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Dear Walter,

Subject: Reduction of Office Space Area in Meriton's Lighthouse Project, Dee Why

Given slow leasing progress for the office space in Meriton's Lighthouse project at Dee Why, a remedy has been proposed by the developer to reduce the first floor office area by 21% with a conversion of space to residential units.

Our brief from Meriton is to provide advice on the following matters:

- Comment on the Planning Controls for office space in the Dee Why Town Centre and the ramifications of this change of use;
- Comment upon the Property Perspectives for this proposed change of use by reference to:
 - Assessment of the commercial office sales and leasing market in Dee Why;
 - Identification of existing supply and demand for above ground floor office accommodation; and
 - Investigation of the current and forecasted office vacancy.

1.1 Background

The parent Site is located within the suburb of Dee Why and is known as the 'Lighthouse', situated within the Local Government Area (LGA) of Warringah, on Sydney's Northern Beaches.

The parent Site was formerly known as 'Site B' located within the western part of Dee Why Town Centre and is bounded by Pittwater Road, Oaks Avenue and Howard Avenue and is currently under construction. The surrounding improvements comprise older style commercial buildings generally ranging in height from two to three storeys with a mixture of retail on the ground floor and commercial above.

Dee Why Town Centre is well positioned on the Northern Beaches and benefits from public transport services that transit along Pittwater Road with existing retail services, although there is no existing railway station.

1.2 Existing approval

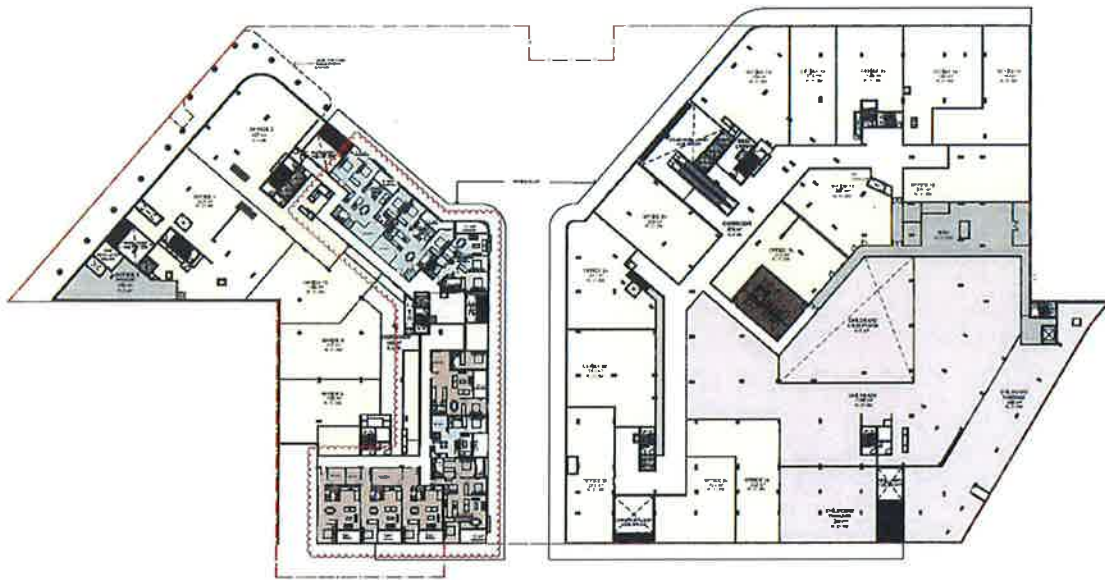
The parent Site was granted approval by the Sydney Planning Panel on 10 May 2017 (JRPP2016SYE076) for the construction of a mixed-use development comprising retail, commercial and residential uses and a child care centre. The proposed buildings will comprise of a 4 storey commercial/retail podium levels fronting Howard Avenue and the Town Square which follows through onto the Oaks Avenue frontage in the form of a pedestrian link.

