

4 October 2016

Gavin Carrier
Holdmark

Dear Gavin,

RE: FEASIBILITY ANALYSIS OF REDUCED DEVELOPMENT SCHEME AT 8 PARSONAGE STREET, RYDE

The site comprises approximately 3,953sqm in area and is zoned B4 Mixed Use under the Ryde LEP (2014). The Site is located within the Church Street precinct as defined by the Ryde DCP (2014).

BACKGROUND

In 2015 AEC Group (AEC) prepared a Preliminary Feasibility Analysis to support a design competition for the site at 8 Parsonage Road in Ryde.

In the preliminary feasibility analysis two design schemes were examined, one that was compliant with the current Concept Plan consent (as modified) with an FSR of 2.4:1 and a second that was non-compliant at over FSR 4:1.

In order to evaluate and consider the financial feasibility implications of each design scheme, the feasibility analysis considers the Site on a standalone basis, i.e. if it were to be developed separate from the broader Shepherds Bay development. It is understood that each stage in the Shepherds Bay development is individually financed so this approach reflects commercial realities of development delivery. In considering the feasibility of a design scheme, it is necessary to impute a site value to represent the opportunity cost of the land for the Site.

Having regard to a residential yield potential of 130 units (as per building envelopes approved under the Concept Plan), we assume a (rounded) site value of \$19.5m (at \$150,000 per unit/site) to represent the opportunity cost of land.

Since the selection of a competition winner, Holdmark have been progressing design development (a 23-level building). It is understood that a reduced design to 15-levels has been proposed as part of the assessment process by Department of Planning & Environment. Accordingly, Holdmark are keen to understand the financial feasibility implications of a reduced development scheme.

Potential Development Scheme

COX has prepared an indicative development scheme which accommodates 15 levels with the following yields. The yields have not been tested for ADG compliance and are accordingly indicative at this stage.

Table 1: Indicative Development Yield

Land Use	GFA (sqm)	Units	Parking
Retail	4,155.8	-	169
Commercial	600.0	-	-
Residential	11,585.7	130	143
Total	16,341.5	130	340*

*includes 26 visitor spaces and 2 car wash spaces
Source: COX

METHODOLOGY AND APPROACH

The feasibility modelling adopts the Residual Land Value approach. This involves assessing the value of the end product of the design scheme, then deducting all of the development costs (including the opportunity cost of land, demolition, construction costs, professional fees, statutory fees) and making a further deduction for the profit and risk that a developer would require to take on the project.

The land value is the 'residual' that remains, i.e. the amount a developer could afford to pay in exchange for the opportunity to develop the site. The residual land value for the design scheme is compared against the opportunity cost of land (\$19.5m) to assess whether the design scheme optimises site value.

In addition to the residual land value of the Site, other performance indicators used in assessing the financial feasibility of the design scheme include development margin and project internal rate of return (IRR). If these indicators exceed the target hurdles (each at 20%), the scheme is considered feasible.

Cost Estimates

Altus Page Kirkland (APK) have prepared a preliminary cost plan for the indicative development scheme which we have adopted in our feasibility modelling.

FINANCIAL FEASIBILITY RESULTS

The indicative development yields were subject to feasibility modelling and subject to set parameters:

- Residual land value measured against imputed opportunity cost of land of \$19.5m).
- Project internal rate of return (IRR) and project margin measured against target rates of 20%.

For a detailed list of assumptions refer to Appendix A.

Table 2: Feasibility Modelling Results

Performance Indicator	Results	Target Hurdle
Residual Land Value	\$8.8m	\$19.5m
Project IRR	10.11%	20.00%
Development Margin	9.55%	20.00%

Source: AEC

The feasibility modelling suggests the indicative development scheme is not financially feasible, falling below the specified hurdle rates. The following are key contributing factors to this result:

- **Iconic design and associated construction cost**
Higher cost associated with iconic design proposed with insufficient height (at 15 levels) to offset the higher construction cost. Residential units on higher levels will fetch higher prices and accordingly improve project viability.
- **High proportion of non-residential uses**
About 29.1% of total GFA is attributed to retail and commercial floorspace. About 50% of car parking provision (169 spaces) is associated with the retail component of the development. Together the relatively high proportion of non-residential GFA and associated car parking result in a poor cost-value proposition.

