4,000-$5,000/sqm. It has also been identified by agents that the rents achieved with commercial office space especially larger floor plates are low compared to the high build costs and there redevelopment for commercial office space is not attractive to developers.

After discussions with agents and our market research, we assume that majority of the rents achieved in St Leonards have incentives included and therefore rents achieved are lower than market. Agents identified that some larger tenants have relocate to Macquarie Park, due to better rents and amenities.

Table 4 outlines the rents for commercial properties have achieved over the last 12 months (2012-2013) in St Leonards. The research suggests that net rents achieved in the St Leonards range between $270-$450/sqm.

Table 2 - Commercial Office Net and Gross Rental Transactions for St Leonards (2012- 2013)

Address	Leased Date	Rental Net	Building Area (sqm)	Analysis $/sqm	Comments
39-41 Chandos St	11/7/2013	$137,060	356	$385	Refurbished Office Suite
118 Christie St	8/10/2013	$22,080	72	$307	Modern Office
170 Pacific Hwy	28/9/2012	$297,000	1,100	$270	Secondhand Office
Address	**Leased Date**	**Rental Gross**	**Building Area (sqm)**	**Analysis $/sqm**	**Comments**
1-5 Albany St	3/11/2012	$33,750	75	$450	Secondhand Office
67-69 Chandos	2/4/2012	$130,075	473	$275	Secondhand Office
130-134 Pacific Hwy	2/4/2012	$27,999	102	$275	Secondhand Office
170 Pacific Hwy	7/6/2012	$414,375	1,105	$375	Secondhand Office

Source: PIMS & Hill PDA Research, 2013

Development Pipeline

In accordance to Cordell Connect 2013, St Leonard's current office development supply pipeline comprises of commercial office refurbishments and mixed use schemes comprising of residential, retail and commercial office space. There is no evidence of new commercial office space being built, except for 88 Christie Street, St Leonards in which pre committed tenancy were agreed. As mentioned above, the slow growth in rents (and hence the sale price linked by the property yield) and the increase in construction costs over the same time provides little incentive for a developer to demolish an existing commercial building and rebuild.

ATTACHMENT 2 - RETAIL AND RESIDENTIAL MARKET RESEARCH

The following attachment provides background research for the St Leonard's retail and residential market to inform the feasibility modelling component of this advice.

Retail Office Space Market Research

Our research and discussions with agents identified the St Leonard's retail market as slow on the up take with a few vacancies located along the Pacific Highway. However there have been signs of improvement over the last 12 months. This improvement is due to rental incentives and better quality stock and layout of premises. Agents indicated that retail premises located within the Forum development are of high demand due to location and exposure of the premises.

Agent identified that the typical buyers include owner occupiers and tenants, who operate small retail business that cater to the footfall from the station. Larger retail premises such as the bulky retailers located along the Pacific Highway towards Crow's Nest have always had a strong presence in the area.

Agents indicated that new retail premises in a good location provide with a good internal layout could sell or lease within 3 months. Furthermore agents identified that retail shops would expect to achieve between $7,500-$9,500/sqm.

Our research showed sales activity in St Leonards for retail premises range between $2,800/sqm-$10,092/sqm. Rentals achieved can range between $600-$1,000/sqm. Both sales and rents are all dependant on age, location, layout, quality, incentives and parking.

Residential Market Research

The apartment market in St Leonards has performed strongly in recent years and this has been exemplified by low vacancies and growth in the rental market. Further analysis reveals that the buyers and rental market tend to invest in one, two and three apartments with overall take up rates with a number of residential developments selling 80% of the apartments off the plan within 6 months.

The median apartment price for Chatswood suburb from September 2013 was reported as $612,000[25]. It is important to note that this classification refers to all strata titled dwellings including units, townhouses, terraces and semi-detached dwellings.

