

APPENDIX I

SYDNEY CBD COMMERCIAL PROPERTY MARKET APPRAISAL - HILL PDA

23 April, 2014

Re: Sydney CBD Commercial Property Market Appraisal

Mirvac and Coombes Property Group are exploring development opportunities for 505-523 George Street (the "subject site"), located in the southern portion of the Sydney CBD. As part of this assessment, Mirvac commissioned HillPDA to provide a commercial property market appraisal of the Sydney CBD. The analysis provides a range of key market indicators including rents, vacancies and supply. Proposed commercial development in the pipeline is also assessed as part of this appraisal.

1.1 MARKET INDICATORS

As a whole, market conditions within the Sydney CBD remain weak with demand conditions remaining subdued due to uncertain economic conditions in office based sectors of the economy since 2007. Weak market conditions has resulted in soft leasing activity and higher vacancy rates, which has in turn pushed up incentives and impacted on effective rents (-6.4% for Sydney CBD in 2013¹). See Table 1 and Figures 1 and 2 overleaf.

As outlined in the Australian Office MarketView Q4 2013 report by CBRE, "*Incentives are at historically high levels across the eastern seaboard and while we don't expect incentives to move at the same pace as 2013, we see some scope for marginal increases and thus further erosion in effective rents.*" As Figure 2 shows, effective rental growth has failed to reach pre-GFC levels, with a decline in effective rents recorded for the year ended July 2013.

Within the Sydney CBD itself, market demand varies across sub-markets. Demand is most effectively represented by what tenants are willing to pay for office space (i.e. rent). As can be seen in Table 1, average net face rents for prime stock are lowest in the Southern precinct, indicating that demand is lowest in this sub-market. The subject site is located in the southern fringe of the Midtown sector, where rents are likely to be similar to those identified in the Southern precinct. Rents in the northern portion of the Midtown precinct are likely to be high, reflecting the prestige of the commercial office market in this area as part of its proximity to the City Core.

Low rents along with high incentives and increasing vacancy rates have created market conditions which have constrained commercial office investment in the southern portion of the CBD.

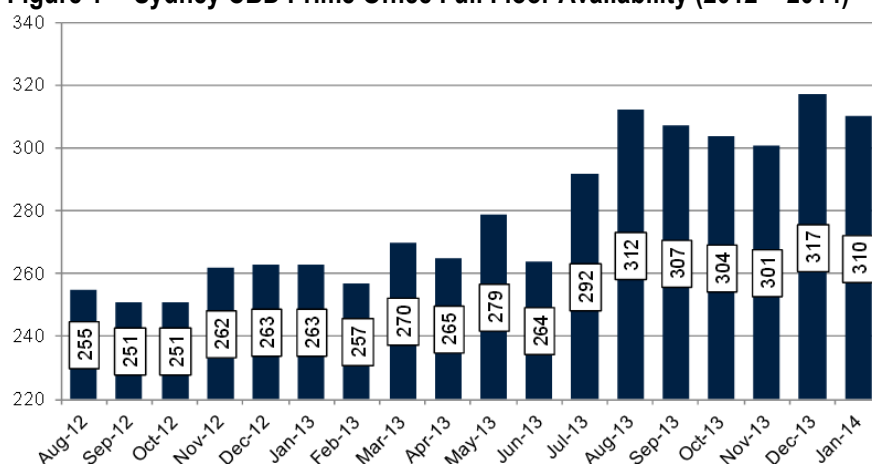
¹ Australia Office MarketView Q4 2013, CBRE (2013)

