FINAL

INDEPENDENT MARKET REPORT

RE: 41 MCLAREN STREET PLANNING PROPOSAL

Prepared for:

RBG Services Group Pty Ltd

Level 2, 41 McLaren Street

(PO Box 6395)

North Sydney, NSW 2060

by Knight Frank Consulting

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EXECUTIVE SUMMARY

This report produced by Knight Frank Research & Consulting has independently considered the current market conditions and factors affecting the supply of new office space across the North Sydney CBD. The report takes into consideration comparable evidence from other major Sydney office markets, and leverages on the knowledge and experience of Knight Frank's Office Leasing and Occupier Solutions teams.

The report also aims to highlight both the nature and extent of likely demand for office floor space within the North Sydney CBD, and relates this to particular floor plate size requirements. The report additionally comments on the Hotel and Retail (ancillary to office) market requirements in the North Sydney locale.

The report has been commissioned in respect of a submission (41 McLaren Street) to Council regarding their recently released Draft Masterplan. The primary issue is whether, from a commercial office (in addition to hotel and retail) market perspective the Council's mixed use tower on its Ward Street carpark site and hotel tower on the amalgamated 56 & 66 Berry Street site, is appropriate for North Sydney. Of high importance is the appropriateness of the Commercial mixed use building; the built form and floor plate size.

Knight Frank understands that on 5 December 2016, Council resolved to exhibit the draft Ward Street Precinct Masterplan. The Ward Street Precinct is a mix of commercial, mixed use and residential developments at the northern end of the CBD. The precinct is bound by McLaren Street to the north, Berry Street to the south, Miller Street to the west and includes a number of properties on the eastern side of Walker Street, south of Hampden Street.

In its own words the draft Masterplan aims to significantly improve the public domain offering of the CBD and carefully plan for its urban renewal. There are a number of catalysts for the draft Masterplan:

- The return of the Ward Street carpark to Council control in 2020
- The planned Victoria Cross Metro Station
- Strong private development interest
- The activation of the North Sydney CBD and implementation of the directions set out by the North Sydney Centre Review.

The draft Masterplan proposes to replace the Ward Street carpark with a major new mixed use tower, community facility and a 1,450m² public plaza that is connected by active, pedestrian focussed laneways.

For the Ward Street carpark site, the draft masterplan proposes, amongst other uses;

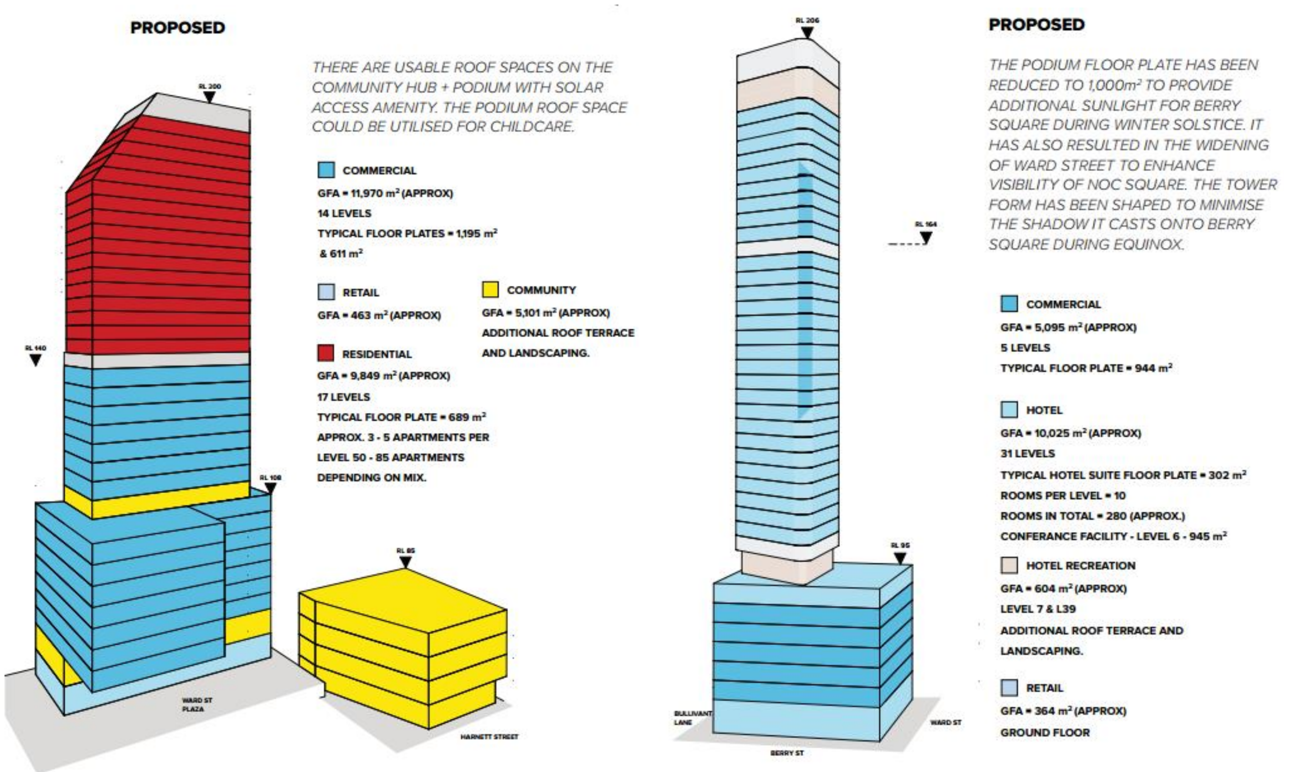
- Commercial floor space: GFA 11,970m², typical floor plates include;
    - 7 levels at 1,195m²
    - 7 levels at 611m²

In addition the draft Masterplan proposes a mixed use tower at 56-66 Berry Street. For this site, the draft masterplan proposes, amongst other uses;

- Commercial floor space: GFA 5,095m², typical floor plates include;
    - 5 levels at 944m²

- Hotel floor space: GFA 10,025m², typical hotel suite floor plates include;
    - 28 levels at 302m²
    - 10 rooms per level

Figure 1. Masterplan Proposals for Ward Street Carpark and 56-66 Berry Street



Source: North Sydney - North of Centre Precinct Plan

It is in the opinion of Knight Frank, and backed up by analysis throughout this report and market knowledge, that the proposed commercial floor plates at the Ward Street carpark are not appropriate for the North Sydney market and are unfeasible/unviable from a development/construction perspective. The main reasons for this are listed below:

1. The North Sydney market has recently been characterised by constrained new supply, in particular prime buildings with larger floor plates and high levels of withdrawals of obsolete commercial space with small floor plates.

2. The second half of last year (2016) saw the strongest level of absorption in North Sydney in 16 years, with the latent demand being constrained by the lack of new space amid diminishing stock. At present there is strong demand for North Sydney office space from large tenants (averaging 10,000m², but ranging from 3,000m² to 30,000m²).

3. The strong take-up in the prime market resulted in a significant decline in the prime vacancy rate, which decreased from 10.5% in July 2016 to 8.7% in January 2017.

4. On the back of positive tenant demand and below-trend vacancy levels, gross face rents continued to increase across both the prime and secondary markets whilst incentives trended down further in the second half of 2016. Over the next five years, prime gross face rents are expected to grow at around 6.0% p.a. whist incentives for existing prime office space are expected to trend down towards 20%.

5. Recent major lease deals highlight that the average floor plate leased measured 1,321m² which indicates that market demand is for larger floor plates.

6. Tenants are placing a greater emphasis on flexible working arrangements such as activity based working and hot desking. In order to do this, office tenants are increasingly seeking larger floor plates which reduces the need for multiple smaller levels. This trend has been steadily gaining traction in recent years, highlighted by the rapid development and take-up of Macquarie Park where large tenants can readily access large floor plates in excess of 3,000m².

7. Despite an increase in demand and tenant enquiry from large businesses seeking office space in North Sydney, the majority of existing office space is not suitable for larger tenants as the floor plate size is significantly less than other office markets across Sydney. On average, existing office stock (average by building) in North Sydney has a floor plate of 759m², significantly under Macquarie Park (2,827m²), Parramatta (1,034m²) and Chatswood (1,423m²). Only a small proportion of buildings in North Sydney have a floor plate over 1,000m², totalling just 20% of buildings. Consequently, there has been an outflow of larger tenants to other competing markets. In this case, for businesses seeking floor plates in excess of 1,000m², it is likely that they will look further afield given the lack of options in North Sydney. We note however, both recent and major proposed office developments in North Sydney are alleviating this pressure to some extent by providing office floor plates which are conducive to market demand.

