LEYSHON CONSULTING

Suite 1106 Level 11
109 Pitt Street, Sydney
NSW Australia 2000

Telephone 61 2 9224 6111
Facsimile 61 2 9224 6150
ABN 12 003 203 709

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12 November, 2010

BY EMAIL

Mr Simon Healy
Senior Development Manager
Development New South Wales
Mirvac
Level 26
60 Margaret Street
SYDNEY NSW 2000

Dear Mr Healy

RE: 7 RAILWAY STREET, CHATSWOOD

Background

This letter has been prepared for Mirvac Projects Pty Ltd (Mirvac) and relates to a proposed mixed use development to be undertaken by Mirvac at 7 Railway Street, Chatswood.

We understand Mirvac has lodged a major project application under Part 3 A of the Act with the Department of Planning for a mixed use commercial/ residential building on this site.

In February 2010, Leyshon Consulting prepared a report for Mirvac (*Peer Review – urbis Chatswood Office Market Assessment Report*). That report examined the office market in Chatswood in the context of the urbis report and, we understand, was submitted to the Department of Planning as part of the Part 3A application referred to above.

We have been provided with a copy of a letter forwarded by Willoughby Council (Council) to the Department of Planning dated 17th of September, 2010 which, in part, comments on the issues raised in our February report.

Council Issues

Specifically, Council takes issue with what we understand to be the opinion of the Department of Planning that 3,600 to 4,000 sq.m. of commercial office space is adequate on the subject site. Apparently, the Department reached this view partly on the basis of the analysis contained in the reports prepared by Leyshon Consulting and urbis.

We understand Council has also received advice from Hill PDA in a report entitled *Chatswood Office Precinct Economic Analysis* and dated March 2010.

In essence, Council is of the view that such a provision of commercial floorspace is inadequate in terms of meeting the jobs target for Chatswood set out in the Inner North Sub Regional Strategy.

In particular, Council considers that the analysis contained in the reports referred to above present a short term view; have failed to estimate the "cost to Sydney" of a theoretical loss of jobs in Chatswood; and fail to take into account the impact of this potential loss of jobs on the retail sector in Chatswood.

Council has specifically stated there is *"potential that a commercial office building could proceed on this site once the office property cycle changes"*.

Our comments raised on the issues put forward by Council are set out below.

Property Market Cycle

There is general agreement that the performance of the office market in the Sydney Region is subject to cyclical behaviour. While this observation appears true generally we do not consider it to be accurate as far as the Chatswood office market is concerned.

As indicated in our February report, the Chatswood office market expanded rapidly in the mid-to-late 1980s. For instance, between 1983-88 Chatswood doubled in office floorspace terms to some 218,000 sq.m.. During this period major "landmark" buildings such as the Zenith Centre and the Aetna buildings were completed.

Since 1988 the total stock of office space in Chatswood has an expanded to 295,000 sq.m.. This represents an increase of only some 77,000 sq.m. over a 23 year period.

During this time there had been two distinct periods during which the office market cycle in the Sydney Region was in "negative territory"–namely those commencing in:

- 1991; and
- 2003

According to Jones Lang Lasalle (*Sydney CBD office Outlook August 2009*) the 1991 negative component of the cycle resulted in about four years of negative absorption of office space in major office markets in Sydney–that is, net absorption of office space did not become positive again until 1995-96.

The 2003 negative component of the cycle saw three years of negative absorption across major office markets in Sydney–that is, the net absorption of office space did not become positive until 2006.

As noted in our February report, since 2001 the office market in Chatswood essentially has been negative in terms of the net absorption of space. In reality, the Chatswood office market has been in long-term decline since 1990 irrespective of the positive components of the office market cycle experienced in the Sydney Region generally between 1997-2002 and between 2006-09.

Indeed, since preparation of our February report, office vacancies in Chatswood have increased. For example, Knight Frank estimates that vacancies rose to 19.2% in June, 2010 with the vacancy factor in the prime sector at Chatswood being some 24% *(Knight Frank North Shore Office Market Overview*, September 2010). By contrast vacancy rates during the same period remained static in North Sydney and St Leonards and declined in Macquarie Park.

