DIA WELLINGTON ACCOMMODATION FINAL COMMERCIAL TERMS: ST PAULS BUILDING

Purpose of the Report

The purpose of this paper is to report back on the final commercial terms negotiated for the St Pauls' office accommodation solution and seek authority for the Chief Executive of the Department of Internal Affairs to execute the Development Agreement. The business case and procurement process was led by the Government Property Group, working closely with the Department of Internal Affairs.

Recommended Actions

We recommend that you:

1. note that the Government Property Group (GPG), supported by the Department of Internal Affairs (DIA), has negotiated a Development Agreement for the majority of its Wellington office accommodation solution as part of its contribution to the Wellington Accommodation Project – Tranche 2 (WAP2);

2. note that authority to agree to the final investment decision for this solution was delegated to Joint Ministers (Minister of Finance and Minister of State Services) by Cabinet on 2 June 2015 (CAB Min (15) 18/7 refers);

3. note that the negotiated solution reduces forecast property-related costs (status quo) across the 20-year appraisal period by $30.47 million;

4. note that the negotiated accommodation solution offers a building with high levels of safety and standards that provide good staff protection and mitigate risk to business continuity;

5. note that the Crown's legal services provider has certified that the Development Agreement (including the Deed of Lease) reflects the agreements reached between the parties during the negotiations, and accordingly, is in order for execution;
6. Note that the Crown's Engineering services provider has certified that the building will meet the Crown's building performance specification;

7. Note that the Landlord has the right to re-negotiate the commercials if the Development Agreement is not executed by 10th June 2016;

8. Approve the final commercial terms of the Development Agreement (including the Deed of Lease) negotiated for DIA's Wellington office accommodation solution; and

   Agree/disagree
   Hon Bill English
   Minister of Finance

   Agree/disagree
   Hon Paula Bennett
   Minister of State Services

9. Delegate to the Chief Executive of DIA the financial authority to execute the Development Agreement (including the Deed of Lease) negotiated for DIA's Wellington office accommodation solution.

   Agree/disagree
   Hon Bill English
   Minister of Finance

   Agree/disagree
   Hon Paula Bennett
   Minister of State Services

Signed: ___________________________       Signed: ___________________________
Date:                                Date:

Endorsed by:

Colin MacDonald
Chief Executive
Department of Internal Affairs

Signed: ___________________________
Date:  28/4/16

David Smol
Chief Executive
Ministry of Business, Innovation and Employment

Signed: ___________________________
Date:  26/4/16
Executive Summary

1. The Department of Internal Affairs (DIA) participated in a collective office accommodation business case during 2015 as it has leases due to expire in the Wellington Central Business District (WCBD) in mid to late 2017. The business case was prepared by the Government Property Group (GPG), hosted at the Ministry of Social Development (MSD), pursuant to the functional leadership mandate delegated from the State Services Commissioner to the Chief Executive of MSD.

2. A preferred solution for the 24 participating agencies of the Wellington Accommodation Project Tranche 2 (WAP 2) was approved by Cabinet on 2 June 2015. DIA was identified to relocate from three sites to 45-47 Pipitea Street (St Pauls). St Pauls is in very close proximity to two other DIA buildings: being the National Library and Archives New Zealand. St Pauls was previously occupied by GPG led the negotiation for St Pauls and was supported by: DIA, a Tenant Advocate (specialist property negotiator), and other external technical services such as legal and engineering. The negotiated solution for DIA has come in better than the business case expectations.

3. As part of the Development Agreement, the landlord will be undertaking a significant refurbishment programme at their cost which will include the following: installing a new Building Management System (BMS), efficient modern HVAC equipment (meeting minimum 4 star NABERSNZ rating), thermal insulation, inter-connecting tenancy stairs (from Ground to 3rd floor), sensor lighting, refurbishment of the lifts, lobby redesign, new ceilings, new lights, new carpet and a re-landscaping of both the South and North entrances.

4. 

5. The key points from the Development Agreement and Deed of Lease are as follows:
   - **Landlord.** [redacted] acts pursuant to a management contract
   - **Lease terms.** Gross lease with an initial term of 15 years, with three rights of renewal based on 6 years. The target lease commencement date is 19 December 2017.
   - **Area Leased.** 13,660m² @ 11.5m² per workpoint.
   - **Costs.**
   - **Incentives.**

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1 Note now hosted at MBIE from 1 April 2016.
2 Heating, Ventilation and Air-Conditioning
3 NABERSNZ is a measure of energy efficiency in buildings that is endorsed by EECA, and is out of 6 stars.
Rent Review. The rent review structure (every third anniversary) is market rent reviews. Having market reviews is important to mitigate against rising property costs, as Wellington’s office accommodation market is expected to soften considerably in the foreseeable future. This is based largely on the Crown’s reduced footprint achieved through both the WAP1 and WAP2 processes.

Sublease and Assignment. The Crown has the automatic right to assign its lease to another Crown organisation without the Landlord’s consent. This provides flexibility for the government to meet changing requirements over time.