Discussions with selling agents active in St Leonards have identified strong demand in for apartments from both owner occupiers and investors. Take up rates achieved as mentioned about are approximately 80% of apartments within a development over 6 months. Agents identified that each apartments sale value may increase $10,000 -$20,000 per level. Local agents indicated that the best developments comprise of mixed uses such as retail and residential.

[25] Residex State Market Report September 2013

Discussions with agents identified that apartment's average $11,000/sqm. Furthermore our market evidence suggests that apartments are selling between $ 10,000-$ 15,000/sqm, dependant on size, location, parking and views achieved.

ATTACHMENT 3 FEASIBILITY TESTING METHODOLOGY AND ASSUMPTIONS

This Chapter focuses on the factors which influence the financial viability of development on the Subject Site building on the market research discussed above. It seeks to better understand the impact varying levels of commercial floorspace within the development could have on its viability and ultimately whether the redevelopment of the Subject Site could proceed.

To undertake this analysis, Hill PDA has adopted the residual land value approach as the method of assessment and utilised its proprietary software Estate Master in the analysis. This involved assessing the value of the end product of the development, allowing for the development costs, and making a further deduction for the profit and risk that a Developer would require to take on the project.

Financial Feasibility Criteria

The financial viability of various land use options can be assessed by comparing the resultant Residual Land Values with the 'Existing' land value of the Subject Site. By way of background, the Subject Site comprises of four commercial office buildings that Hill PDA have individually valued. Hill PDA has arrived at a total site value of $69,076,180.

The Charter Hall valuation used a $/sqm for Net lettable area (NLA) of $2,615/sqm. Hill PDA adopted $2,615/sqm to all the properties located on the site to arrive at a valuation amount for each property with the exception of 472 Pacific Highway, in which we adopted the purchase price. The valuation figures are outlined in Table 4 below:

Table 3 - Subject Site Valuations

Address	Site Area	NLA		$/sqm	Valuation
472 Pacific Highway					
Valuation	2666	4,800	x	$2,615	$12,552,000
Purchase Price					$18,000,000
					We have adopted $18m
486- 494 Pacific Highway	2516.2	6,733	x	$2,615	$17,606,795
500 Pacific Highway	482.4	1,748	x	$2,615	$4,571,020
504-520 Pacific Highway	1844.5	11,051	x	$2,615	$28,898,365
Total Site	**7509.1**				**$69,076,180**
Total Site Value					**$69,076,180**

This Chapter measures feasibility by the project Internal Rate of Return (IRR) and Residual Land Value (RLVs) with the ranges of acceptability indicated below.

Table 4 - Performance Criteria

Performance	Project IRR
Feasible	>18%-20%
Marginally feasible	16%-18%
Not feasible	<16%

Options Analysed

In light of the methodology described above, Hill PDA assessed the feasibility of four different development options for the Subject Site. The options were premised on:

- The base case comprises of a mixed use scheme approximately 82,405sqm GFA (as per Planning Proposal)
- Car Parking Rates for residential tested both 0.75 and 1 car space per dwelling
- Commercial and retail rents reduced by 20% over a 5 year lease for start-up business.

In light of these matters, four scenarios were identified as follows:

Option 1: The planning proposal in its current form[26]

Option 2: The planning proposal with an alternative car parking rate[27]

Option 3: Amending the planning proposal so that Tower 1 and Tower 3 remain as proposed but Tower 2 (23 levels – 20,365sqm) was entirely commercial.

Option 4: Amending the planning proposal so that it was 100% commercial office.

Modelling Results

Each option was also assessed against a 20% Project IRR and Development Margin.

The results of our high-level feasibility testing under various land use and density controls are summarised below.

[26] Using a car parking rate of 0.75 space per residential unit and 1 car spot for 110sqm of retail / commercial floorspace.

[27] Using a car parking rate of 1 space per residential unit and 1 car spot for 110sqm of retail / commercial floorspace.