Table 1 - Sydney Commercial Precinct Market Indicator Comparison (2012)¹

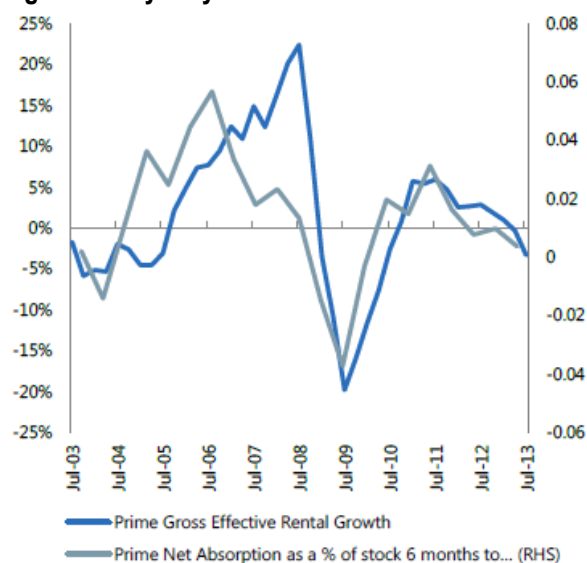
Precinct	Existing Stock (sqm NLA)	Vacancy Rate (%)	Annual Net Absorption (sqm)	Avg. Prime Net Rent (\$/sqm)	Avg. Prime Yield (%)	Avg. Incentives ²
The Rocks	42,501	8.1%	-861	\$500	8.5%	
City Core	2,118,326	11.4%	-38,772	\$815	6.8%	
Western Corridor	1,216,931	5.6%	36,495	\$548	7.8%	
Midtown	1,152,882	10.8%	15,430	\$524	7.9%	
Southern	339,825	9.9%	-945	\$384	8.5%	
Walsh Bay	58,902	0%	2,615	\$516	8.1%	
Total	4,929,367	9.6%	13,961	\$651	7.4%	29%

¹ Sydney CBD Marketview Q1 2012, CBRE (2012)

² September 2013 Sydney CBD Office Market Overview, Knight Frank (2013)

Figure 1 - Sydney CBD Prime Office Full Floor Availability (2012 – 2014)


Source: Spotlight Sydney CBD Office, Savills (2014)

Figure 2 - Sydney CBD Prime Effective Rental Growth and Prime Net Absorption (2003 - 2013)


Source: September 2013 Sydney CBD Office Market Overview, Knight Frank (2013)

1.2 EMPLOYMENT DEMAND

A driver of demand for commercial office space is employment growth, and in particular jobs which are typically undertaken from an office environment². A weakened job market following the GFC has limited demand for commercial office space in the Sydney CBD and in other locations over the previous six or so years.

Based on ABS data, growth in office based employment since the GFC (2008 onwards) in NSW has been below historic averages at only 0.9% per annum, with just 40,236 such jobs added over this period. In contrast, over a four year period from 2004 to 2008, there was an additional 62,093 such jobs added to the NSW economy at a far more robust growth rate of 2.3% per annum.

At a more localised level, within the Sydney LGA between 2006 and 2011, office based employment grew at 0.9% per annum. This represented much slower average growth than that experienced in the LGA by retail, hospitality and recreation employment (3% per annum).

1.3 COMMERCIAL DEVELOPMENT TRENDS IN THE SYDNEY CBD

Past development trends and anticipated future supply shows that the Sydney CBD is made up of a number of sub-markets. Commercial office market conditions and activity can vary significantly between the sub-markets.

Existing commercial space data in Table 1 shows that commercial space has predominantly been provided in the City Core (approximately 2.1 million sqm of existing stock), Western Corridor (1.2 million sqm) and Midtown (1.2 million sqm) precincts.

In the coming years, additional demand for office floorspace is likely to continue to predominantly locate in these areas. In addition to those established sub-markets, the Barangaroo development (forming part of the Western Corridor and Walsh Bay precincts) will accommodate a significant portion of new stock in the CBD in the coming years. All up the precinct is expected to have capacity to accommodate an additional 320,000sqm GFA of commercial office space in Barangaroo South alone³, with approximately 267,500sqm of office space either under construction or mooted for development in the precinct as part of the development of towers 1, 2 and 3⁴.

The Barangaroo precinct has already gained a number of pre-committed tenants including KPMG, Westpac, Gilbert and Tobin Lawyers and Lend Lease who together will occupy approximately 130,000sqm of prime commercial office space once development is complete from 2015 onwards.⁵ The availability of prime space, in a prestigious location with expected excellent surrounding amenity attributes is likely to flatten demand in other parts of the CBD over the next few years. In addition, pre-commitments from firms for space in the Barangaroo precinct and other new prestigious developments (including 333 George Street) will create a large quantum of

² Includes information media and telecommunications, financial and insurance services, rental, hiring and real estate services, professional, scientific and technical services, administrative and support services and public administration and safety.

