

FRENCHS FOREST INSIGHT

OCTOBER 2015



Key Findings

The Frenchs Forest Employment Area is set to experience employment growth of 1,685 jobs between 2016 and 2021, 84% within white collar industries

With the new Northern Beaches Hospital opening in 2018, the bulk of employment growth will stem from healthcare providers. This is expected to create substantial demand for medical office suites

Additional office demand in the area is anticipated to total just under 60,000m² over the next 20 years, with the potential to be higher as existing medical professionals relocate to the area

Frenchs Forest has a relatively affordable rental base with prime rents substantially below that of competing non-core suburban markets such as Epping and Norwest.

Recent sales in the office market have traded at circa 10%, however depending on the opportunity, the area's prime assets are likely to trade in a range of 8.00% to 9.25%

The Frenchs Forest office market is set to experience a significant boost in tenant demand over the next five years, underpinned by medical professionals resulting from the completion of the new Hospital

Market in Context

Located 15km north from Circular Quay, Frenchs Forest is part of Sydney's northern beaches region. The area is being transformed through the construction of a state funded hospital, which is the first major investment in public health infrastructure on the northern beaches for decades, and a long-held ambition for the local community.

The Northern Beaches Hospital is being built on a 6.5 hectare Frenchs Forest site, bound by Frenchs Forest Road West, Warringah Road, Wakehurst Parkway and The Forest High School. The Northern Beaches Hospital project, which will complete in 2018, will deliver level 5 hospital services to the local community; with 488 beds, a large emergency department, theatres and a GP clinic on site.

Alongside the delivery of new health infrastructure the NSW Government is planning to invest \$400 million in road infrastructure upgrades scheduled to be completed in time for the hospital opening.

Warringah Council is also preparing the Northern Beaches Hospital Precinct Structure Plan. The purpose of the Plan is to look at the

wider land use implications of the proposed new hospital. It will involve a detailed analysis of opportunities and constraints, to properly plan for future development around the new hospital. It is envisaged that this plan will recommend the rezoning of a number of parcels of land around the site for medium and high density housing.

New residential development is expected to have several positive implications to the local economy and office markets. From a utilisation perspective, a larger resident population is anticipated to result in greater demand for employment and a focus of Government spending, giving local residents the ability to work closer to where they live (and therefore fulfilling a state Government objective). Alternatively, compared to office workers, permanent residents spend extends beyond working hours, effectively providing more support for retail provisions, leading to a more prosperous local economy.

With the area's amenity expected to improve greatly off the back of a larger resident population and further investment into large format retail, including a potential Masters store, office tenants will become more attracted to the area.

OFFICE MARKET

As at 2011, the Frenchs Forest Employment Area (see back page for definition) supported just under 10,000 jobs, 36% of which were within white collar industries (those who require office space). With the area being home to a large number of logistical and warehousing operators, which predominantly sits in conjunction to office provisions, wholesale trade employment represents 26% of the area's employment base.

At present, health care and social assistance workers account for 12% of all jobs within the Frenchs Forest Employment Area, however its share of total jobs is set to rise significantly once the Northern Beaches Hospital is completed in 2018. Jobs growth in the health care industry will not only stem from core hospital functions such as nurses, doctors, surgeons, etc. but also allied health professionals such as physiotherapists and chiropractors. With these key workers requiring office space close to the hospital, they will provide a key source of office demand in the Frenchs Forest Employment Area going forward.

What Business are Located in the Area

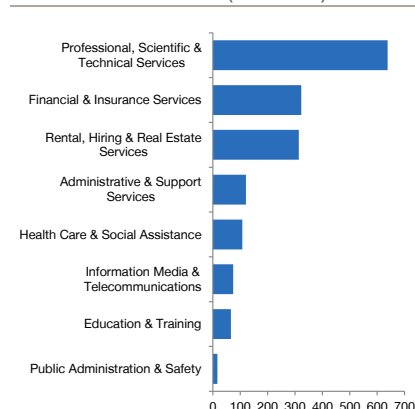
The Frenchs Forest Employment Area is characterised by a diverse and large range of businesses where as at June 2014, there were 2,925 businesses trading within the Frenchs Forest - Belrose SA2 region (all industries). Of this total, 57% were within dominant white collar industries, the largest being professional, scientific and technical services (38%), financial and insurance services (19%) and rental, hiring and real estate services (19%).