Table 5 - Options Analysed for the Subject Site

Site/Options Specifics	Option One Proposed Scheme .75 Car space per Unit	Option Two Proposed Scheme Increased Parking to 1 car space per unit	Option Three Tower 1 & 3 Mixed Use with Tower 2	Option Four Tower 1 – 3 Commercial
Site Area	7,509sqm	7,509sqm	7,509sqm	7,509sqm
Developable Area[1]	82,405sqm	82,405sqm	82,405sqm	82,405sqm
Development Yield	910 units	910 units	616 units	42 units
Performance Indicators:				
Project IRR	22%	22%	17%	4%
Feasibility	**Viable**	**Viable**	**Marginal Viable**	**Not Viable**

Source: Estate Master V5.

Key Findings

Our financial modelling based on industry knowledge and research therefore shows that Option 1 and 2 are financially viable and attractive development options. Option 3 is however marginal in its viability and therefore represents the 'tipping point' of commercial floorspace within the overall mixed use scheme. Accordingly Option 4 (which was 100% commercial office) across the Subject Site was found not be financially viable in the current market.

Assumptions

Project Timeframe:

- Project commencement in Dec 2014
- Construction spans 28 months.
- We have assumed the floor areas from the Planning Proposal. This was confirmed by the client.
- We have assumed a land purchased price of $69,076,180 based on the Charter Hall Valuation 2013.

End Sale Values:

- Due to the high-level nature of this assessment and in the absence of detailed plans, Hill PDA has adopted sale value in the order of:
- Option1 –3 Residential @ $10,000- $15,000/sqm dependant on low to high levels.

End Rental Values:

- Due to the high-level nature of this assessment and in the absence of detailed plans, Hill PDA has adopted rental values at a 20% discount over a 5 year lease in the order of:
- Option1 –4 – Retail @ $640/sqm
- Option 1-3 – Commercial @ 360/sqm
- Option 4- Commercial low levels@ 360/sqm

- Option 4- Commercial mid-levels @ $400/sqm
- Option 4- High Levels @ $460/sqm

Additional sales assumptions include:

- Sales escalations at 5% per annum for residential
- Sales escalations at 3% per annum for residential
- GST excluded on non-residential sales
- Selling costs are assumed at 1.5% of non-residential sales
- Marketing costs 1% of gross sales
- Legal costs 0.50% of gross sales
- Capital Works, Construction and Land Costs

Constructions costs have been sourced from Rawlinson's Construction Handbook 2012 and are as follows:

- Demolition and site preparation at $60/sqm (approximately 3,600sqm of improvements)
- Residential construction@ $3,750/sqm
- Commercial construction @ 3,250-$3,500/sqm – dependant on height of building
- Retail construction - $3,000/sqm

Additional cost assumptions include:

- Professional fees have been assumed at 5% of building construction costs (1% expensed prior to construction of each stage and 2% pro-rated with the costs of development during construction and
- Construction contingency of 5% of construction costs.

Statutory costs:

- DA, CC and, Section 94 contributions and Construction Certificate fees assumed Councils estimates and
- Landholding costs estimated based on prevailing statutory rates and assumed to diminish with sales

Performance Criteria

- Hill PDA has adopted a project discount rate of 20% per annum nominal on the cash flow of the project which includes financing costs but excludes interest.
- Additionally, a developers target development margin of 20% on total development costs (including selling costs) has been assumed both reflecting the size of the development and the associated risk.

