



10 November 2016

Jeffrey Bretag
Senior Strategic Planner
Port Stephens Council
116 Adelaide Street
Raymond Terrace NSW 2324
Via email: Jeffrey.Bretag@portstephens.nsw.gov.au

Dear Jeff,

Re: Peer Review – Hill PDA Nelson Bay Feasibility

1 INTRODUCTION

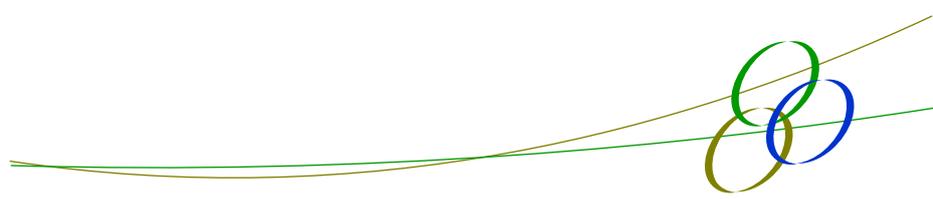
Environmental Property Services Pty Ltd (EPS) has been commissioned by Port Stephens Council to undertake a peer review of the “Nelson Bay Town Centre Feasibility Testing of Residential Development Sites” report prepared by Hill PDA (‘the Report’).

The Report examines the viability of various development heights and car parking configurations (above and below ground) in five (5) key test sites around the Nelson Bay town centre.

The feasibility testing aimed to identify causation for the lack of recent residential development in Nelson Bay Town Centre and is intended to inform Council’s review of the Nelson Bay Town Centre and Foreshore Strategy.

EPS has been instructed to consider the following in undertaking this peer review:

- Confirm that the approach and methodology are robust and reflect industry practice. Identify strengths and weaknesses for consideration by Council;
- Confirm the validity of assumptions, including site yields, use mixes, cost allowances, property values, revenue assumptions and sale rates;
- Review the conclusions and recommendations of the report to ensure these are consistent with the underpinning data and modelling; and
- Comment on the validity of the methodology, assumptions and recommendations within the context of EPS’ local market knowledge.



Note that EPS has not been provided with a working version of the Hill PDA financial modelling and accordingly this peer review does not include detailed quality assurance of the model to ensure that all calculations are accurate.

Note further that EPS review of the report alone does not enable a complete detailed analysis of the data imputed to a degree sufficient to provide a robust conclusion to be drawn as to the adequacy of the reports output. Limited by the scope, this peer review is likened to provision of commentary on an executive summary.

Notwithstanding, EPS are well positioned to undertake a peer review of these works and provide additional insight, given our local knowledge and development experience.

2 PEER REVIEW

Hill PDA are a well-regarded consultancy within the property industry. Overall the methodology, modelling and reporting provided appears to be robust, detailed and supported by thorough market research.

EPS confirms that the adopted underlying methodology of testing various sites, at various densities and the measurement of viability by consideration of IRR and development margins is both robust and consistent with industry practice.

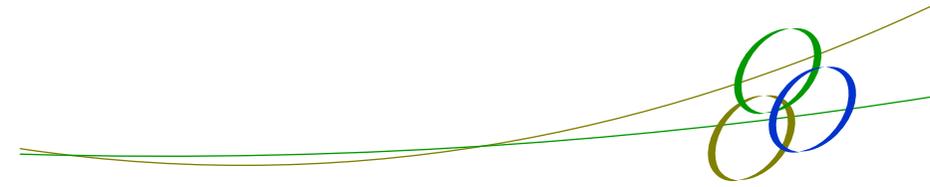
The feasibility modelling has been undertaken using HillPDA's proprietary financial model 'EstateMaster', which is widely used and accepted in the Australian property industry.

In undertaking the peer review EPS has identified various issues recommended for further attention. Many of these flagged issues may be resolved simply by HillPDA providing additional detail or justification for their modelling and reporting assumptions; while others may require further research and re-consideration by HillPDA.