From a growth perspective, the largest increase in business numbers has been derived from financial and insurance services where over the two years to June 2014 an additional 22 businesses became operational. At the same time, a further five health care and social assistance businesses became operational over the same period.

FIGURE 1

Number of Businesses by Main White Collar Industries

Frenchs Forest - Belrose (June 2014)



Source: Knight Frank Research, ABS

Demand Projections

Off the back of the completion of the Northern Beaches Hospital, the Frenchs Forest Employment Area is set to experience significant jobs growth over the next 20 years, underpinned by robust gains in the health care industry.

Over the 20 years to 2031, an additional 4,265 jobs are expected to be created (all industries) in the Frenchs Forest Employment Area. From a white collar perspective, jobs growth of 2,880 is anticipated over the same period, 49% of which (or 1,417 jobs) are expected over the five year period to 2021. Notably, the annual growth rate for white collar employment growth in the area is expected to be double that of Greater Sydney at 3.0% and 1.5% respectively over the next 20 years.

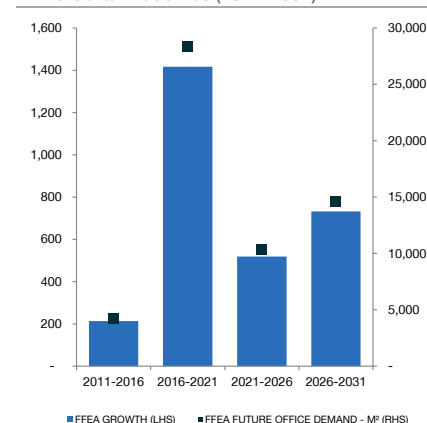
Based on a conservative office density ratio of 20m² per worker, office demand in the area is anticipated to total 57,600m² over the next 20 years, highlighting the economic and employment benefits associated with a new hospital.

While this office demand projection only accounts for the growth associated with future employment gains (new jobs), it

FIGURE 2

Frenchs Forest Employment Area Growth & Office Demand

White Collar Industries (2011-2031)



Source: Knight Frank Research, BTS

does not take into account demand stemming from existing professionals in other precincts relocating to the area. At present, medical and allied health professionals occupy office space throughout the Northern Beaches in areas such as Frenchs Forest, Brookvale, Dee Why, Mona Vale and Manly. With the existing hospital locations on the Northern Beaches being at a considerable distance from one another with one located in Mona Vale and the other in Manly, there is no single location in which these key workers gravitate to.

However, with the closure of the Manly Hospital and the downsizing of Mona Vale Hospital, the Northern Beaches Hospital will become the primary hospital for the Northern Beaches and surrounding areas.

Given the strong preference for medical professionals to be located close to hospital functions, it is likely that a considerable share of existing medical workers who occupy office space in nearby areas will seek office space in and around the new medical precinct. This is likely to see the Frenchs Forest Employment Area become the logical choice for these professionals. In this environment, Frenchs Forest has the potential to become the medical hub for the region.

Office Market Fundamentals

Office space in the Frenchs Forest Employment Area is provided through a range of dedicated stand alone buildings and shared office formats in conjunction with warehouse space. In total, Knight Frank's stock count of A and B grade office space in the area totals approximately 80,000m².

With a modest improvement in tenant demand over the past four years stemming from existing operators in the area either relocating to larger premises or taking additional space at their existing address, the vacancy rate has improved from the heights recorded in 2010 and 2011. Over the 10 months to October 2015, the vacancy rate in the Frenchs Forest Employment Area has trended upwards which is the result of non-core office tenants ceasing operations. For example, a child care provider at 18 Aquatic Drive Frenchs Forest recently closed its doors after trading since 2008. The circa 850m² tenancy (1.1% of total NLA) was a major factor behind the recent increase.