8. The average floor plate size across North Sydney has grown significantly over the years to match market demand. During the 1980's, the average floor plate of buildings completed in North Sydney was just 606m², rising dramatically throughout the next development phase during the 2000s to average 1,237m², and steadily rising during the two most recent periods of development, 2010-2016 (1,498m²) and 2018-2020 (1,550m²). The Masterplan proposals for the Ward Street carpark and 56-

66 Berry Street sites average just 914m², across all floors. This average floor plate size is 41% below what is currently being prepared to be delivered to the market, and 39% below what has been constructed during the most recent development phase (2010-2016). Furthermore, the largest floor plates proposed (seven levels at 1,195m²) at the Ward Street carpark site are 23% below the average of what is being prepared to be delivered to the market during 2018-2020.

9. The last office building to be constructed and delivered in the North Sydney market with an average floor plate size of less than 611m² was in 1990 (the smallest floor plates proposed, seven levels, at the Ward Street carpark site).

10. There has not been an A Grade or Premium Grade building built with an average floor plate of less than 1,053m² since 1988. The average floor plate of A Grade and Premium Grade buildings built across North Sydney since 1990 equals 1,342m². No B Grade or below buildings have been constructed since 1990.

11. In comparison to the past four periods of significant office space development across North Sydney, the Masterplan proposals for the Ward Street carpark and 56-66 Berry Street site fall short of what both the market demands and what developers/owners will be feasibly able to construct.

12. Since the beginning of 2013, 49,235m² of commercial space has been permanently withdrawn from the North Sydney office market, significantly above competing markets. Withdrawals have entirely comprised secondary office stock. Looking forward, there remains a further 58,613m² that has been earmarked for potential conversion to residential, 46% of which is anticipated to be withdrawn within the next 24 months. Of the withdrawal pipeline, the average floor plate is 763m².

13. While the average floor plate of potential stock to be withdrawn is marginally above the existing North Sydney average of 759m² per floor plate, it remains well below recent trends in development which is being built to match market demand, and hence making them viable to be built. If we focus on the financing requirements which drive the delivery of new stock a developer must find a tenant of up to 50% of the total NLA.

14. Observing business count data between June 2013 and June 2016 shows that North Sydney experienced the equal largest increase in the number of businesses employing 200+ workers, compared against competing markets. Over the three year period, six additional large businesses /office users were operating in North Sydney, on par with Parramatta. Parramatta's result however was aided by the NSW Government's decentralisation policy which saw an influx of government departments. Elsewhere, business growth in large tenants was limited, with both Chatswood and Sydney Olympic Park (SOP) experiencing a contraction over the period.

15. Subsequently, this further supports the mismatch between market demand and existing supply. Given North Sydney's ease of access to other parts of Sydney including its proximity to public transport infrastructure, large office tenants are increasingly seeking space in North Sydney. Currently we (Knight Frank and other real estate professionals) have 100,000m² of enquiry for North Sydney office space. This enquiry needs to be satisfied in the next three years. In terms of supply only 100 Mount Street, of 40,608m², will be built so significant shortfall is anticipated.

16. With existing stock being significantly skewed to smaller floor plates, future supply in North Sydney will need to bridge the gap and provide larger floor plates in order to maintain the attractiveness of the market. Furthermore, it is the opinion of the Knight Frank Office Leasing team that the Council's proposed suggestion that floorplates sized 611m², 944m² or 1,195m² is suited to demand does not consider the economic difficulties of modern development. It may be that there is the potential to interest tenants in 611m² floorplates but this would require the supply to be built on a purely speculative basis and the market has only seen a few office buildings built on that basis since 1992. Certainly in the past seven years the market has not seen any speculative new office development.

It is also in the opinion of Knight Frank, and backed up by analysis throughout this report and market knowledge, that the proposed hotel floor plates at the 56-66 Berry Street site are not appropriate for the North Sydney market and are unfeasible/unviable from a development/construction/operation perspective. The main reasons for this are listed below:

1. A newly developed hotel in this location would ultimately service corporate travellers, especially with the inclusion of conferencing facilities within the proposed design. Generally in Australia, corporate travellers require a 4*+ hotel offering. Across Australia, and generally within this location a 4* hotel would ideally have a hotel room size of no less than 25m². In comparison, a newly developed 3* offering, such as a Holiday Inn Express hotel, would require approximately 20m² hotel rooms.

2. Using the proposed 302m² floor plate as a base, we have calculated the amount of available space for an individual hotel room (based on 10 rooms per floor, as indicated within the proposal). Adding together the space required for a lift core, lobby area, corridor, emergency staircase and maid store (95m²) reduces the available space for hotel rooms to 207m² per floor. The remaining available space would assume an average hotel room size of 20.7m² (based on 10 rooms per floor), significantly below the requirements of a 4* hotel as noted in Point 1.

3. If one would reduce the number of hotel rooms to eight per floor, to reach above the 25m² 4* hotel room requirements then this would have a severe impact on operational costs. In the opinion of Knight Frank a hotel tower in this location would ideally accommodate approximately 20 hotel rooms per floor, in order to achieve optimal operational savings.

1.0 NORTH SYDNEY OFFICE MARKET OVERVIEW

This section of the report highlights and provides an overview of the key market indicators for office space within the North Sydney market, as well as commenting on the medium term outlook for specific market indicators and the market in general.

1.1 SUPPLY & DEVELOPMENT

Over the past ten years, the North Sydney market has been characterised by constrained new supply, in particular prime buildings with larger floor plates. This constrained new supply has also been exacerbated by high levels of (compared to historic levels) existing office space being withdrawn from commercial use for residential and alternative uses.

The second half of 2016 saw the completion of North Sydney's first office tower in six years at 177 Pacific Highway, delivering 39,419m^2 to the market. The development had a 100% pre-commitment from Leighton Group. The development was to be used as Corporate Headquarters of Leighton Group who took a head lease of 76% of the NLA and provided a rental guarantee for four years for any vacant space upon completion. This, together with the refurbished space at 101 Miller Street (5,713m^2), took the gross office supply in the six months to January 2017 to 45,132m^2.

On a net supply basis, 30,014m^2 was delivered in the second half of 2016, the highest level of net supply since the last major office development at 40 Mount Street (Coca-Cola Building - 28,500m^2) was completed in July 2010. On the withdrawal front, the depletion of office stock in North Sydney CBD continued in the second half of 2016 resulting in 15,118m^2 of space taken offline for the construction of the proposed Victoria Cross metro station and also residential redevelopment (see Section 2.2 for further detail).

Major office buildings removed from the total stock in 2016 included 181 Miller Street (12,112m^2 - withdrawn for Sydney Metro construction), 189 Miller Street (2,635m^2 - Sydney Metro), 194 Miller Street (1,420m^2 - Sydney Metro) and 30 Alfred Street (3,952m^2 - residential conversion).

The future withdrawal pipeline will include 61 Lavender Street (10,500m^2 - expected to be withdrawn for residential redevelopment in 2018), 88 Walker Street (3,064m^2 - hotel conversion ~2018), 168 Walker Street (17,663m^2 - residential redevelopment ~2019) and 52 Alfred Street (9,947m^2 - residential ~2019).

The new supply additions coming to fruition over the next five years will include the two developments at 100 Mount Street (40,608m^2), to be completed by the end of 2018, and 1 Denison Street with completion expected in early 2020 (see Figure 9 for floor schedule). Laing O'Rourke has secured 6,229m^2 at 100 Mount Street while Channel 9 has pre-committed to circa 15,500m^2 at 1 Denison Street, at which the owner (Winten Property) is currently seeking approval for uplift in the office GFA from 45,720m^2 to 65,000m^2.

Another potential project is 118 Mount Street, which has a DA lodged by Zurich Insurance as at February 2017 for a new 29 floor office building with an NLA of 22,982m^2 and the demolition of the 4,034m^2 existing office building.