While EPS broadly agree with the conclusions which HillPDA have drawn from the modelling outputs, we have not been provided with a working version of the modelling nor sufficient input data to confirm the veracity of the conclusions. Hence it is difficult to quantify the impact that the issues we have flagged will have on the modelling outputs, particularly when viewed in light of their aggregated affects.

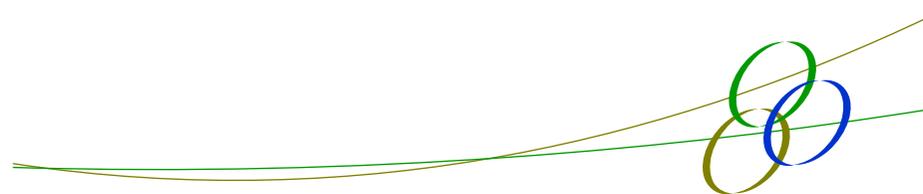
For ease of interpretation we have split the identified issues into two separate tables.

- 1 Key Issues. For important issues which have the potential to materially impact the modelling results; and
- 2 Secondary Issues and Inconsistencies. For issues which appear to be typographical errors or inconsistencies between the provided feasibility models and the body of the report.

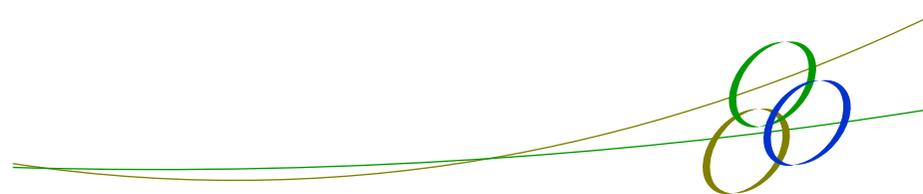


3 IDENTIFIED ISSUES

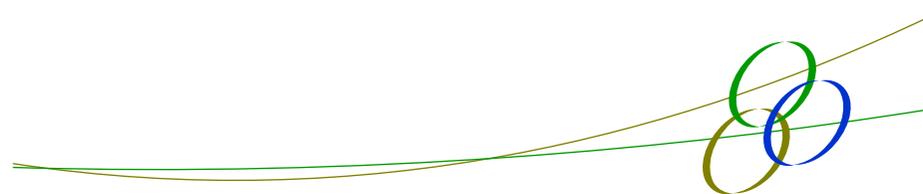
Key Issues		
Issue	Reference	Discussion
1. Spatial – Parking and height limits	All Estate Master modelling	<p>EPS recommend that HillPDA provide detail in respect of the site and building area analyses; their assumptions for each site’s building footprint, car parking footprint; number of car parking levels and number of apartments per floor etc.</p> <p>This would give EPS and Council comfort that the modelling represents a scheme that is both broadly feasible and practically deliverable on the site from a spatial perspective.</p> <p>For example, EPS estimate that the ‘Church Street 17 Storey, parking above’ scenario is likely to require 4 to 5 levels of above ground parking. If this is the case, then Council and HillPDA must consider the reasonableness of this assumption from both a visual impact and marketability perspective.</p>
2. Apartment pricing – elevation of above ground parking	All Estate Master modelling	<p>Subject to the detail to be provided under Issue 1, unit pricing should be differentiated between the above and below ground parking scenarios.</p> <p>For example, ‘Church Street - 17 Storeys - Parking Above Ground’ prices 28/110 units as having views, while the same scenario with below ground parking adopts identical pricing.</p> <p>Consider that this scenario provides 153 car spaces @ 30m² per space (EPS estimate) = 4,590m² of parking; or 4 to 5 levels of parking on this site.</p> <p>Therefore, in the above ground parking scenario an additional 4 to 5 levels of apartments (or c.25% of the building) will enjoy views as the residential levels will presumably sit above the parking levels.</p> <p>This is not currently reflected in the modelling.</p>
3. Council’s nominated height limits	All Estate Master modelling	<p>Further to Issue 2, EPS understand that Council have nominated the various height limits to be tested under the various scenarios, as outlined on the report page 7.</p> <p>While Hill PDA has not disclosed the assumed floorplates or number of units per floor, it would appear that they have not made an adjustment to adhere to the height limit in the scenarios where parking is to be above ground.</p> <p>E.g. In a scenario where 4 – 5 levels of above ground parking are required, it would appear that the height limit may be breached by 10 to 15m.</p>