The commercial component will comprise 1,901sqm of speciality retail NLA, 5,693sqm of commercial NLA, 4,185sqm of supermarket space NLA and 2,347sqm for a child care centre (indoor and outdoor on the first floor) totalling 14,126sqm of non-residential floor space and 350 residential apartments above (73 x 1 bedroom, 5 x 1 bedroom + study, 152 x 2 bedroom, 9 x 2 bedroom + study, 100 x 3 bedroom, 11 x 3 bedroom +study). This development is over 3 levels of basement car parking to accommodate for 1,035 car parking spaces.

In addition, a 2,500sqm public Town Square plaza fronts Howard Avenue.

The Site has subsequently gained approval for stratum subdivision to create two lots being a lot comprising land to be dedicated to Northern Beaches Council for road widening purposes.

The following figure shows the proposal to convert part of the approved commercial space on the first floor to provide 5 x 1 bedroom plus study apartments, 1 x 2 bedroom apartment and 3 x 2 bedroom plus study apartments.



1.3 Planning Controls

The Site is identified as a Key Site known as 'Site B' in the Warringah Local Environmental Plan 2011 ('LEP') which forms part of the Dee Why Town Centre and is part Town Square and part Pedestrian Connection.

We note that Clause 7.12 of the LEP is inconsistent with the Dee Why Town Centre Masterplan in relation to the land uses to be provided on the first and second floors. In April 2016, Clauses 7.12 (c) and (d) of the LEP was omitted, removing the requirement for the second floor to be used for commercial use only. The current LEP (Section 7.12) has a provision that the first floor is not to be used for residential accommodation.

Meriton is proposing to convert approximately 21% (1178sqm) of the commercial space (first floor) into residential units by way of amending the LEP controls, which we consider to be still consistent with the zone objectives 'to integrate suitable business, office, residential, retail and other development in accessible locations so as to maximise public transport patronage and encourage walking and cycling' and will have negligible impact on the long term outlook of the town centre. In addition, this small increase in residential numbers would add to the overall vitality of the town centre, through additional demand for goods and services.

1.4 Demand for commercial office space

1.4.1 Key findings on the Dee Why market

Our discussions and industry knowledge of the commercial office space in Dee Why has indicated the following key findings:

1. **Demographics:-** HillPDA Research and the ABS have indicated that there is approximately 25,755sqm of floor space in the suburb of Dee Why in 2016 (latest figures) which appears to have remained unchanged from 2011. Using a benchmark of 25sqm and 35sqm per worker, they have estimated that the Dee Why Town Centre would require an additional floor space from year 2016 to 2036 of 15,740sqm reflecting an average floor space requirement of 787sqm per year. This translates to an oversupply situation once the parent site is completed.
2. **Location:** The subject office space has inferior market appeal compared to Brookvale and Frenchs Forest employment areas. As such speculative commercial space above the ground floor is likely to experience longer vacancy periods. The majority of the Dee Why retail structure is a mixture of older style one or two storey structures or modern mixed-use development mainly serving locals with a stronger demand for retail space than commercial offices.
3. **Demand for Office Space:** Evidence has demonstrated that office space demand in Dee Why is limited mainly due to the available transport mode (bus only) and the likely lessee profile is a local operator. Typical purchasers or tenants of office space generally include small professional businesses, such as dentists, doctors, lawyers, accountants and property firms and architecture firms. Office space is highly sought after in areas such as Frenchs Forest (proposed new town centre and new Hospital hub), Brookvale, Warriewood and Manly by larger corporate entities (>300sqm) compared to typical enquiries in Dee Why. Anecdotal evidence from local leasing agents suggest that lease up rates range from 3 to 12 months. In some cases, premises are left vacant for longer periods.