Map 1. North Sydney Office Supply

North Sydney

1 — 100 Mount St - 40,608m² [Laing O'Rourke]
Dexus Q4 2018 - 15% committed

2 — 1 Denison St - 65,021m² [Channel 9]
Winten Property Group H1 2020 - 25% committed

3 — 118 Mount St - 21,103m²
Zurich - DA Submitted

Under Construction/Complete

DA Approved/Confirmed/Site Works

Mooted / Early Feasibility

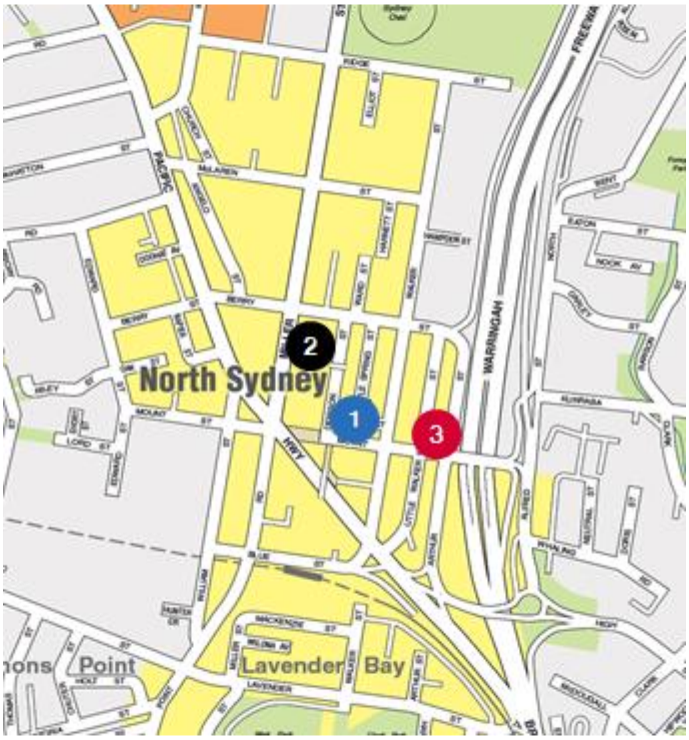
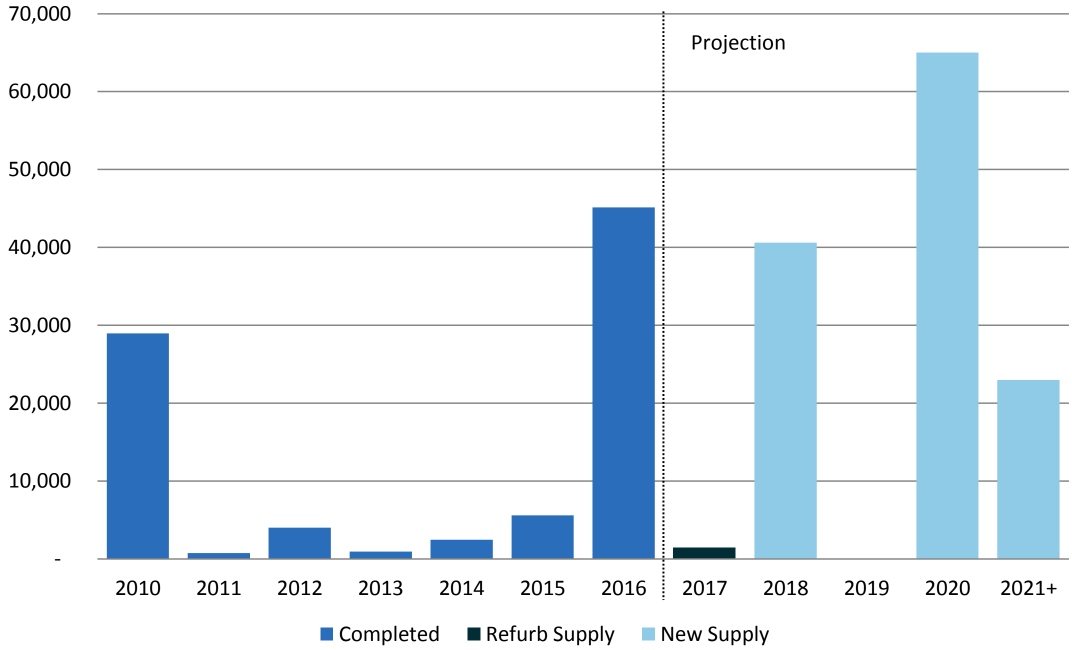


Figure 2. North Sydney CBD Gross Office Supply (m²)



Source: Knight Frank Research, PCA

1.2 NET ABSORPTION & VACANCY

The North Sydney office market recorded strong net absorption of 27,870m^2 in the six months to January 2017 as a result of the take-up at the newly completed building at 117 Pacific Highway. The office tower was fully leased upon completion by anchor tenants including Jacobs Engineering Group, Vodafone, Pepper Group, Cisco Systems and Objectives Corporation Ltd.

The second half of last year was the strongest level of absorption in North Sydney in 16 years. The average semi-annual net absorption in North Sydney over the past 10 years is only 1,228m^2 with the latent demand being constrained by the lack of new space amid diminishing stock.

Driving the current strong absorption levels are major occupiers in the engineering, telecommunication, IT, financial and property services sectors.

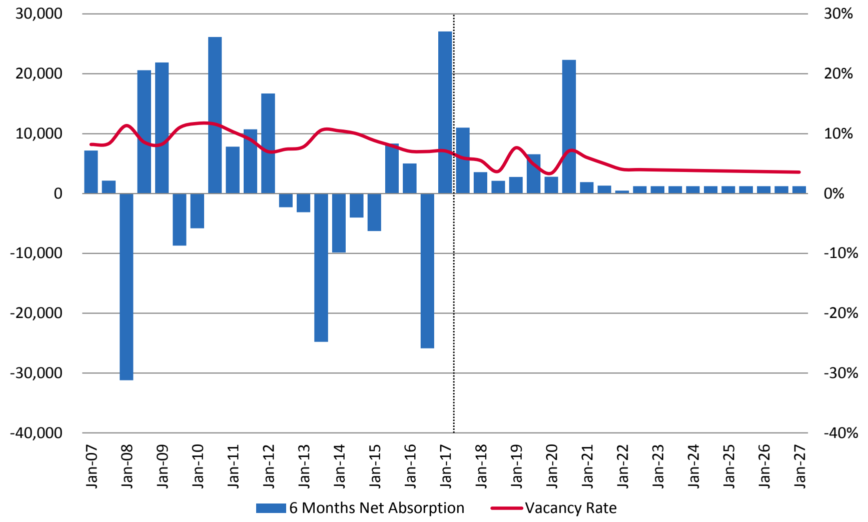
In the secondary market, withdrawals continued to have a major effect on secondary absorption which decreased by 16,681m^2 in the six months to January 2017 and 28,452m^2 for the 2016 calendar year.

The overall vacancy rate remained steady at 7.1% in January 2017 (7.0% in July 2016). However, the current vacancy levels are around three percentage points below the 10-year average of 9.1%, putting further pressure on rents and incentives.

The strong take-up in the prime market resulted in a significant decline in the prime vacancy rate, which decreased from 10.5% in July 2016 to 8.7% in January 2017.

In the secondary market, the average vacancy rate increased slightly from 5.7% in July 2016 to 6.4% in January 2017, albeit this remained significantly below the long-term average of 9.7%.

Figure 3. North Sydney Net Absorption (m²) & Office Vacancy Rate (%)



Source: Knight Frank Research, PCA

*net absorption post 5 year forecast based on long term average

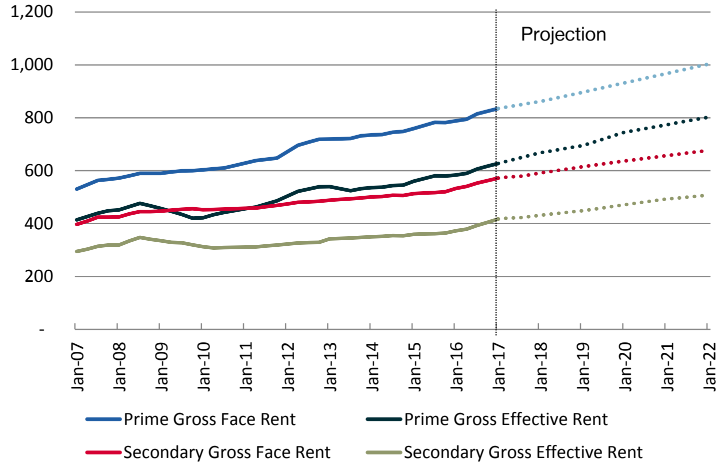
1.3 RENTAL GROWTH

On the back of positive tenant demand and below-trend vacancy levels, gross face rents continued to increase across both the prime and secondary markets, whilst incentives trended down further, in the second half of 2016.

The average prime gross face rent increased by 5.99% YoY to $835/m^2$ as at January 2017. Furthermore, the decline in prime incentives resulted in gross effective rental growth of 7.52% in the 12 months to January 2017, taking the average prime gross effective rent to $627/m^2$.