³ <http://www.lendlease.com/australia/projects/barangaroo-south>

⁴ September 2013 Sydney CBD Office Market Overview, Knight Frank (2013)

⁵ <http://www.colliers.com.au/News> Accessed 22.04.2014

backfill space as existing tenancies are vacated. As outlined in a January 2014 article in The Australian “added supply would increase pressure on office landlords, with rents expected to stay low and incentives to stay high.”⁶

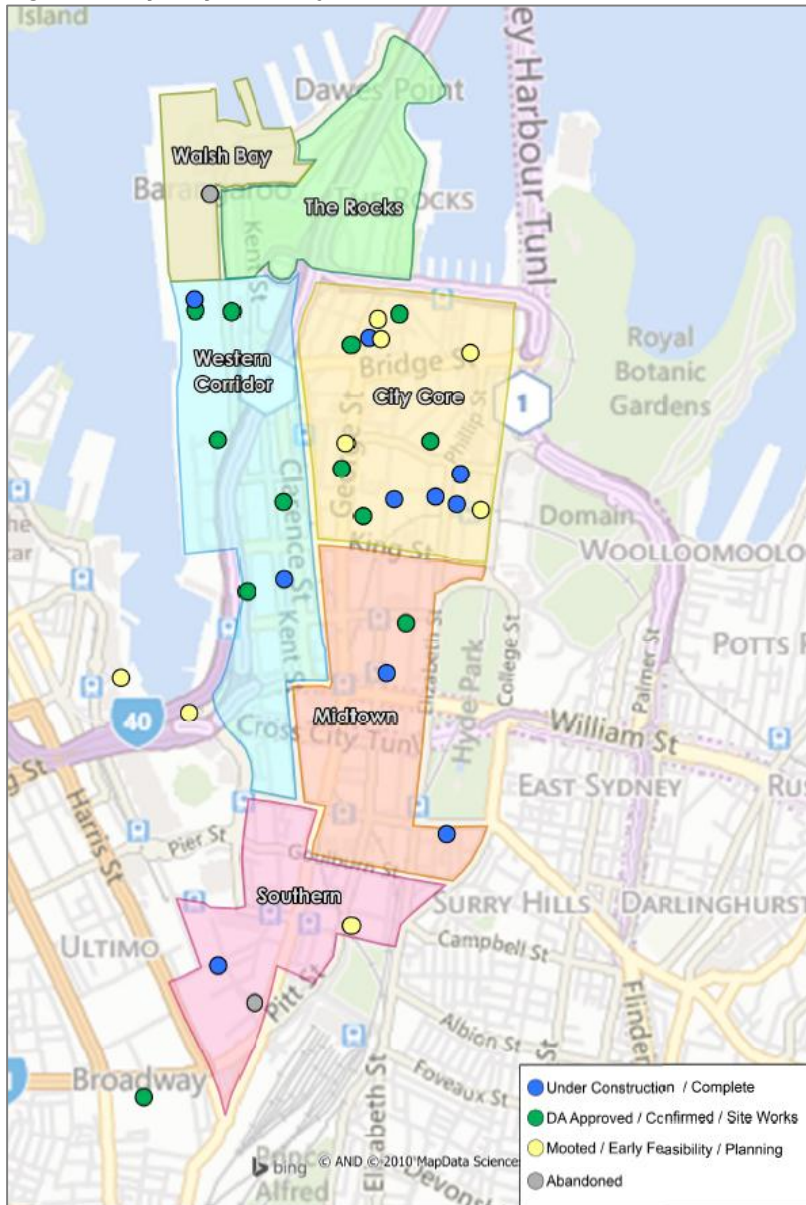
An assessment of recently completed commercial office development and development in the pipeline, including proposals that have been granted development approval along with those that are mooted or in the early stages of planning has been undertaken for the CBD as part of this assessment.⁷ Figure 3 shows that most recently completed commercial office development and development in the pipeline is focused around the City Core area and Western Corridor (including Barangaroo). This indicates that these areas remain the most desired locations for office development in the CBD.

The Midtown and Southern precincts have little commercial office development in the pipeline.