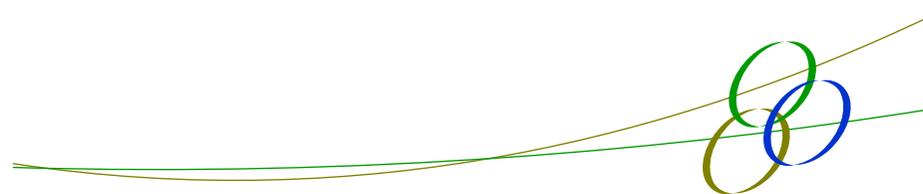
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4. Apartment sizing (GFA)	All Estate Master modelling	<p>Neither the report nor the modelling provides a breakdown of the assumed GFA of the various unit typologies (e.g. 1 bed, 2 bed, 3 bed).</p> <p>This is critical to ensure that the feasibility analysis is robust; as both the construction cost and revenue from each apartment will vary substantially depending on the floorplate size. For example, a 2-bedroom apartment might typically be in the range of 50m² to 90m².</p> <p>It is difficult for EPS to meaningfully review the adopted sales prices without understanding the assumed size of each unit typology.</p> <p>Based on the total project GFA (which is the only GFA shown in the modelling), an average GFA per apartment can be inferred and appears to be in the order of 110m² per apartment.</p> <p>Given that 75% of apartments are assumed to be 2-bedroom, this GFA seems unusually high. Page 16 of the report states in relation to pre-selling 2 bedroom units that 'living areas range from 75 to 103m² with the latter applying to penthouses'.</p>
5. Apartment Pricing (Revenue)	All Estate Master modelling	<p>While the pricing model adopted by HillPDA appears broadly reasonable, without having knowledge of the assumed apartment sizing it is difficult to substantiate whether fair market pricing has been reflected. It is again recommended that Hill PDA disclose the specific floor area assumptions used in the modeling.</p>
6. Number of Car spaces	All Estate Master modelling	<p>Parking spaces allocated to each hypothetical development are inconsistent with both the PSDCP and RMS's 'Guide to Traffic Generating Development'. SEPP 65 articulates that either Council or RMS' guidelines can be used to define minimum resident and visitor parking requirements for a development, whichever is less. We recommend that HillPDA clarify the basis for the carparking assumptions as both construction cost and revenue are sensitive to the level of parking provided.</p> <p>It is difficult to confirm that the assumed level of carparking is reflected in the revenue assumptions without details of assumed apartment sizes as per point 4 above.</p>



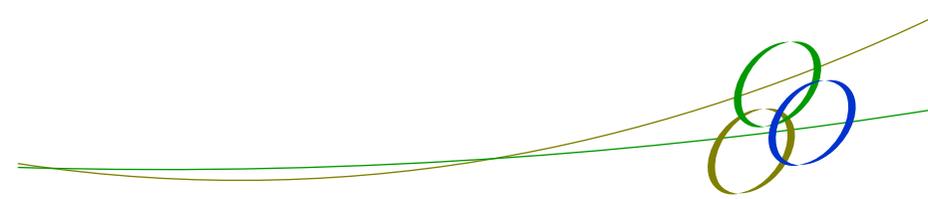
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7. Target Profitability (IRR and Margin)	Report Table 10	<p>EPS consider the adopted profitability target of 18% IRR and 20% Development Margin to be at the lower end of reasonable, given recent poor development performance and market climate in Nelson Bay, including the reluctance of lenders to support development.</p> <p>EPS recommends a target of 22% IRR and 25% Development Margin; however, acknowledge that this is a subjective metric which is not possible to accurately confirm with market evidence given the lack of recent development activity.</p>
8. Bushfire Affection	All Estate Master modelling	<p>Several of the test sites are identified by Council as being Bushfire Prone Land. Of particular concern is Site 1 which adjoins dense vegetation.</p> <p>EPS recommends further investigation into how this constraint may affect development viability of the site. For example, development yield and developable area may be significantly impacted by the need to provide asset protection zones for the site, while construction costs can be substantially escalated if additional bushfire standards are required.</p>
9. Unit Mix	All Estate Master modelling	<p>Hill PDA has assumed an apartment typology mix of 15% x 1-bedroom, 75% x 2-bedroom and 10% x 3-bedroom. EPS' view, drawn from local market understanding, coupled with extensive experience in this area, is that a mix of 5% 1-bedroom, 75% 2-bedroom and 20% 3-bedroom is more reflective of what the market is likely to deliver in Nelson Bay.</p> <p>This is reflected in:</p> <ul style="list-style-type: none"> • The ratio of existing apartments across Port Stephens is reported at 4% 1-bedroom, 48% 2-bedroom and 48% 3-bedroom; and • The ratio of apartments in the proposed Ascent project of approximately 5% 1-bedroom, 75% 2-bedroom and 20% 3-bedroom.