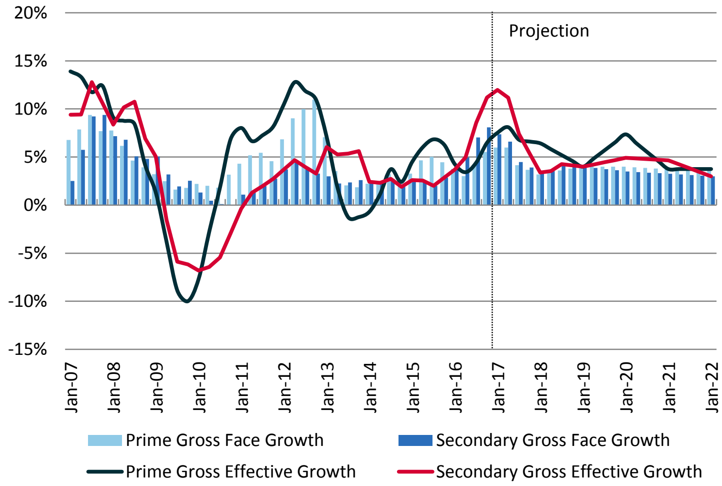
In the secondary market, the average gross face rent grew by 6.00% YoY to $691/m^2$ as at January 2017. The average secondary effective rent grew by 7.06% YoY to reach $512/m^2$.

Figure 4. North Sydney Gross Effective Rent and Gross Face Rent ($/m²)



Source: Knight Frank Research

Figure 5. North Sydney Quarterly Rental Growth, Gross Effective Rent and Gross Face Rent



Source: Knight Frank Research

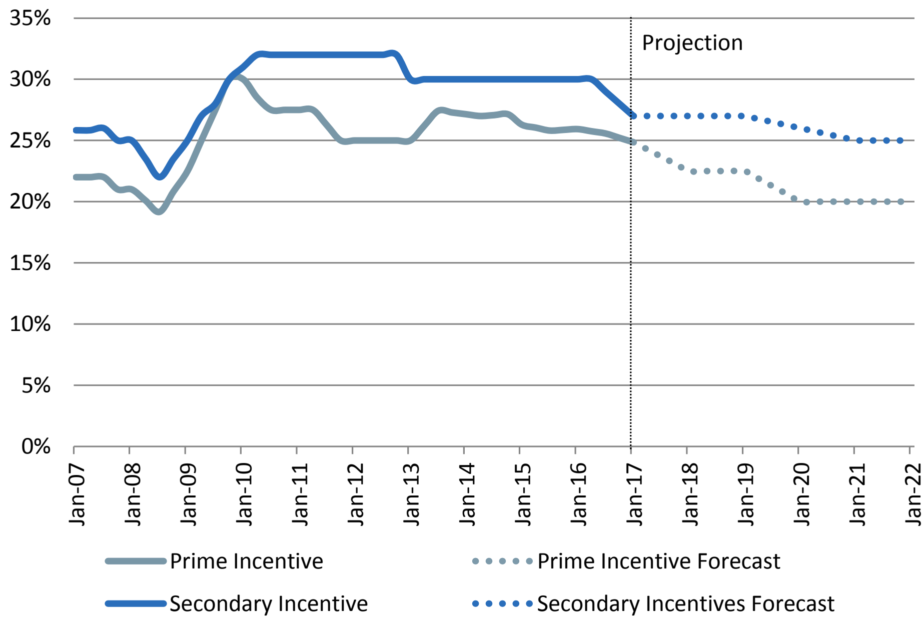
1.4 INCENTIVES

Although very asset specific, incentives for existing prime space in the North Sydney office market (assuming a full floor, mid-rise five year lease term) average 24.9% as at January 2017, down from 25.9% a year earlier.

More broadly, incentives for leases of Prime existing office buildings range from 23.5% to 26.0% whist the pre-commitment deals at 177 Pacific Highway acheived incentive levels of 30% and above.

In the secondary market, current incentive levels range between 25% and 27%, down from circa 30% a year ago.

Figure 6. North Sydney Incentives, Indicative



Source: Knight Frank Research

1.5 LEASING ACTIVITY

The table below shows a list of significant and recent lease deals in prime buildings within North Sydney.

Of the below lease deals, the average floor plate leased measured 1,321m² which highlights market demand for larger floor plates. We also note, an average floor plate of 1,321m² is significantly above existing floor plate provisions in North Sydney which average 759m² (see Section 2.1) and above those proposed for Ward Street Carpark and 56-66 Berry Street sites.

Table 1. Recent North Sydney Office Lease Deals

Tenant Name	Level	Property Address	Area m²	Lease Start Date	Net Rental $/m²	Lease Term	Incentive
Vodafone	1, 10-16	177 Pacific Highway	9,398	Q1 2017	$690 - $800*	12	Circa 35%
CIMIC	2-4	177 Pacific Highway	2,498	Q1 2017	$675.00	12	U/D
Jacobs	5-9	177 Pacific Highway	6,720	Q1 2017	$675.00	7	42%
CIMIC	17-21	177 Pacific Highway	6,371	Q1 2017	$675.00	12	U/D
CISCO Systems	22-24	177 Pacific Highway	4,421	Q1 2017	$675.00	7	30%
CIMIC	25	177 Pacific Highway	1,569	Q1 2017	$750.00	12	U/D
Pepper	26-28	177 Pacific Highway	4,707	Q1 2017	$750.00	7	30%
CBRE	29	177 Pacific Highway	1,517	Q1 2017	$750.00	7	30%
Objective Corp	30	177 Pacific Highway	1,517	Q1 2017	$790.00	7	32%
AJ Gallagher	11-12	80 Pacific Highway	2,008	Q1 2017	$708.00	7	25%
Chubb Insurance	17-19	101 Miller Street	3,569	Q1 2017	$745.00	10	32%
Bedford Titley	16	101 Miller Street	1,428	Q1 2017	$745.00	U/D	U/D
White Clark	15	101 Miller Street	1,427	Q1 2017	$720.00	5	24%
Inflor Global	3	40 Miller Street	1,173	Q1 2017	$650.00	5	29%

Source: Knight Frank Research
(*$800 level 1 & $690 levels 10 – 16) U/D = Undisclosed

1.6 MARKET OUTLOOK

With limited new supply to enter the North Sydney market over the next 18 months, the overall vacancy rate is expected to trend down towards sub-4% by mid-2018 before picking up to circa 7.5% once 100 Mount Street (40,608m² – 15% pre-committed) is completed towards the end of 2018.

Beyond 2019, we expect the continued withdrawal of stock and the strong tenant demand stemming from the Sydney CBD market to keep the overall vacancy in North Sydney at around 4.5% to 5.0% over the medium term (See Figure 3). The only confirmed new development beyond 2019 is 1 Denison Street (Potentially 65,021m²), which has a major pre-commitment (circa 25%) by Channel 9 of 15,500m².

Over the next five years, prime gross face rents are expected to grow at around 6.0% p.a. whist incentives for existing prime office space are expected to trend down towards 20%. However, we expect new developments to maintain incentive levels of 20%+ to entice pre-committed tenants.

The significant depletion of secondary stock will see secondary rents rising at a faster pace than prime rents over the next five years. Gross face rents are projected to grow at around 6.75% p.a. whilst secondary incentives are forecast to drop to 17.5%.

2.0 NORTH SYDNEY OFFICE SUPPLY AND DEVELOPMENT

Over the past decade, office tenant requirements have changed markedly in response to evolving work practices brought about by technological advancements with a greater focus on collaboration. As a result, larger tenants are placing a greater emphasis on flexible working arrangements such as activity based working and hot desking. In order to do this, larger office tenants are increasingly seeking larger floor plates which reduces the need for multiple smaller levels. This trend has been steadily gaining traction in recent years, highlighted by the rapid development and take-up of Macquarie Park where large tenants can readily access large floor plates in excess of 3,000m².

For landlords, having the right type of space which can accommodate changing tenant layout requirements is essential to the leasing success of their property as buildings which are functionally obsolete will not meet the functional, economic and social requirements being placed on them by tenants. As such, landlords are increasingly focused on providing flexible and efficient building space solutions which enhance operational functionality by incorporating flexible space design and specifications. These include large uninterrupted floor plates, adaptable building structures and flexible building services.

2.1 OFFICE SUPPLY & DEVELOPMENT FLOOR PLATE ANALYSIS

2.1.1 EXISTING FLOOR PLATES

Despite an increase in demand and tenant enquiry from large corporations seeking office space in North Sydney, the majority of existing office assets are not suitable for larger tenants as the floor plate size is significantly less than other office markets across Sydney. Consequently, there has been an outflow of larger tenants to other markets. For example, Fujitsu and Optus moved to Macquarie Park, RMS to Parramatta and Rozelle and Symantec, Havas Worldwide and AGL all moved to the CBD. We note however, both recent and major proposed office developments in North Sydney are alleviating this pressure to some extent by providing office floor plates which are conducive to market demand.

To highlight and benchmark North Sydney office floor plates against other competing markets, we have assessed the floor plates of office buildings sized above 2,000m² in North Sydney, Macquarie Park, Rhodes, Sydney Olympic Park (SOP), Parramatta and Chatswood. As highlighted by Table 2, the scale of existing floor plates across North Sydney is well under competitive markets. On average, existing office stock in North Sydney has a floor plate of 759m², significantly under Macquarie Park (2,827m²), Parramatta (1,034m²) and Chatswood (1,423m²). Only a small proportion of buildings in North Sydney have a floor plate over 1,000m², totalling just 20% (16) of buildings.

