

## Valuation Report

**91 Beardy Street and 102 Taylor Street  
ARMIDALE NSW 2350**

21 August 2019

Under instruction from  
**Commonwealth Bank of Australia (Bank)  
and Bank Group Members**



Reference: MS/12629

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### Key Points

- We have been provided with a Contract of Sale between Stirloch Developments and MPG Funds Management dated 23 October 2018. The front page of the Contract of Sale nominates a purchase price of \$15,895,000. The Special Conditions in the contract provide a mechanism for the calculation of the purchase price. This document agrees a purchase price of \$15,895,000 exclusive of GST based on an agreed net income of at least \$1,072,926 capitalised at a purchase price yield of 6.75%. Additional provisions within the Special Conditions include clauses pertaining to the obligation by the Vendor for completion of works in line with Agreements for Lease, clauses in relation to both Vendor and Purchaser warranties, and registration of leases at practical completion. We are satisfied that these conditions are typical for a transaction of this nature.
- We have been previously provided with signed Deeds of Agreement for Lease for both tenants and have since been provided with a signed lease for the anchor tenant Australian Pesticides and Veterinary Medicines Authority (APVMA). In relation to the lease to the Department of Human Services, we have been advised that the lease is still awaiting government signature, and we have been provided with an unsigned copy of this lease agreement. The Applicant advises (which is supported by the unsigned lease document) that the tenant took formal occupation of their accommodation in May 2019.
- Given the strength of the lease and cashflow, a considerable proportion of the Property's value is contingent upon the Commonwealth government leases to the Department of Human Services and the Australian Pesticides and Veterinary Medicines Authority. We note that a lower valuation may result should the Property be valued subject to 'Vacant Possession'.
- Both the leasing and sales evidence herein consistently indicates the presence of a two tier market for modern government buildings in small regional centres across the eastern seaboard. It is our experience that government departments have specific requirements as to NABERS and other specifications that are often unable to be delivered by existing office stock in a small regional centre such as Armidale on the scale and quality required by these tenants. Hence market rents for these buildings for government tenants are often well in excess of the rents being achieved for lower tier smaller buildings let to private enterprise. In addition the scale of the government department occupancy in this investments is also more often than not well in excess of any single tenant private tenant occupancy in one of these regional centres.
- These government office buildings are all in effect specialised investments which all contain an intrinsic significant reversionary risk related to lease expiry – both in relation to filling of the vacancy if the government tenant leaves and the fall in rent if the building reverts to private enterprise occupation. This risk is present in the market evidence was well as the subject, with the cap rates spreading as expiries approach the expiry risk. As such, whilst the market rent for the subject to a non government department is well below the rent adopted herein, the rent adopted herein is nonetheless the market rent that buyers in this market are pricing these specialised investments. In terms of valuation approach, because the cap rates analysed from the sales evidence is understood on similar rental levels for similar quality buildings in similar locations with similar reversionary risks, the required application of consistency of analysis of the evidence (and its application to the subject) is in place.
- Recent sales across the commercial markets and various other sectors indicate strong competition for assets and yield compression. This yield compression has been of varying degrees, being more pronounced for "prime" assets, although secondary CBD and suburban/regional markets have shown recent strong compression. Overall, commercial markets are trading below their long-term averages, with "prime" assets trending to previous peak GFC levels. Whilst it is typical for assets in a buoyant investment market to trade below longer-term averages, the trend does indicate that general asset pricing and cyclical risk has increased and is more exposed to adverse movements/volatility due to external shocks. In this regard we note that under more balanced market conditions assets such as the subject have traded at softer yields, depending upon lease profile at the time.

### Critical Conditions

- This Valuation Report is prepared for the Lender named above for mortgage purposes and is not to be used or relied by any other party for any other purpose. It is subject to the terms and conditions, disclaimers, qualifications and limitations contained in the Report and any annexures thereto.
- This Report is for the sole use only of Commonwealth Bank of Australia (Bank) and Bank Group Members for mortgage purposes only and is not to be used for any other purpose by any other party. Any reliance, use, distribution, publication of the Report and/or any other representations made relating to the contents of the Report is restricted solely to the Lender, and any additional parties expressly named in this Report.
- No responsibility is accepted by the Valuer and/or Knight Frank Newcastle in the event that the Lender to which this Report is addressed, or any other agreed additional reliant party(s) noted in this Report, relies, uses, distributes, publishes and /or otherwise represents anything contained in the Report for any other purpose apart from that expressly noted previously.
- No responsibility is accepted by the Valuer and/or Knight Frank Newcastle to any other parties who rely, use, distribute, publish and/or otherwise represent anything contained in the Report for any purpose.
- Our valuation is conditional upon full execution of the lease to Department of Human Services.
- The valuation is also conditional on the important notices, disclaimers and qualifications contained in the body of this report.

*This Executive Summary forms a part of and should not be used or read independently from the complete report. Particular attention is drawn to the Qualifications, Important Notices and Disclaimers included in this report. Liability limited by a scheme approved under Professional Standards Legislation.*

# SWOT Analysis



## Strengths

- Commonwealth government lease covenants with long tenure (13.4 year Weighted Average Lease Expiry) and fixed annual 3.25% increases providing a buffer to inflation.
- 4.5-star NABERS base building rating.
- Functional office accommodation with efficient floorplates.
- Significant tax depreciation benefits.
- Minimal capital expenditure requirements over the short to medium term.
- Good regional location at Armidale supported by University of New England, New England Conservatorium of Music and numerous public and private schools.

## Weaknesses

- Negative rental reversion at the expiry of the Department of Human Services lease.
- Non-metro location.

## Opportunities

- Hold the Property for income return over the medium to long term.

## Threats

- Significant letting up and incentives allowances should the tenants' vacate at the end of the respective initial terms.
- Rise in interest rates presenting a market risk to all investment properties.
- Significant softening in commercial yields in regional locations should there be a downturn in the commercial property sector.

## Buyer Profile

- We note that the firm yields being achieved for commercial property is largely a reflection of the current low interest rate environment. Discussions with financial institutions indicate that investors are able to secure fixed term funding for commercial property at competitive rates, particularly for assets with long term secure lease covenants such as the subject Property. This has created yield compression in not only major capital city markets, but also in secondary regional markets. The subject Property is well located within the Armidale Central Business District, has strong incoming Commonwealth government lease covenants and tenure to the Department of Human Services and the Australian Pesticides and Veterinary Medicines Authority, and will benefit from a 4.5 star NABERS rating. These features are appealing to prospective purchasers, especially small to mid-cap Real Estate Investment Trusts, private equity syndicates, and high net worth investors.