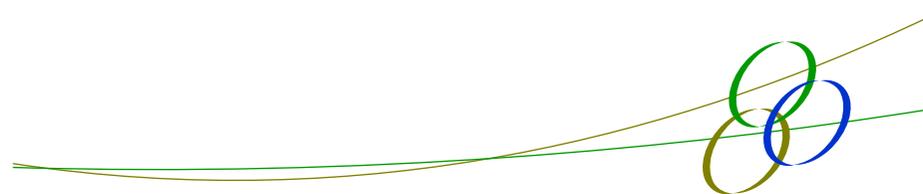
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10. External Works	Table 11 Code 4000	<p>Table 11 Row 3 lists 'External Works' at 4% of total construction cost. In the Estate Master modelling this figure is calculated at 2%.</p> <p>Notwithstanding this inconsistency EPS' view is that calculating external works as a fixed % of construction cost unfairly impacts the higher density scenarios.</p> <p>For example, for 'Site 2 - 5 storeys' the external works are \$357,000 (\$77/m² site area) while the 17 Storey scenario for the same site is costed at \$787,000 (\$170/m²). This allowance appears expensive for a relatively small site where the extent of external works will be limited by the building footprint.</p>
11. DA/CC Fees + Long Service Levy	Code 5001 of Estate Master Models	<p>DA/CC Fees + Long Service Levy cost is calculated as 1% of construction cost. Long Service Levy is legislated at 0.35% of construction cost, leaving 0.65% for DA/CC fees.</p> <p>While this is reasonable for the lower height scenarios, for the 11 – 17 storey scenarios (with a higher overall construction cost) this calculation overstates the likely cost.</p> <p>For example, the modelling for 'Site 1 – 17 Storeys Parking Below' equates to \$412,000 for DA/CC fees (exclusive of long service levy). A review of PSC's fees and charges (2016-2017) document suggests that the above figure is excessive, and should more closely be in the order of \$85,000 to \$90,000.</p>
12. Sales Rates		<p>EPS believe that the adopted apartment sales rates are optimistic overall, particularly given the shallow apartment market depth in Nelson Bay.</p> <p>HillPDA appear to have adopted sales rates in excess of 4 units/month; EPS agree that pent up market demand will see the next project sell well initially, however we do not believe there will be sufficient market depth to maintain a rate of 4 units/month for, say, a 110-apartment project.</p> <p>A rate of 4 units/month for the first 50 units, dropping back to a rate of 2 to 3 units/month thereafter may be a more prudent assumption.</p>