Table 2. Building & Floor Plate Sizes (for buildings with a total NLA of 2,000m²), by Market – All Grades

	Average Building Size (m²)	Average Floor Plate (m²)	% above 1,000m²
North Sydney	**10,338**	**759**	**20%**
Macquarie Park	12,103	**2,827**	93%
Rhodes	16,435	**2,208**	89%
SOP	9,744	**2,240**	93%
Parramatta	7,563	**1,034**	40%
Chatswood	10,218	**1,423**	47%

Source: Knight Frank Research, Cityscope

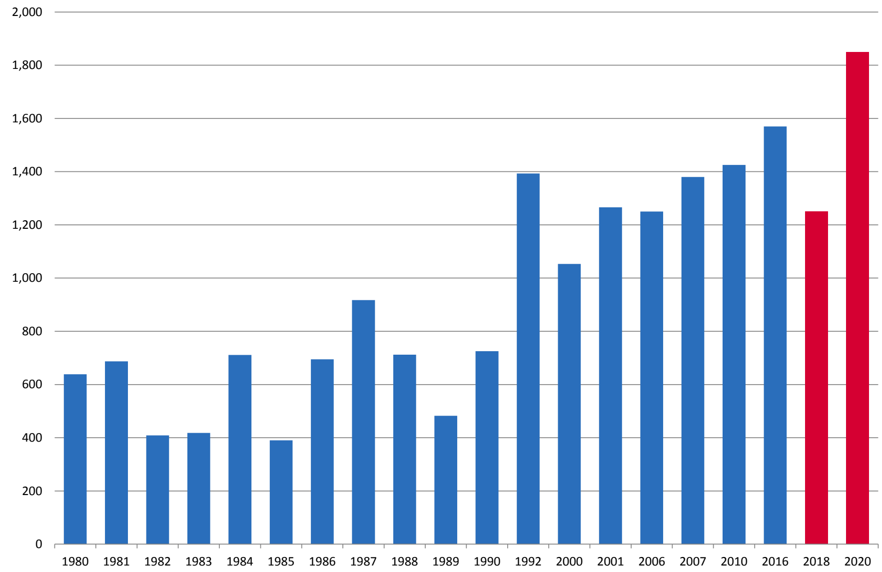
Consequently, North Sydney has a larger proportion of smaller office plates despite being Sydney's third largest office market (822,496m² total floorspace) behind the CBD (5,079,899m²) and Macquarie Park (878,950m²). This represents a large mismatch between supply and demand as there has been a significant shift in demand towards larger tenants in North Sydney.

Larger floor plates in suburban locations such as Macquarie Park, Rhodes and SOP where floor plates exceed 2,000m² has meant that a growing number of companies are heading towards these locations instead of traditional office locations such as North Sydney. In this case, for businesses seeking floor plates in excess of 1,000m², it is likely that they will look further afield given the lack of options in North Sydney. This can create an on flow effect as larger office occupiers take with them smaller tenants which they rely on to do business. For example, NBN moving into North Sydney in 2010 saw demand increase considerably as IT related companies moved into the surrounding area.

2.1.2 AVERAGE FLOOR PLATE BY YEAR OF DEVELOPMENT

Drilling down further, we have assessed the average floor plate of each office building (NLA of over 2,000m²) in North Sydney by the year it was completed to analyse any trends. As shown by Figure 7, the average floor plate size has grown significantly over the years to match market demand. In the 1980s, the average floor plate of buildings completed in North Sydney was just 606m² and included developments such as 60 Miller Street and 141 Walker Street. More recently, buildings constructed throughout the 2000s had an average floor plate of 1,237m² and since 2010 this figure has jumped to approximately 1,498m² floor plates, due to the construction of 40 Mount Street and the recent completion of 177 Pacific Highway. Inbound tenants such as Leightons and Jacobs (moving from St Leonards) to 177 Pacific Highway and Vodafone (relocating from Chatswood) to 40 Mount Street represent market evidence of the demand for larger floor plates.

Figure 7. North Sydney Average Floor Plate Sizes by Building and Year of Completion (m²) – All Grades



Source: Knight Frank Research, Cityscope
Note – years are not consecutive and only represents the year in which a development was complete
Red indicates proposed developments

Looking ahead, there are two developments in the North Sydney pipeline which will bring even larger floor plates to the market, averaging 1,550m² (average across the two buildings). Notably, these include DEXUS' 100 Mount Street development (40,608m²) and Winten Property Group's 1 Denison Street project (65,021m²).

For 100 Mount Street, floor plates will average 1,250m², ranging from 1,200m² to 1,300m². With a pre-commitment to Laing O'Rourke Australia for 6,229m² it highlights the demand and desirability for larger floor plates in North Sydney. 1 Denison Street, due for completion in 2020 will become the largest office building in North Sydney, eclipsing 101 Miller Street which offers 46,302m² of office space. In line with market demand, floor plates within the development will average 1,850m² ranging from 1,474m² to 2,825m².

There are two major connected reasons for the increase in floor plate size across the North Sydney market. The first is the financial viability and feasibility of constructing an office tower. Historically, and in the current, market without pre-commitments to take office space an owner/developer will not speculatively begin construction and is unlikely to obtain finance. Secondly, the market (tenants) is now demanding larger floor plates than previously available. With a large tenant, and with a considerable pre-commitment- a development in this environment has the ability to progress, however without significant pre-commitments a development will stall.

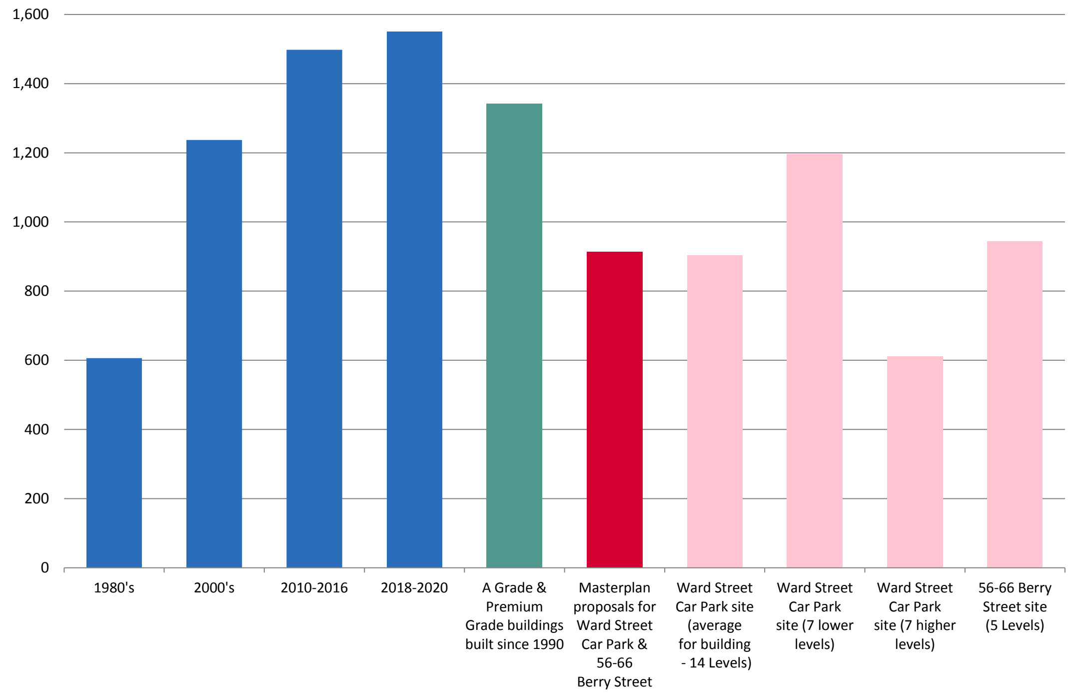
In comparison to the past four periods of significant office space development across North Sydney, as highlighted by Figure 9, the Masterplan proposals for the Ward Street carpark and 56-66 Berry Street site fall short of what both the market demands and what developers/owners will be able to construct.

As previously noted in this section of the report, during the 1980's, the average floor plate of buildings completed in North Sydney was just 606m², rising dramatically throughout the next development phase during the 2000s to average 1,237m², and steadily rising during the two most recent periods of development, 2010-2016 (1,498m²) and 2018-2020 (1,550m²). The Masterplan proposals for the Ward Street carpark and 56-66 Berry Street sites average just 914m², across all floors. This average floor plate size is 41% below what is currently being prepared to be delivered to the market, and 39% below what has been constructed during the most recent development phase (2010-2016). Furthermore, the largest floor plates proposed (seven levels at 1,195m²) at the Ward Street carpark site are still 23% below the average of what is being prepared to be delivered to the market during 2018-2020.