Unless at-grade parking can be provided, the provision of supermarket retail (and basement car parking) is not in itself a viable proposition, generally requiring high density residential uses to cross-subsidise its provision.

Our analysis suggests that despite achieving a residential yield similar to that which could be achieved under the approved Concept Plan, the reduced scheme is not financially feasible owing to the more cost-intensive requirements of the iconic design and inclusion of significant retail space and associated parking.

It is understood that the retail space has been included to provide a high amenity public plaza and to offer convenience shopping within walking distance for the thousands of new residences being created in the area.

We trust this provides you with an understanding of the financial feasibility implications of a reduced development scheme. Please contact the undersigned should you have any questions.

Yours sincerely



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APPENDIX A: FEASIBILITY ASSUMPTIONS

Project Timing

Development application is assumed to be progressed immediately upon settlement with pre-sales occurring shortly thereafter.

Construction is staged and assumed to begin in Month 12 with development stages spanning 12-24 months depending on the scale of the development and sale of floorspace.

Revenue Assumptions

End sale values of non-residential uses and residential uses are as follows:

- Residential end sale values (average of \$11,500/sqm).
- Unit take-up has been assumed at 10-15 units per month with pre-sales commencing before each stage.
- Non-residential end sale values:
 - Speciality retail at \$7,000/sqm.
 - Supermarket retail rent commencing at \$1.1m per annum and turnover rent component once supermarket is fully operational. Supermarket capital value is obtained by capitalising the income streams at 4.5%*.
 - Commercial floorspace at \$5,000/sqm.
- Revenue was assumed to escalate at 3% per annum.

*It was assumed that supermarket retail would be pre-committed prior to construction and the balance of space would be settled after construction.

Other revenue assumptions:

- GST is excluded on non-residential sales and included on the residential sales.
- Sales commission and legal costs on sales was included at 2.5% of gross residential sales and 2.0% of gross non-residential sales.
- Legal cost on sales was included at 0.3% of gross sales.
- Marketing costs are included at 2% of gross sales.

Cost Assumptions

We have relied on Preliminary Cost Estimate by Altus Page Kirkland prepared for the indicative design scheme.

Additional cost assumptions include:

- Professional fees at 10% of construction costs, 5.5% expended pre-construction and 4.5% during construction.
- Construction contingency of 5% of construction costs.
- Statutory costs:
 - DA and CC fees at schedule rates.
 - Section 94 contributions at: \$10,690/unit (1 bedroom unit), \$12,828/unit (2 bedroom unit), \$16,391/unit (3 bedroom unit), \$76 per 100sqm of retail GFA, \$131 per 100sqm of commercial GFA.
 - Long service levy at 0.35% of construction costs.
 - Land holding costs including land tax, Council and water rates based on assumed unimproved land values.
- Cost escalation of 3% per annum was assumed to commencement of construction.

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- Imputed opportunity cost of land (\$19,500,000) is assumed to be injected as upfront equity contribution with the remaining debt funded at 7% per annum capitalised interest.

Hurdle Rates and Performance Indicators

Target hurdle rates are dependent on the perceived risk associated with a project (planning, market, financial and construction risk). The more risk associated with a project, the higher the hurdle rate.

A number of performance indicators are relied upon when ascertaining the feasibility or otherwise of a development.

- Development margin is the profit divided by total development costs (including selling costs). A target development margin of 20% is generally a minimum hurdle required by financiers.
- Discount rate refers to the project internal rate of return (IRR) at which the net present values of an investment becomes zero. A target discount rate of 20% is generally a minimum hurdle required by financiers.
- Residual Land Value is determined by establishing the maximum land value a developer is willing to pay based on a 20% internal rate of return (IRR) and 20% development margin taking into account all other costs and project revenue.

A project discount rate of 20% per annum effective on the cash flow of the project which includes financing costs but excludes interest. Additionally, a developer's target margin of 20% on total development costs (including selling costs) has been assumed in line with market expectations. These hurdle rates are considered reasonable for the Site given its location and likely target developer market.

If the resulting profit from this feasibility analysis is large enough to meet the target hurdles (in this case the discount rate and development margin), the project is considered financially viable for redevelopment.