Frenchs Forest has a relatively affordable rental base when compared with other non-core suburban markets throughout Sydney, with an indicative net face rent of \$263/m² and a range of \$240–\$285/m² (see Figure 4). Of note, net face rents are substantially below that of competing suburban markets which are located

further away from the CBD including the likes of Epping and Norwest. With recent strong rental growth in core markets such as North Sydney, Parramatta and Macquarie Park, ripple effects are likely, with rentals in the non-core suburban markets such as Frenchs Forest, likely to be pulled up over the short to medium term. This is expected to be accentuated by infrastructure improvements and stock withdrawals. Incentive levels for the area currently average around 30%.

With office market conditions in the Frenchs Forest Employment Area projected to undergo a period of stronger tenant demand, the vacancy rate is projected to decline from its current level of 13.9%. Markets such as Frenchs Forest are likely to experience additional demand from tenant displacements in other suburban markets stemming from the increase in office building conversions into residential.

The lack of forthcoming supply in the Frenchs Forest Employment Area is also likely to place further downward pressure on the vacancy rate as the only increase is expected to come from additions to existing office buildings. This includes a DA approved extension to level 5 at 20 Rodborough Road where there is potential to add 1,160m² of NLA. With the potential rezoning of certain sites surrounding the new Hospital, it is likely that future office development will be constrained in the area as developers choose the more financially viable option of residential development. Simultaneously, there is

potential that some secondary stock will be withdrawn for residential use. With a larger resident population, additional demand for office space is expected as smaller financial and professional service businesses seek to relocate closer to where they live.

Sales and Investment Activity

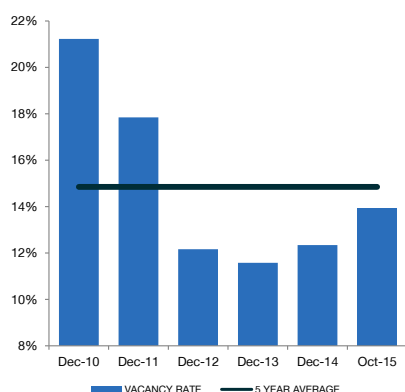
Nationally, non-CBD office markets have been subject to solid investor demand from both domestic and offshore capital as investors focus on assets with high relative yields and an upside to growth. The expected increase in office demand resulting from medical professionals is likely to draw attention to the Frenchs Forest market, with higher quality buildings expected to achieve average core market yields of around 8.00% - 9.25% depending on the profile of current leasing covenants and potential value add opportunities.

There have been two office buildings sold within Frenchs Forest over the past nine months. The latest reported property sale in the area was the 3,435m² office building at 18 Rodborough Road which sold off market for a reported \$9.6 million with a passing yield of circa 10%. In December 2014 28 Rodborough Road (4,975m² office NLA) transacted for \$15 million, reflecting a core market yield of 10.17%. The building was 100% occupied at time of sale; however, the property now has circa 600m² of ground floor office space available for lease.

Outlook

The outlook for the Frenchs Forest office market is favourable, with a projected increase in tenant demand expected to coincide with a period of weak supply and the possibility of stock withdrawals. In this case, the current vacancy rate of 13.9% is expected to steadily decline as medical and allied health professionals seek office space in close proximity to the hospital. Frenchs Forest has the potential to replicate the likes of the Norwest where the opening of the Norwest Private Hospital in 2009 led to robust demand from professionals associated with the hospital. With current office stock being well suited to accommodate smaller suites for medical professionals, the vacancy and rental growth outlook looks brighter.

FIGURE 3
Frenchs Forest Employment Area Office Vacancy Rate
Dec 2010—Oct 2015



Source: Knight Frank Research

FIGURE 4
Avg Prime Net Face Rents
By selected Sydney Suburban Markets,
October 2015 (\$/m²)



Source: Knight Frank Research

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Abbreviations & Glossary:

Core Market Yield: The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc.)

Vacancy: Based on a selected basket of 14 A and B Grade commercial buildings amounting to 78,037m² of NLA. These are the largest buildings in Frenchs Forest all with NLA of over 862m².

Frenchs Forest Employment Area (FFEA): This area is defined by the Bureau of Transport Statistics (BTS) Travel Zones of 2135, 2136, 2139, 2140, 2153, 2104, 2138.

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