Analysing the Masterplan proposals against the 1 Denison Street project alone, further highlights the shortfall in proposed floor plate size with the proposed floor plates significantly (35%) below the average floor plate, and 58% below the largest floor plate at 1 Denison Street.

The last office building to be constructed and delivered in the North Sydney market with an average floor plate size of less than 611m² was in 1990 (the smallest floor plates proposed, seven levels, at the Ward Street carpark site). 194 Miller Street (now C Grade) and 65 Walker Street (now B Grade) were both completed in 1990 with average floor plates of 430m² and 396m² respectively. Additionally, there has not been an A Grade or Premium Grade building built with an average floor plate of less than 1,053m² since 1988 (99 Walker Street, an average of 881m²). The average floor plate of A Grade and Premium Grade buildings built across North Sydney since 1990 equals 1,342m². No B Grade or below buildings have been constructed since 1990.

Figure 8. North Sydney Average Floor Plate Size (m²) – Comparison to Masterplan Proposal



Source: Knight Frank Research, Cityscope

Figure 9. 1 Denison Street Area Schedule

Level	Use	Area (m²)
Level 35	Commercial	1,474
Level 34	Commercial	1,503
Level 33	Commercial	1,531
Level 32	Commercial	1,560
Level 31	Commercial	1,588
Level 30	Commercial	1,617
Level 29	Commercial	1,646
Level 28	Commercial	1,674
Level 27	Commercial	1,703
Level 26	Commercial	1,732
Level 25	Commercial	1,760
Level 24	Commercial	1,789
Level 23	Commercial	1,787
Level 22	Commercial	1,791
Level 21	Commercial	1,836
Level 20	Commercial	1,828
Level 19	Commercial	1,856
Level 18	Commercial	1,885
Level 17	Commercial	1,914
Level 16	Commercial	1,942
Level 15	Commercial	1,971
Level 14	Commercial	2,000
Level 13	Commercial	2,028
Level 12	Commercial	2,057
Level 11	Commercial	2,057
Level 10	Commercial	2,022
Level 9	Commercial	2,022
Level 8	Commercial	2,022
Level 7	Commercial	2,022
Level 6	Commercial	2,022
Level 5	Commercial	2,022
Level 4	Commercial	2,022
Level 3	Commercial	2,022
Level 2	Commercial	419
Level 1	Commercial	2,826
Mezzanine	Retail	361
Ground Level	Commercial	1,069
Ground Level	Retail	805
Lower Ground	Retail	258
Basement	Retail	261
Total Office NLA		**65,021**
Average Floor Plate		**1,846**

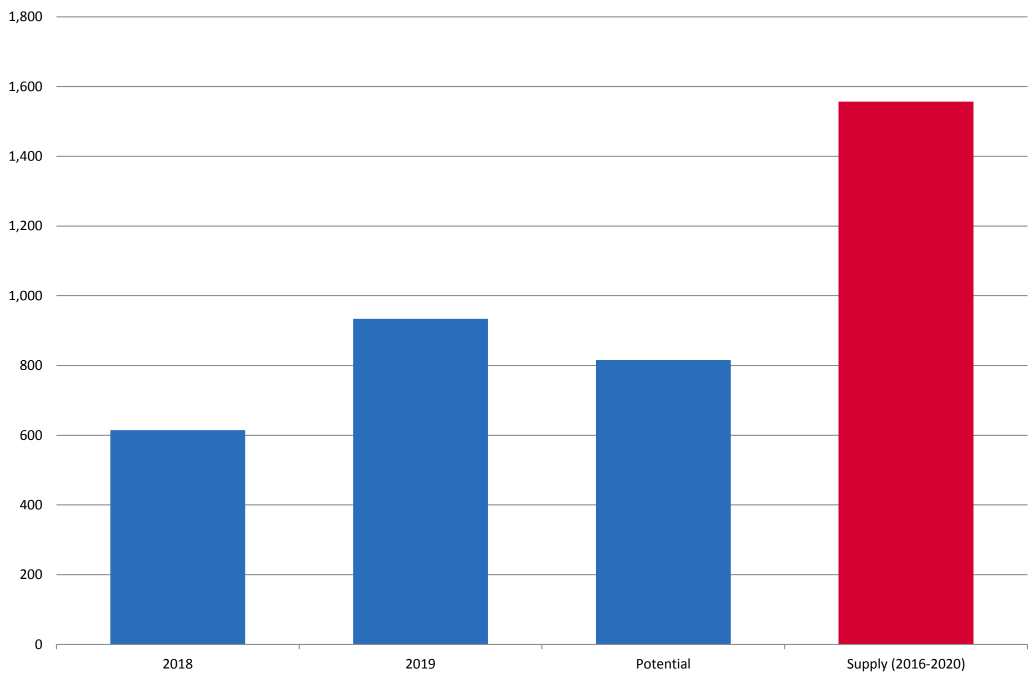
Source: Winten Property Group

2.2 OFFICE WITHDRAWALS

In addition to the previous section of this report, the withdrawal of office stock in North Sydney has been significant over the past five years as a number of obsolete buildings have been withdrawn for alternative uses. Since the beginning of 2013, 49,235m² of commercial space has been permanently withdrawn from the North Sydney office market, significantly above competing markets. Withdrawals have entirely comprised secondary office stock and have predominantly been located in periphery locations of Milsons Point and north of Berry Street.

Looking forward, there remains a further 58,613m² that has been earmarked for potential conversion to residential, 46% of which is anticipated to be withdrawn within the next 24 months. Of the withdrawal pipeline, the average floor plate is 763m², underpinned by Aqualand's 168 Walker Street site where floor plates average 960m². While the average floor plate of potential stock to be withdrawn is marginally above the existing North Sydney average of 759m² per floor plate, it remains well below recent trends in development which are being built to match market demand (see Figure 10), and hence making them viable to be built.

Figure 10. Average Floor Plate of Future Withdrawal Stock Vs Supply (2016-2020), North Sydney (m²)



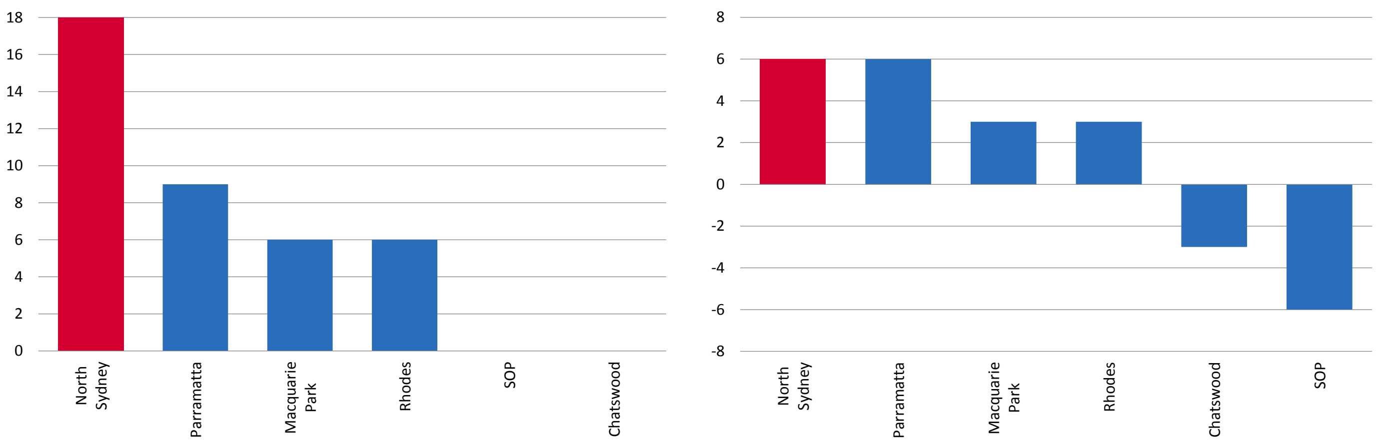
Source: Knight Frank Research

2.3 BUSINESS COUNT DATA

To illustrate the increase in demand from larger tenants in North Sydney, we have drawn on ABS business count data for the North Sydney SA2 region and compared this against other competing markets. As at June 2016, there were 18 businesses in North Sydney employing 200 or more workers, well above comparable markets. Based on an office density ratio of $20m^2$ per worker a business employing 200 or more workers would require $4,000m^2$ of office space. As shown by Figure 11, the next biggest office market (excluding the Sydney CBD) in terms of businesses' employing 200 or more workers was Parramatta where there are nine, half that of North Sydney.