Knight Frank also noted in their report that gross effective rents in Chatswood fell by 6% to 8% in the year to September, 2010.

The above observations are, in our assessment, indicative of the fact that the problems facing the Chatswood office market are structural in nature rather than cyclical. Accordingly, we do not share Council's view that the Chatswood market is likely to return to some positive condition once the effects of the GFC have moderated and the general Sydney office market has returned to a positive absorption of space which is predicted by most experts to occur after 2012.

In this regard we note that Hill PDA concluded, as we did, that Chatswood could not compete effectively with office locations such as Macquarie Park and other centres such as St Leonards and North Sydney, both of which have substantial components of vacant space.

In relation to the office market cycle, Hill PDA concluded:

> *"In summary, the Chatswood office precinct has seen little redevelopment activity over the past 10 to 15 years. Whilst wider economic trends and changes to industry indicate that demand for commercial office space will increase significantly in the future, existing vacancy levels in Chatswood coupled with a growth in new supply in other centres, will mean that it is likely to be another 10 to 15 years before major office development will become attractive once again in Chatswood."* (Hill PDA Section 5.1 page 20)

In essence Hill PDA is saying it may not be until 2020 to 2025 before major office development will become "attractive" in Chatswood.

Costs to Sydney

In our opinion it is highly theoretical to argue that there is some implicit "cost to Sydney" as a result of the provision of office space on the subject site being reduced from the level originally envisaged.

Presumably, any construction of office space which does not occur in Chatswood–if the Mirvac proposal is approved by the Department–will be deflected to some other centre in the Sydney Region which is well located and accessible in terms of public transport. Under this scenario Chatswood's theoretical loss is another centre's gain and overall there is no net "cost to Sydney" however that might be defined.

Impact on Retail Sector

Council has argued that a decision to reduce the amount of office space on the subject site will have a negative effect on the Chatswood Town Centre's retail sector as a result of fewer workers being available in the future to direct their spending to shops in the centre.

Firstly, this argument overlooks the fact that Mirvac is proposing to substitute the commercial floorspace with residential floorspace. Residents generate considerably more available retail spending than do workers. Households located within a centre will, over a 12 month period, spend far more in a retail centre such as Chatswood than any equivalent number of workers. Workers only spend a small proportion of their household's available retail spending associated with trips to work. Consequently, retailers and centre managers would, if offered the choice, prefer residents within the boundaries of a centre such as Chatswood rather than the equivalent number of workers.

Second, it appears that retailers generally in the Chatswood Town Centre are already performing strongly. In a recent survey of the performance of Australia's major shopping centres published by *Shopping Centre News* ("Big Guns 2010", Volume 28, No. 1, 2010), Chatswood's two largest retail centres (Westfield Chatswood and Chatswood Chase) were rated number 13 and 12 respectively out of Australia's 88 major centres in terms of sales per square metre per annum (the standard industry benchmark).

This suggests Chatswood's retail sector is performing strongly and would not be adversely affected by any theoretical decline in its future potential office workforce catchment which, in any event, is likely to be offset by an increase in the residential population within the Chatswood Town Centre boundaries.

Conclusion

Council's desire to see office employment in Chatswood increase in future years in line with projections in the Subregional Strategy is understandable. Nonetheless, we remain of the view that major structural problems exist which impact on the performance of Chatswood's office market. These mean that a lesser provision of office space on the subject site than originally envisaged is appropriate.

In relation to the employment targets contained in the Department of Planning's *Draft Inner North Subregional Strategy*–namely a growth of 7,300 jobs by 2031 in the Chatswood centre–this target may require some reconsideration if new office space development in Chatswood remains problematical over the mid-to-longer term. Our research suggests that office development will not prove to be as strong a "driver" of employment growth in Chatswood as was assumed at the time the Subregional Strategy was formulated.

We do not consider there is likely to be a change in the demand for office space in Chatswood in the foreseeable future having regard to general market conditions and the particular constraints which apply to new office projects in Chatswood.

I trust the above is of assistance. Please contact me on 9224-6111 or pdl@leycon.com.au if any further information can be provided.

Yours sincerely
LEYSHON CONSULTING PTY LTD

PETER LEYSHON
DIRECTOR.