Attachment 4- Consolidate Summary Sheet - Feasibility Models Options 1 to 4

EstateMaster DF DEVELOPMENT FEASIBILITY

Summary of Stages and Consolidated Project

Peer Review - 472-520 Pacific Highway

Estate Master Licensed to: Hill PDA Pty Ltd - Administration Account

	1	2	3	4	5	6	7	8	TOTAL
	DA Option Mixed Use development	DA Option Mixed Use Adjusted Parking development	2 towers mixed use/ 1 tower commercial	Commercial Only development only					
	.75 CARS PER UNIT	1 CAR PER UNIT	Mixed use development, retail, commercial and residential	Commercial					
	910. Units 82,405. GFA 7,509.1 SqM	910. Units 82,405. GFA 7,509.1 SqM	910. Units 82,405. GFA 7,509.1 SqM	72,516.4 NLA 82,405. GFA 7,509.1 SqM					
	Miscellaneous Under Review	Miscellaneous Under Review	Miscellaneous Under Review	Miscellaneous Under Review					
REVENUE									
Gross Sales Revenue	954,383,210	954,508,382	863,264,344	566,509,044					3,338,664,980
Less Selling Costs	(41,992,861)	(41,998,369)	(36,320,403)	(12,463,199)					(132,774,832)
Less Purchasers Costs	-	-	-	-					-
NET SALES REVENUE	912,390,348	912,510,013	826,943,941	554,045,845					3,205,890,148
Gross Rental Income	6,330,516	6,354,824	20,491,487	69,681,583					102,858,411
Less Outgoings & Vacancies	-	-	-	-					-
Less Letting Fees	-	-	-	-					-
Less Incentives (Rent Free and Fit Out Costs)	(3,103,194)	(3,115,110)	(10,057,059)	(100,201,781)					(116,477,144)
Less Other Leasing Costs	-	-	-	-					-
NET RENTAL INCOME	3,227,322	3,239,714	10,434,429	(30,520,198)					(13,618,733)
Interest Received	-	-	-	-					-
Other Income	-	-	-	-					-
TOTAL REVENUE (before GST paid)	915,617,670	915,749,728	837,378,370	523,525,647					3,192,271,414
Less GST paid on all Revenue	(83,895,820)	(83,896,946)	(68,765,364)	(1,862,090)					(238,420,220)
TOTAL REVENUE (after GST paid)	831,721,851	831,852,781	768,613,006	521,663,557					2,953,851,195
COSTS									
Land Purchase Cost	75,983,798	75,983,798	75,983,798	75,983,798					303,935,192
Land Acquisition Costs	5,297,348	5,297,348	5,297,348	5,297,348					21,189,391
Construction (inc. Construct. Contingency)	379,909,203	381,734,034	376,843,147	357,029,890					1,495,516,275
Professional Fees	41,060,750	41,248,124	40,858,164	38,688,296					161,855,334
Statutory Fees	16,972,789	16,972,789	14,240,985	7,437,216					55,623,779
Miscellaneous Costs 1	-	-	-	-					-
Miscellaneous Costs 2	-	-	-	-					-
Miscellaneous Costs 3	-	-	-	-					-
Project Contingency (Reserve)	21,363,736	21,462,277	21,061,579	19,651,475					83,539,068
Land Holding Costs	1,066,370	1,066,370	9,036,430	10,023,878					21,193,048
Pre-Sale Commissions	-	-	-	-					-
Finance Charges (inc. Line Fees)	-	-	-	-					-
Interest Expense	59,485,061	59,750,064	59,789,340	85,483,126					264,507,591
TOTAL COSTS (before GST reclaimed)	601,139,055	603,514,803	603,110,791	599,595,028					2,407,359,677
Less GST reclaimed	(50,863,609)	(51,055,996)	(50,035,730)	(50,407,816)					(202,363,151)
Plus Corporate Tax	-	-	-	-					-
TOTAL COSTS (after GST reclaimed)	550,275,446	552,458,807	553,075,060	549,187,212					2,204,996,525