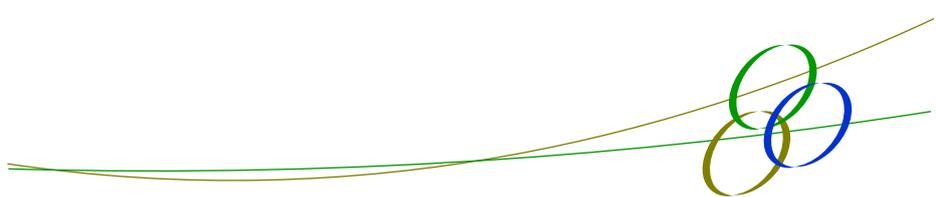
Secondary Issues and Inconsistencies.																								
Issue	Reference	Discussion																						
1. Feasibility Testing Results	Report Table 16 and 26	In five (5) scenarios, the reported 'Feasibility Testing Results' do not align with the Estate Master modelling outputs. It appears that the modelling may have been updated and not carried through to the body of the report.																						
		E.g. Table 16 - '3 Storeys – 24 Units, Below Ground Parking'																						
		<table border="1"> <thead> <tr> <th></th> <th>Report: Table 16</th> <th>Estate Master Model</th> </tr> </thead> <tbody> <tr> <td><i>Development Profit</i></td> <td>(\$115,940)</td> <td>(\$239,346)</td> </tr> <tr> <td><i>Development Margin</i></td> <td>(1.02%)</td> <td>(2.09%)</td> </tr> <tr> <td><i>IRR</i></td> <td>1.68%</td> <td>1.40%</td> </tr> <tr> <td><i>Residual Land Value</i></td> <td>(\$231,046)</td> <td>(\$483,100)</td> </tr> </tbody> </table>		Report: Table 16	Estate Master Model	<i>Development Profit</i>	(\$115,940)	(\$239,346)	<i>Development Margin</i>	(1.02%)	(2.09%)	<i>IRR</i>	1.68%	1.40%	<i>Residual Land Value</i>	(\$231,046)	(\$483,100)							
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		<table border="1"> <thead> <tr> <th>Table</th> <th>Site</th> <th>Storeys</th> <th>Above/below ground</th> </tr> </thead> <tbody> <tr> <td>16</td> <td>1</td> <td>3</td> <td>Below</td> </tr> <tr> <td>16</td> <td>1</td> <td>3</td> <td>Above</td> </tr> <tr> <td>16</td> <td>1</td> <td>5</td> <td>Below</td> </tr> <tr> <td>16</td> <td>1</td> <td>5</td> <td>Above</td> </tr> <tr> <td>26</td> <td>4</td> <td>11</td> <td>Above</td> </tr> </tbody> </table>	Table	Site	Storeys	Above/below ground	16	1	3	Below	16	1	3	Above	16	1	5	Below	16	1	5	Above	26	4
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26	4	11	Above																					
It does not appear likely that these errors will have a material impact on the viability assessment of each scenario.																								



Secondary Issues and Inconsistencies.		
Issue	Reference	Discussion
2. Section 94A Contributions	Code 5003 of Estate Master Models	Modeling has applied a broad-brush approach of 1% of construction costs incl. GST. Notwithstanding EPS' recognition of the industry's typical adoption of this rate, a brief review of PSC's Development Contributions Plan, suggests a nominal contribution in the order of \$15,000 per dwelling. EPS recommends that Council confirm the likely development contributions which would be levied on each scenario.
3. Construction Costs	Table 11	Table 11 outlines the adopted construction costs for all scenarios: \$2,200/m ² Low Rise, \$2,500/m ² Medium Rise, \$2,600/m ² High Rise. It appears that these have been applied with 3, 5 & 8 storeys being Low Rise, 11 storeys being Medium Rise and 14 to 17 storeys being High Rise. These rates are generally consistent with Rawlinsons Construction Cost Guide 2016 and reflect a medium to high end standard of finish.
4. Design and Consultants	Table 11	Row 2 of Table 11 has an error – mislabeling 'Balconies' and an allowance for 'Design and consultants'. Notwithstanding the typo, the cost allowances for both these items are reasonable.
5. Carparking Costs	Table 13	Within the body of the report (Table 13) above ground parking spaces are indicated at being costed at \$20,000 per space, while some of the feasibility modeling adopts \$25,000 per space. Rawlinson's confirms that a costing in the order of \$20,800 to \$22,450 per above ground multi-storey carparking space is reasonable.
6. Apartment Numbers	Stockton Street, 3 storey, above ground Code 8000	In this Estate Master model the Sales table lists 28 units, rather than the nominated 24. It appears that the calculation may be based on part units, but we recommend that HillPDA confirm this is correct in the working model.