4. **Vacancy:-** Discussions with agents have indicated that there are low vacancy rates for above ground floor commercial office space in Dee Why mainly due to the dearth of new stock. Agents have indicated that the addition of new stock from the 'Lighthouse' will result in more stock available than existing demand. The subject office space is located above an open piazza, Woolworths supermarket and a new restaurant precinct with the majority having pre-committed leases and approximately 700sqm of retail space is still available. Broadly, the success of this tenancy mix will affect the marketability of the remainder of the subject office space, however the take up has been slower than expected. According to recent conversations with local agents, there has been a steady demand for ground retail space especially for retail suites with prominent street exposure whilst commercial office space has been relatively slow. The supply of the subject commercial space will result in an oversupply of commercial office floorspace (particularly first floor level) within the Dee Why Town Centre therefore resulting in longer vacancy periods and higher incentives/concessions.
5. **Layout, size and access:** Commercial offices on the first floor would offer reasonable sized spaces and flexible layouts with the option of amalgamation of units. The subject office space has large floor plates approximately 1,000sqm plus in size. Smaller suits (50sqm to 200sqm) are more appealing to typical local tenants who occupy space in Dee Why (i.e. local lawyers, accountants and medical professionals like GP's and chiropractors).
6. **Cost of development:** The total development cost of delivering modern commercial space is in the order of \$6,500/sqm NLA. In this location, agents have indicated that new office space would sell from \$7,500/sqm to \$8,000/sqm suggesting that office space is not viable on its own.
7. **Achieved rents and incentives:** Agents have indicated that achieved rents for retail space within the Centre with good street exposure, location, size and layout can range from \$300/sqm to \$450/sqm net. However in fringe locations, with less pedestrian footfall and older stock, the rents are lower at around \$200/sqm to \$250/sqm net and let periods are typically from 3 to 12 months. Recent conversations with Meriton's leasing agent have indicated that the commercial space has been marketed for approximately two years with a limited level of enquiries. Consequently, the initial asking market net income of \$450/sqm has been discounted to \$250/sqm. This is supported by local agents which have indicated that rents achieved for office space in the proposed location would need to be discounted or an attractive incentive given.
8. **Amenities and Transport:** Dee Why is not accessible by rail and the lack of a train station has an adverse effect on the marketability of the commercial property for the workforce unless adequate on-site car parking is provided.

1.4.2 Development Pipeline

The Site was formerly improved by one to three storey commercial buildings which have since been demolished to make way for a future mixed use development resulting in office space supply withdrawals in the Dee Why office market.

There is limited new supply (excluding the subject development) in the medium to long term and this is an indication of business sentiment by developers that there is soft demand for commercial space. Additional competition is expected to be encountered in the suburbs of Frenches Forest (new Hospital Hub with proposed new Town Centre and will also benefit from a \$1B government investment in infrastructure), Brookvale and Manly Vale. This may result in an oversupply situation in Dee Why once the parent site is completed, resulting in longer vacancy periods and higher incentives/concessions.

Table 1: Dee Why Commercial and Retail Development Supply Pipeline

Property	Suburb	NLA (sqm)	Status	Completion
697-703 Pittwater Road	Dee Why	422 (retail) 282 (commercial)	Under assessment	Early
18 Howard Avenue	Dee Why	46 (retail)	Under assessment	Early
627-631 & 635 Pittwater Road & 5 Mooramba Road	Dee Why	622 (retail/commercial)	Approved	Possible

Source: HillPDA Research 2018, Cordell Connect

1.4.3 Office Rental Rates

Table 2: Dee Why Commercial and Retail rentals

Address	Suburb	Asking Price \$/sqm (Net)	Area (sqm)	Comments
2a/32 Fisher Road	Dee Why	\$409	42	Ground floor office with direct access off the street
3b/32 Fisher Road	Dee Why	\$422	40	Ground floor office with direct access off the street
Top floor, 7 Oaks Avenue	Dee Why	\$432	184	Fitted with 6 offices, boardroom, large open plan area & 6 car spaces
20b/818 Pittwater Road	Dee Why	\$208	150	First floor office with separate consulting rooms
683 Pittwater Road	Dee Why	\$230	122	Open plan suite with great natural light and kitchenette
834 Pittwater Road	Dee Why	\$346	52	Located in the modern Dee Why Grand complex