PERFORMANCE INDICATORS

	1	2	3	4	5	6	7	8	TOTAL
[1] Gross Development Profit	281,446,405	279,393,974	215,537,946	(27,523,655)					748,854,669
[2] Net Developer's Profit after Profit Share	281,446,405	279,393,974	215,537,946	(27,523,655)					748,854,669
[3] Development Margin (Profit/Risk Margin)	47.52%	47.00%	36.57%	(4.86%)					31.97%
Target Development Margin	20.00%	20.00%	20.00%	20.00%					
[4] Residual Land Value (Target Margin)	196,917,215	194,991,361	145,757,312	(63,528,311)					474,137,576
[5] Breakeven Date for Cumulative Cash Flow	Jan-2019	Jan-2019	Apr-2019	N.A. (Negative Profit)					Nov-2019
Discount Rate (Target IRR)	20.00%	20.00%	20.00%	20.00%					
[6] Net Present Value @ Start of Stage	12,839,328	11,824,641	(22,852,328)	(117,178,423)					
Date of Commencement	Dec-13	Dec-13	Dec-13	Dec-13					
Holding Discount Rate 10.00%									
[7] NPV at Start of Consolidated Cash Flow	12,839,328	11,824,641	(22,852,328)	(117,178,423)					(115,366,782)
[8] Benefit Cost Ratio	1.042	1.038	0.926	0.596					
[9] Project Internal Rate of Return (IRR)	21.69%	21.55%	17.00%	3.64%					16.12%
[10] Residual Land Value (NPV) @ Start of Stage	80,848,201	79,917,864	48,123,523	(41,372,511)					167,517,077
Peak Debt Exposure	477,887,677	480,050,883	478,071,563	498,788,524					1,898,016,741
Date of Peak Debt Exposure	Nov-2018	Nov-2018	Nov-2018	Oct-2019					Nov-2019
[11] Breakeven Date for Project Overdraft	Jan-2019	Jan-2019	Jan-2019	Nov-2019					
Total Equity Contribution	82,891,416	82,891,416	82,891,416	82,891,416					331,565,664
Peak Equity Exposure	82,891,416	82,891,416	82,891,416	82,891,416					331,565,664
Date of Peak Equity Exposure	Dec-2013	Dec-2013	Dec-2013	Dec-2013					May-2021
[12] IRR on Equity	23.55%	23.45%	20.08%	(6.50%)					18.54%
Weighted Average Cost of Capital (WACC)	11.19%	11.18%	11.19%	11.11%					

YIELD ANALYSIS

	Qty	Area	Qty	Area	Qty	Area	Qty	Area	5	6	7	8	Qty	Area
SALES		SqM		SqM		SqM		SqM						SqM
Apartment	85	67,148	85	67,148	64	49,700	0	0					234	183,997
Commerical Office	1	3,579	1	3,579	5	21,027	9	70,726					16	98,910
Retail Shops	1	1,789	1	1,804	3	1,789	3	1,789					8	7,172
Parking	0	0	0	0	1	185	2	749					3	934
TOTAL	87	72,516	87	72,531	73	72,701	14	73,265					261	291,014
TENANCIES		SqM		SqM		SqM		SqM						SqM
Commerical Office		3,579		3,579		17,448		70,726						95,332
Retail Shops		1,789		1,804		473		1,789						5,856
Parking		0		0		185		749						934
TOTAL		5,368		5,383		18,106		73,265						102,121

Footnotes (based on current Preferences):

1. Development Profit: is total revenue less total cost including interest paid and received
2. Developer's Net Profit after distribution of profit share.
3. Development Margin: is profit divided by total costs (inc selling costs)
4. Residual Land Value: is the maximum purchase price for the land whilst achieving the target development margin.
5. Breakeven date for Cumulative Cash Flow: is the last date when total debt and equity is repaid (ie when profit is realised).
6. Net Present Value: is the project's cash flow stream discounted to present value.
   It includes financing costs but excludes interest and corp tax.
7. Net Present Value of each stage at commencement of the consolidated cash flow using the Holding Discount Rate.
8. Benefit:Cost Ratio: is the ratio of discounted incomes to discounted costs and includes financing costs but excludes interest and corp tax.
9. Internal Rate of Return: is the discount rate where the NPV above equals Zero.
10. Residual Land Value (based on NPV): is the purchase price for the land to achieve a zero NPV.
11. Payback date for the equity/debt facility is the last date when total equity/debt is repaid.
12. IRR on Funds Invested is the IRR of the equity cash flow including the return of equity and realisation of project profits.