⁶<http://www.theaustralian.com.au/business/property/barangaroo-may-add-to-sydneys-office-oversupply/story> Accessed 22.04.2014

⁷ The analysis is based on major office supply as identified in the September 2013 Sydney CBD Office Market Overview undertaken by Knight Frank in September 2013 updated with data from Cordell Connect from September 2013 onwards and includes significant abandoned projects.

Figure 3 - Sydney CBD Major Office Development Pipeline (2012/13 – April 2014)



Source: September 2013 Sydney CBD Office Market Overview, Knight Frank (2013), Cordell Connect (2014) and HillDPA (2014)

1.4 SOUTHERN CBD PIPELINE

A more detailed examination of all pipeline activity in the area around the subject site (including all proposed development south of Druiitt / Park Street) is provided in Table 2. The development pipeline as a whole reflects the mixed use nature of the southern portion of the CBD, with a diverse range of activity being pursued.

The data shows that there are a significant number of projects that relate to retail, hospitality and entertainment in the southern portion of the CBD (south of Druiitt / Park Street), including a number of hotel refurbishments and additions, as well as commercial office and residential proposals. This indicates the precinct is being consolidated as a mixed-use area.

Table 2 - Southern Sydney CBD (south of Druiett / Park Street): Development Pipeline (2012 – April 2014)

Project / Owner	Address	Approved Floorspace (sqm) (GFA)	Type	Value (\$ million)	Stage
Office Development					
Haymarket Substation Airspace – Transgrid Development	29A-31 Ultimo Rd	16,109	Commercial / Retail - 9 storey	\$59.7	Contract Let
Pitt Street Offices	390-396 (Lot 1) Pitt St	3,162	Office - 6 storey - refurbishment & altns	\$3.7	Construction
Flight Centre House	815-821 (Lot 101) George St	11,801	Office - refurbishment - 4 level	\$3.7	Contract Let
Quay Street Commercial Building	10 (Lot 1) Quay St	6,185	Commercial - 8 storey - altns & addns	\$4.9	Development Approval
Australia Square Commercial Building	264-278 George St	4,140	Office –altns & addns	\$4.4	Development Approval
Former American Express Building	169-183 Liverpool St	58,986	Office / car wash – 31 level	\$45.7	Construction
Total Office		100,383sqm		\$122.1m	
Retail, Hospitality & Recreation / Leisure					
Woolworths	61-79 Quay St	1,560	Supermarket - fitout	\$2.6	Development Approval
Pitt St backpacker accommodation	390-396 (Lot 1) Pitt St	510	Backpacker Accom - 2 level - addns	\$0.8	Contract Let
Sussex St Cyber Cafe	374-386 Sussex St	831	Internet Cafe - 2 storey - altns & addns & fitout	\$0.8	Contract Let
Elite Room & Prince Restaurant - Chinatown Centre	405-411 Sussex St	2,125	Restaurant - 2 level - fitout	\$0.9	Construction
Scruffy Murphy's Hotel	51-57 Goulburn St	910	Hotel - altns & addns - 2 storey	\$1.8	Completed
Triple Eight Hotel	25-29 Dixon St	700	Hotel - refurbishment	\$0.7	Contract Let
Aarons Hotel	35-39 Ultimo Rd	6,440	Hotel - 4 storey - altns & addns	\$5.3	Development Approval
Crystal Palace Hotel	789-791 George St	600	Hotel - altns & addns	\$0.8	Development Approval
Four Points by Sheraton Hotel	161 Sussex St	24,115	Hotel - 25 storey – redevelopment	\$148.5	Development Approval
Darling Park	201-249 Sussex St	1,460	Retail Podium – Level 2 – upgrade	\$9.6	Contract Let
Hugo Boss	Shop – 2 level – altns	430	Shop – Level 2 – altns	\$1.4	Construction
Pitt Street Retail Building	182 Pitt St	596	Retail – 3 storey	\$3.25	Construction
Total Retail, Hospitality and Entertainment		40,277sqm		\$176.5m	
Residential					
Dixon St mixed Development - Hing Loong Apartments	49-53 Dixon St	4,202	Units (47)/ commercial / restaurants (2) - 17 storey	\$20.3	Construction
Quay St Mixed Development	61-79 Quay St	30,614	Units (240)/retail - 16 storey	\$104.7	Construction
Mission Australia site mixed development	4-10 Campbell St	17,359	Serviced apartments (247)/commercial/retail - 32 storey	\$73.0	Construction
George St mixed development	710-722 George St	25,908	Units (218)/commercial - 36 storey	\$48.5	Construction
Kent St Mixed Use Development	189-197 Kent St	18,903	Residential / commercial – conversion from commercial building – 21 storey	\$400.0	Deferred
Her Majesty's Theatre carpark site	81-91 Quay St	7,758	Student accommodation - 16 storey	\$33.1	Contract Let
Total Residential		104,744sqm		\$679.6m	