Secondary Issues and Inconsistencies.		
Issue	Reference	Discussion
7. Market Evidence		<p>In addition to the market evidence cited by HillPDA, EPS is aware of the following:</p> <ol style="list-style-type: none"> 1 DA lodged over Site 2 (Church Street) for the proposed Ascent apartment development currently being marketed. Comprising a total of 56 apartments including 20% Silver Level 'Livable Housing Design' allocation with: <ul style="list-style-type: none"> • 38 x two-bedroom apartments; • 12 x three-bedroom apartments; • 2x one/two-bedroom dual key access apartments; and • 4x two-bedroom townhouse dwellings. • A total of 97 car parking spaces provided, with 78 allocated to residential apartments and an additional 19 for visitor parking. Parking is provided within three secure basement levels; • A private gymnasium, outdoor pool and decked communal BBQ area for residents; • (http://www.ascentnelsonbay.com.au/about.php).



4 DISCUSSION

4.1 Approach and Methodology

EPS has undertaken a review of the adopted approach and methodology and confirm that (subject to the issues identified) the approach is robust and reflects industry practice.

4.2 Assumptions

We have undertaken a thorough review of all underlying assumptions and confirm that the adopted assumptions (again subject to the issues identified in Section 3) are within reasonable market parameters based on our experience in the Port Stephens Market.

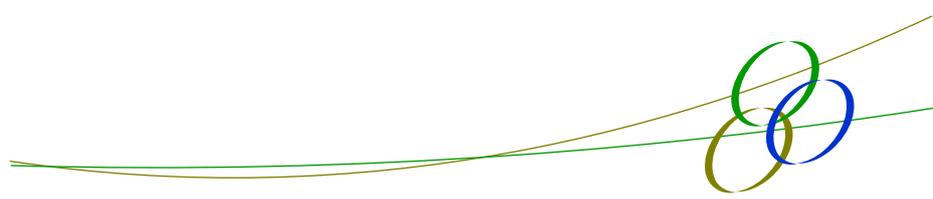
The supported assumptions include:

- Cost escalations
- Revenue escalations
- Professional fees
- Construction cost rates
- Parking construction costs
- Selling costs
- Timing
- Finance

Assumptions that EPS do not support include:

- Target profitability (IRR and margin)
- Sales rates

Notwithstanding the high-level nature of the exercise, the key issues identified by EPS principally relate to HillPDA providing a greater level of clarity around the assumptions for how the modelled project physically addresses the site. Issues around the total GFA, average GFA per apartment, number of apartments per floor, number of carparking levels and impact of above ground parking on heights & views need confirmation to ensure that the adopted revenue and construction cost assumptions are reasonable.



4.3 Conclusions

EPS broadly agree with the conclusions HillPDA have drawn from the modelling. Including:

- Site 1
 - Site 1 is unlikely to be developed for high density residential and a land subdivision for detached housing is more likely; particularly when bushfire provisions are considered.
- Sites 2, 3 and 4
 - Projects are generally viable at around 8 levels, particularly with above ground parking. This density also provides a total number of apartments where required levels of pre-sales (typically 50 – 70%) are more achievable given the local market depth. It also limits the practical and visual impact of providing too many levels of parking above ground.
 - Project viability above 8 levels is varied depending on quality of location; with the sites close to the water with superior views generally being viable, while sites further from the water do not appear to be viable.
- Site 5
 - The impost of a developer being required to deliver a 140 bay public carpark results in this site being not viable.
 - The 17 Storey above ground scenario is shown as ‘marginal’ but the ability of the site to sensitively accommodate above ground parking for both the public and a large residential building, while also activating the ground plane, is questionable.

EPS has also reviewed the market commentary contained in Section 6 of the report. We support these conclusions.

5 CONCLUSION

Overall EPS commend HillPDA on the quality of their report. We believe that once the issues identified above have been addressed, Council will have a robust and defensible basis for making future strategic decisions for Nelson Bay CBD.

I trust that the contents of this review are to your satisfaction. Please do not hesitate to contact me to discuss any aspect further.

Kind regards

Jeff Burns
Principal