Source: HillPDA Research 2018, RealCommercial

1.4.4 Office Sales Rates

Table 3: Dee Why Commercial sales transactions

Address	Date	Sales Price	Area (sqm)	\$/sqm
Dee Why Grand, Suites 4203 & 4204, 834 Pittwater Road , Dee Why	11/15	\$635,000	118	\$5,381
	Medical/office strata suites located within the Dee Why Grand building which was completed circa 2010. The suite comprises a reception and waiting area, a consulting room, a store room, a bathroom, breakout area, a quiet room and two scan rooms. At the time of sale, leased to Sydney Ultrasound for Women (SUFW), a diagnostic ultrasound medical practice for women at time of sale with an annual income of \$49,000 having a 3+3 term at CPI annual increases.			
Dee Why Grand, Suites 4104, 834 Pittwater Road , Dee Why	11/15	\$400,000	57	\$7,018
	Medical/office strata suites located within the Dee Why Grand building which was completed circa 2010. The suite comprises a reception and waiting area, a consulting room, a store room, a bathroom, breakout area, a quiet room and two scan rooms. Sold with vacant possession.			
687 Pittwater Road, Dee Why	04/16	\$1,810,000	416	\$4,351
	Older style multi-tenanted freehold building with ground floor retail and 9 suites above. Sold with a net passing income of \$100,132 per annum, reflecting a yield of 5.5%. Provides adequate suburban quality office fitout.			
Suite 778, 846 Pittwater Road, Dee Why	10/17	\$317,000	62	\$5,113
	First floor office suite with 1 car space located within an older style two storey commercial building.			
Lots 218 & 219, 117 Old Pittwater Road, Brookvale	11/17	\$2,000,000	380	\$5,263
	In one line sale of two modern strata office suites within the modern 'Lifestyle Working' development situated on the eastern side of Old Pittwater Road close by to Warringah Mall. The units have associated car parking for 10 car spaces. At the time of sale the premises were leased to a long term tenant, CXC Global, producing a net passing income of \$183,617 per annum.			
'Dee Why Grand' 834 Pittwater Road , Dee Why				
Lot 4	08/17	\$400,000	59	\$6,780
Lot 12	06/17	\$300,000	57	\$5,263
Lot 42 & 43	10/17	\$880,000	144	\$6,111
Lot 58	12/17	\$330,000	57	\$5,789
	Medical/office strata suites located within the Dee Why Grand building which was completed circa 2010. Suites provide an adequate level of suburban office fitout and each lot was sold with associated tandem parking.			

The sales evidence above demonstrates that there has been minimal variance in sales rates over recent years indicating a sales rate of \$4,351/sqm to \$7,018/sqm which shows only little viability above the cost to build and indicates soft demand for commercial space.

1.5 Planning Perspective

In our view, the conversion of the commercial space into residential units is a more appropriate and viable option as conversations with Meriton's leasing agent has indicated soft demand for commercial space. This lack of demand may result in either an inferior tenancy mix or vacancies which will detrimentally affect the urban vitality of the town centre.

In contrast, the residential housing market is buoyant in Dee Why and housing close to services and transport is highly sought after. It is considered that the proposed removal of the first floor office space would not compromise the intent of Council to ensure economic development in Dee Why, given the size of the subject space in relation to the overall commercial space in the town centre. In addition, the small increase in resident numbers would contribute to the overall sustainability of the town centre, through additional demand for goods and services.

For any further information or clarification of the consultancy advice provided do not hesitate to call me in the Sydney office on 8198 7611.

Yours faithfully,



CATHERINE HUYNH

Senior Valuer AAPI CPV

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