In addition, observing business count data between June 2013 and June 2016 shows that North Sydney experienced the equal largest increase in the number of businesses employing 200+ workers. Over the three year period, six additional businesses were operating in North Sydney, on par with Parramatta. Parramatta's result however was aided by the NSW Government's decentralisation policy which saw an influx of government departments. Elsewhere, business growth in large tenants was limited, with both Chatswood and Sydney Olympic Park (SOP) experiencing a contraction over the period.

Figure 11. No. of Businesses with 200+ workers (left) & Change in No. of Businesses with 200+ workers between June 2013 and June 2016 (right), by Market



Source: Knight Frank Research, ABS

Subsequently, this further supports the mismatch between market demand and existing supply. Given North Sydney's ease of access to other parts of Sydney including its proximity to public transport infrastructure, large office tenants are increasingly seeking space in North Sydney. With the Sydney Metro project only going to fortify this, demand is set to only increase. Tenant's ability to secure suitable office space which fits their requirements will be dependent on both existing and future supply. With existing stock being significantly skewed to smaller floor plates, future supply in North Sydney will need to bridge the gap and provide larger floor plates, in order to maintain attractiveness of the market.

3.0 OFFICE TENANT DEMAND

This section of the report will include an overview of the current tenant office requirements across the North Sydney region. We will liaise directly with, and include anecdotal evidence and commentary from Knight Frank's Office Leasing and Occupier Solutions teams, specifically with regard to depth of demand for smaller and larger floor plates.

3.1. OFFICE LEASING AGENCY & TENANT REPRESENTATION PERSPECTIVE

At present there is strong demand for North Sydney office space from large tenants (averaging 10,000m², but ranging from 3,000m² to 30,000m²). This trend isn't new, but has been the trend since the 1970's when tenants flowed from the Sydney CBD to North Sydney and back, as a result of economic fortune or the creation of specialist precincts which suit certain enterprises. North Sydney has generally always offered a 25% discount to the Sydney CBD rents on like for like supply.

Since 2000 onwards the North Sydney office supply has been constrained for new development. Developers have been unable to secure finance for purely speculative development. Changes to financing have created the need for developers to secure pre-commitment leasing at levels of up to 50% of occupancy of the total project. This requirement has changed the nature new stock to much larger space and inhibited the refurbishment of existing stock, due to the lack of demand from larger tenants. As a consequence, North Sydney's office supply has aged to a point where just over 20% of all stock - by number of buildings – or only 39.1% of all floor space is A Grade or Premium. Regardless demand has remained but not been satisfied.

In the past 10 years the market has only delivered three new projects totalling 96,396m² of NLA which is broadly 11.4% of the market. This is very little new supply and to some extent offset the existing A Grade supply which fell into B Grade quality through age over that time.

Currently we (Knight Frank and other professionals) see 100,000m² of enquiry for North Sydney office space. This enquiry needs to be satisfied in the next three years. In terms of supply only 100 Mount Street, of 40,608m², will be built so significant shortfall is expected.

If we focus on the financing requirements which drive the delivery of new stock a developer must find a tenant of up to 50% of the total NLA. With projects totalling 40,000m²+ this means that tenants of 20,000m² must be targeted and then secured (or 2 x 10,000m², or 3 x 8,000m²).

This size of tenant has become satisfied in the Sydney CBD by buildings with a minimum 2,000m² floorplate, for example the three new towers at Barangaroo have floorplates ranging between 2,350m² and 2,500m². To produce a floorplate of less than 1,500m² (traditionally North Sydney's largest floorplate size) means that a tenant must take more space than they would take on a larger floor. This is simply efficiency through size and means that a tenant must discount the rent to offset the inefficiency of space causing rent rates to fall.

In terms of commenting on floorplates proposed by North Sydney Council of 611m² (the floor plates proposed at Ward Street carpark) we (Knight Frank Office Leasing) see difficulties ahead. This size of floor plate was common in 1970 but today a tenant of 5,000m² will not consider a floorplate of less than 1,500m². A tenant of 600m² would certainly consider a new floor of 600m² however these tenants generally look to take space just 12 months before an existing lease expires. This lead time is too short for a pre-commitment as it takes three years to build a new office building in North Sydney and tenants are unlikely to wait this long. In addition to, the difficulty in aligning a significant number of smaller tenants to reach pre-commitment thresholds.

It is the opinion of the Knight Frank Office Leasing team that the Council's proposed suggestion that floorplates sized 611m², 944m² or 1,195m² is suited to demand does not consider the economic difficulties of modern development. It may be that there is the potential to interest tenants in 611m² floorplates but this would require the supply to be built on a purely speculative basis and the market has only seen a few office buildings built on that basis since 1992. Certainly in the past seven years the market has not seen any speculative new office development.

4.0 NORTH SYDNEY HOTEL MARKET

This section of the report includes general commentary and anecdotal evidence from Knight Frank Hotel Valuations in regard to the appropriateness of the hotel floor sizes proposed and the North Sydney market in general.

4.1 HOTEL MARKET OVERVIEW

Over the past five years, there has been a significant pick-up in the demand for Sydney hotel accommodation, reflected by the strong performance in room occupancies and an increase in average daily rates (ADR). Driving this has been rapid growth in international tourism numbers, a limited supply pipeline (albeit expanding) and depreciation of the Australian Dollar (AUD), which has made international travel for Australians comparably more expensive and Australia more affordable for international visitors.

In the 12 months to June 2016, there were 3.41 million international visitors into Sydney, supported by a significant pick-up from Asia. Similarly, international passenger growth through Sydney Airport is up 8.9% in the year to December 2016. This was the fastest growth rate experienced in 12 years and the strongest total passenger traffic growth for six years. Strong foreign nationality demand contributed to the international passenger growth with Chinese (+17.6%), American (+16.8%), Japanese (+30.5%), South Korean (+19.4%), Indonesian (+15.0%) and Indian (+14.4%) arrivals all increasing over the past year. In number terms Chinese nationals were the largest foreign contributor of incremental passengers, primarily due to an increase in seat capacity from new and existing airline routes.

Notably, international tourism into Sydney is 40% higer than the second largest tourist destination in Melbourne. In addition to this, Sydney registered approximately 24 million domestic daytrip visitors and 10 million domestic overnight visitors over the past year.

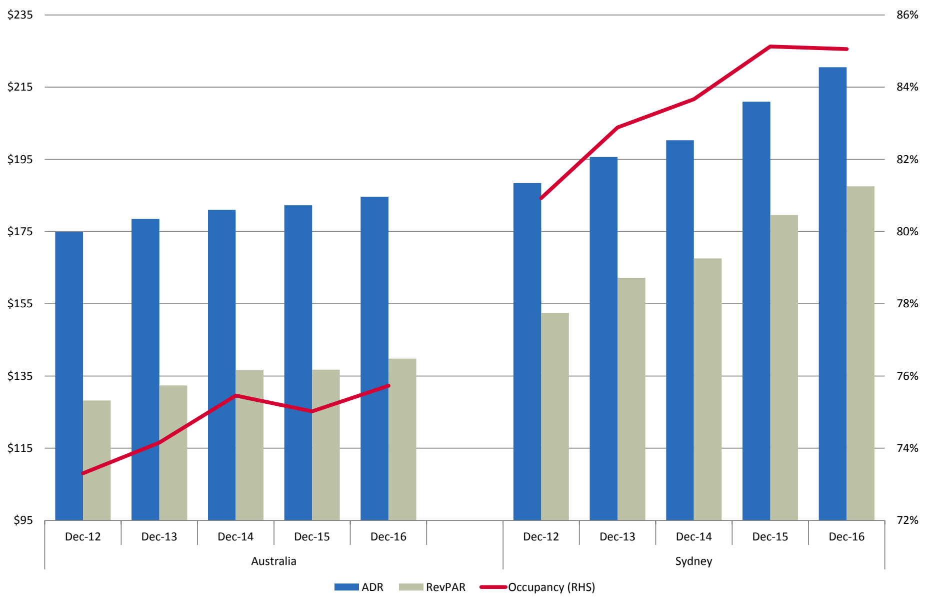
4.2 HOTEL PERFORMANCE

Strong international arrivals have led to a shortage of hotel rooms across the Sydney metropolitan region, highlighted by recent occupancy rate trends. Currently, as at December year-to-date (YTD) occupancy rates in Sydney average 85.1%, significantly above the Australian average of 75.7% for the same period, and trending 4.2% higher compared with YTD July 2012 (see Figure 12), according to STR Global.

Tight occupancy rates are flowing through to average daily room rates (ADR) across the broader Sydney region. In the 12 months to December 2016, the ADR across Sydney measured $220.50, up 4.5% on the 12 months prior. In comparison, ADR nationally increased 1.3% over the same period to $184.65.