Source: Cordell Connect (2014) and HillDPA (2014)

1.5 SYDNEY LGA DEVELOPMENT CAPACITY

In 2008, the City of Sydney prepared a Capacity Study “that measured ‘the ‘gap’ between floor space currently available ‘as built’ and the potential floor space that could theoretically be achieved if the property was developed to the maximum floor space ratio (FSR) control under the prevailing planning instrument.”⁸ In 2010, a Supplement was prepared that updated the estimates. The Supplement identified that the Sydney LGA could accommodate between 86% and 96% of additional capacity based on residential and employment targets set out in the Sustainable Sydney 2030 and Draft Sydney City Subregional Strategy documents.

At the higher range, there is essentially enough floorspace capacity to accommodate residential and employment targets as nominated in the Subregional Strategy, with a potential slight undersupply of floorspace based on targets in the Sustainable Sydney 2030 document. The estimates did not take account of a number of currently constrained land uses which could potentially also be redeveloped in the coming years, including (but not limited to) strata-titled properties, heritage buildings / locations, properties with a special use zoning (e.g. schools, hospital).

Furthermore, the analysis does not delineate between residential capacity and employment capacity. It may be that there is sufficient capacity for all published employment targets.

Finally, the analysis also assumes that every additional employee in the Sydney LGA would require approximately 41sqm of floorspace. This is high given that within the Sydney LGA the vast majority of employment is concentrated in the CBD, particularly in office and retail activities. Office workers typically require 15-20sqm per employee, whilst retail employment densities vary but it is common for specialty shops, restaurants and cafes to require anywhere from 25-35sqm per worker. Assuming that, at the most, each additional worker would require 35sqm then the Sydney LGA has capacity to accommodate between 93% and 100% of residential and employment requirements depending on the targets used. With a lower average employment density applied, the LGA would be capable of accommodating even more commercial and retail floorspace.

1.6 CONCLUSION

The market appraisal of the Sydney CBD highlights the following.

1. Weak commercial office market conditions have contributed to soft leasing activity and relatively high vacancy rates in the Sydney CBD. This in turn has led to incentives significantly rising which has impacted materially on effective rental growth.
2. Within this context, demand conditions and development activity varies by sub-market or precinct in the CBD area. Some precincts are stronger than others, with most commercial office activity focused in the established market areas of City Core, Western Corridor and Walsh Bay / Barangaroo area.
3. Low commercial office rental returns are particularly applicable in the southern portion of the CBD, indicating lower demand than in other parts of the CBD such as around the City Core precinct.

⁸ City of Sydney Capacity Study 2008: City Plan Supplement, City of Sydney (2010)

4. Some established precincts of the CBD are likely to continue to experience weak commercial office market conditions from 2015 onwards as significant office supply is added primarily in Barangaroo.
5. This demand context indicates limited commercial development in the southern portion of the CBD, with lower levels of stock and fewer office developments in the pipeline in the Midtown and Southern precincts compared to the prime commercial office precincts and development hot spots. The southern portion of the CBD performs a mixed-use role.
6. City of Sydney analysis suggests that the CBD has capacity to accommodate significant additional residential and employment targets. A market responsive approach to meeting the targets would seek to facilitate a greater share of commercial office capacity in locations preferred by the market – such as City Core, Western Corridor and Walsh Bay / Barangaroo – and facilitate a greater share of mixed-use development in the southern portion of the CBD.
7. On the basis of the above analysis we are of the view that a proposal to utilise land in the southern portion of the CBD for predominantly non-commercial office purposes is market responsive and appropriate for the area.

Should you have any questions regarding the above, please do not hesitate to contact Fergus Stewart or myself on 03 9629 1842.

Yours sincerely,



Alex Hrelja

Principal
Hill PDA

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