A combination of increased occupancy and ADR has led to considerable upward pressure on Revenue per available room (RevPAR) in recent years. In the year to December 2016, RevPAR across Sydney averaged $187.55, up 4.4% over the year, compared to 2.2% for Australia over the same period.

Figure 12. Hotel Sector Performance, YTD December 2016



Source: Knight Frank Research, STR Global

Following a period of limited hotel room supply as developments were not feasible due to the surge in residential development land values, Sydney will enter a period of increased supply over the next three years due to rising hotel earnings and planning concessions.

During 2016, 2,454 hotel and serviced apartment rooms were completed (25% of room supply is within Western Sydney), underpinned by Travelodge and the Pullman at Sydney Airport. For North Sydney, in October 2016 Meriton opened a 218 room serviced apartment building located at 80 Arthur Street. However, over the short term, supply across Sydney will be somewhat balanced by the withdrawal of 227 rooms in the Mercure Potts Point and the recently closed Menzies Hotel (446 rooms).

Beyond 2016, an additional 1,995 hotel rooms are earmarked for completion by 2018, including the 188-room Vibe Hotel North Sydney which will become one of the next generation of Vibe Hotels, and due for completion in early 2017. As a result of the increased supply pipeline, by 2018, there is anticipated to be approximately 42,000 hotel rooms available across the broader Sydney region.

4.3 HOTEL MARKET OUTLOOK

Despite the modest outlook for economic growth globally, weighed down by more moderate growth within the Chinese economy, both domestic and international tourism into Australia is expected to strengthen. This outlook is founded on the view that the Australian Dollar will trend downwards over the coming two years which will create increased demand from Australians holidaying locally, and making Australia as a destination, relatively more affordable from an international perspective. Continued demand is forecast from Chinese tourists to the gateway destinations of Sydney and Melbourne, which will drive international visitor volumes to record highs.

A strengthening tourism outlook is expected to underpin growing demand for hotel and serviced apartment accommodation with occupancy and room rates expected to increase over the coming 12 months. Sydney is expected to again lead the way as occupancies are already high at around 85% on average. As a result, significant upward pressure on room rates in Sydney is earmarked over the medium term. While the supply pipeline is picking up across Sydney, demand is expected to remain strong which will keep hotel occupancy rates at relatively high levels.

While Sydney room rates have been driven by inbound international tourists over the past 12 months, the opening of the $1.5 billion International Convention Centre Sydney in Darling Harbour in late 2016 is expected to support increased hotel demand from the business and conference sector.

4.4 NORTH SYDNEY HOTEL MARKET REQUIREMENTS

This section of the report has taken professional views from Knight Frank Hotel Valuations and Knight Frank Project Management & Building Consultancy team, in relation to proposals at the 56-66 Berry Street Site.

The Masterplan proposals show a possible hotel development of 31 levels, this includes;

- One level for conference facilities
- Two levels for hotel recreation
- 28 levels for hotel rooms (10 rooms per floor) assuming a floor plate of 302m²

A newly developed hotel in this location would ultimately service corporate travellers, especially with the inclusion of conferencing facilities within the proposed design. Generally in Australia, corporate travellers require a 4* hotel offering. Across Australia, and generally within this location a 4* hotel would ideally have a hotel room size of no less than 25m². In comparison a newly developed 3* offering, such as a Holiday Inn Express hotel, would require approximately 20m² hotel rooms.

As the proposals suggest 10 rooms per floor, we have assumed a floor plate configuration of 15.1m by 20.0m (302m²) for our analysis and calculations. From our experience and knowledge of hotels, we have assumed a minimum requirement for three occupier/guest lifts and one service lift in a hotel of this size and configuration. We have assumed a minimum requirement for three occupier/guest lifts as one would assume an occupancy of 1.5 per room (420 guests). For a four lift core, sizes can range between 30m² (tight) to 40m² (this does not include service risers etc.), for a 4* hotel required core would be closer to the upper end of this scale. There would also be a requirement for a small lobby/foyer/sitting area immediately outside of the lift entrances, requiring a conservative 10m² of space.

A hotel floor also requires a corridor width of at least 1.25m to 1.5m, again for a 4* hotel this would be closer to the upper end of this scale. Assuming a depth of 20m this would equate to 30m² of space required for corridors per floor.

There would be a further requirement for an internal emergency staircase, which we have assumed to take up a conservative 10m² of space.

In addition, a hotel floor would also require a cupboard/room for a maid's store (linen and cleaning equipment). We have assumed a conservative $5m^2$ for this space. Adding together the space required for a lift core, lobby area, corridor, emergency staircase and maid store ($95m^2$) reduces the available space for hotel rooms to $207m^2$. The remaining available space would assume an average room size of $20.7m^2$, significantly below the requirements of a 4* hotel as previously discussed.

If one would reduce the number of hotel rooms to eight per floor, to reach above the $25m^2$ hotel room requirements then this would had a severe impact on operational costs. In the opinion of Knight Frank a hotel tower would ideally accommodate approximately 20 hotel rooms per floor, in order to achieve optimal operational savings. Reducing to eight rooms per floor would also reduce the number of hotel rooms to 224, 56 below current proposals.

5.0 NORTH SYDNEY RETAIL MARKET

This section of the report includes general commentary and anecdotal evidence from both the Knight Frank Office and Retail Leasing teams in regard to the market conditions and requirements for ancillary retail.

5.1 MACRO-ECONOMIC TRENDS

In seasonally adjusted terms retail spending across NSW increased by 0.2% over the past month (January 2017), this followed the first monthly (December 2016) decrease in five months, since two consecutive monthly (June and July) falls. In annual terms retail turnover in NSW has increased by 3.2%, in comparison retail turnover at a national level increased by 3.1%.

In NSW, by sub-category, Takeaway food services was the standout performers over the past year, recording annual growth of 19.0%. Annual turnover across the clothing, footwear and personal accessory retailing sub-category increased by 5.9%.

NAB estimate that Australian consumers have spent around $21.65 billion online over the 12 months to December 2016. This is equivalent to 7.1% of spending at traditional bricks & mortar retailers as measured by the ABS in the 12 months to November 2016 making Australia a very bricks and mortar dominant region. However that did not stop high profile retail chains Dick Smith, Pumpkin Patch and Masters to cease trading. In year on year terms (December 2016 v December 2015), online sales grew by 10.4% with online spending dominated by those aged between 25 and 54.

5.2 NORTH SYDNEY MARKET OVERVIEW

Retailing is an important component of any major commercial centre, both in terms of the facilities that are made available to the workforce and residential population, in addition to the added activity which enhances the vitality and vibrancy of the centre’s environment, particularly at the weekends and in the evenings.

Much of the retail provision across North Sydney is contained within a number of small shopping centres, with the traditional role of North Sydney retail being highly focused on the shopping needs of the daytime workforce. The lower north shore is a densely populated and affluent catchment, however residents have not traditionally used North Sydney to any great extent for shopping purposes and this is reflected in the lack of activity in North Sydney in the evening and weekend periods. This historic trend is likely to change once the new Metro stations open and the residential population increases upon the completion of a number of new apartment projects within close proximity to the North Sydney CBD.

5.3 NORTH SYDNEY RETAIL RENTS & DEVELOPMENT

As an example of retail leasing in North Sydney, 116 Miller Street, North Sydney has approximately 1,056m² of retail space currently leased to tenants; Commonwealth Bank of Australia, Ephrain International Pty Ltd, ANZ and MFVG Pty Ltd. Rents charged range from $700/m², to $2,667/m², with the current income from these retail tenants is $809,355p.a. In comparison gross retail rentals in the Sydney CBD Super Prime Retail Core (encompassing Pitt Street Mall) ranges between $10,000/m² and $17,000/m². Outside of Pitt Street Mall, gross rental rates for George Street and Castlereagh Street precincts (in the Sydney CBD), currently average between $2,500/m² and $7,000/m².

The asking retail rents for space facing Miller Street are in the range of $1,800 - $2,000/m² at the Northpoint retail complex, which is currently being constructed by Cromwell at 100 Miller Street. The development is estimated to be completed in Q1 2018 and will contain 4,700m² of retail space.

The completion of the Victoria Cross Metro Station directly adjacent to 116 Miller Street is expected to result in increased pedestrian traffic and demand for retail amenity. Given this, it is expected that retail rents will reach the range of $1,800-$2,000/m² in surrounding properties.

Any queries please contact the author:

Paul Savitz
Director – Consulting
Knight Frank Australia
Ph: (02) 9036 6811
paul.savitz@au.knightfrank.com

Alex Pham
NSW Research Manager
Knight Frank Australia
Ph: (02) 9036 6631
alex.pham@au.knightfrank.com