Building Performance Specifications – Key Outcomes.
- Energy efficiency including thermal insulation, sensor lighting control and efficient, modern HVAC equipment
- Structure rated at a minimum of 90% New Building Standard (NBS) on commencement, and must not fall below 80% NBS for the entire term of the lease, including renewals
- Space efficient and contiguous floor plates, including inter-connecting tenancy stairs connecting levels ground to level 3. Upgrading the lifts, including the installation of a fifth lift between Ground and Level 3
- Lobby redesign to provide an enhanced experience for staff and customers
- New ceilings, lights and carpets.

6. Specialist external expertise was used to support the negotiation process in order to achieve the most favourable terms and conditions for the Crown. The Crown’s legal services provider used during the negotiation

7. The key outcomes to DIA and the Crown are as follows:
- Excellent value for money
- Good building safety and business continuity capability
- Upgraded and refurbished premises that meet the Crown’s Building Performance Specification
- The refurbished premises allows DIA to introduce modern and flexible working styles to future-proof against changing requirements
- An efficient footprint (11.5m² per work point down from the current 14.0m²)
- Enhanced agency effectiveness and productivity through a precinct solution
- A single move with minimal staff disruption, business risk and legacy lease tails.

4 Government expectations for office accommodation are 12-16m² per workpoint.
Background

8. DIA participated in a collective office accommodation business case during 2015, as it had leases due to expire in the WCBD in mid to late 2017. The business case was prepared by the GPG, hosted at MSD, pursuant to the functional leadership mandate delegated from the State Services Commissioner to the Chief Executive of MSD.

9. The centrally-led procurement and business case process for Wellington office accommodation resulted in a preferred solution which was approved by Cabinet on 2 June 2015. As part of the preferred solution, DIA was identified to occupy the building situated at 45-47 Pipitea Street (St Pauls). St Pauls is located within 100 metres of two other DIA-owned buildings; being the National Library and Archives New Zealand. This creates a precinct of buildings that supports better business engagement as a Department and also allows greater opportunities to share facilities between buildings.

10. A strategic objective for DIA is ensuring that it is 'a robust, sustainable and fit for purpose Department'. Currently, Wellington-based DIA staff are dispersed across several properties (both leased and owned) in the Wellington CBD. With the expiry of several leases in the CBD, DIA now has the opportunity to bring many of its staff together into a single precinct (spread across properties in St Paul's, Mulgrave Street and Molesworth Street). As part of this work, DIA is considering how it might also look to make changes to how its staff work together, the optimisation of space available and the tools used at DIA. These changes will benefit everyone in DIA, not just those based in Wellington.

11. Consolidating DIA into a precinct provides greater efficiencies for the Department than being spread over multiple sites, as has been the case for some time. Space efficiency is also being achieved at St Pauls by having reduced functions and facilities, as well as through more efficient desk utilisation and alternate workpoints. There will also be greater use of common facilities such as meeting rooms and kitchens. Although not quantified, there will also be considerable cost and productivity savings by not having staff needing to transition between buildings for meetings and the like.

12. GPG utilised external specialist property negotiation services, legal services, architectural services and engineering services to support the negotiation of the Development Agreement (including the Deed of Lease). DIA supported GPG through this process to ensure that DIA's needs were met and to assist in achieving WAP2's overarching objectives.

Note – now hosted at MBIE from 1 April 2016
Final Commercial Terms

13. Since the WAP2 business case, some of the assumptions that DIA was working to have changed. This is not uncommon for government agencies where property procurement and implementation occurs over long periods of time.

14. A significant assumption that has been revised is associated with the staff located at DIA’s fourth Wellington-based building, 120 Victoria Street, that were intended to occupy both the new building and the upgraded Archives New Zealand building in 2020. DIA has subsequently undertaken an indicative business case (IBC) around its National Library and Archives New Zealand buildings in the North Island, and how investment should be targeted to preserve documentary heritage collections and holdings. Indicatively, the IBC recommends that only specialist archival staff are accommodated in the Wellington-based Archives New Zealand building.

15. In response to staff no longer being able to occupy the Archives New Zealand building, the preferred solution now assumes that two floors at 120 Victoria Street will be retained from 2020, together with providing for a further 600m² of office space within the WCBD to accommodate the Customer Services counter. After taking these changes into account, DIA’s leased footprint reduces by 4,226m² to 15,232m².

16. The finalised cost-benefit analysis, and KPIs of DIA’s negotiated solution, as compared to the June 2015 business case, are as follows:

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<th>Table 1: CBA of DIA’s negotiated solution</th>
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1 Headcount adjusted to include contractors
2 Made up of St Pauls (13,800m²), 120 Victoria St (832m²) and Customer Services counter (600m²)
17. The key points from the Development Agreement and Deed of Lease are as follows

- **Landlord.**
- **Lease terms.** Gross lease with an initial term of 15 years, with three rights of renewal based on 6 years. The target lease commencement date is 19 December 2017.
- **Area Leased.**
- **Costs.**

- **Rent Review.** The rent review structure (every third anniversary) is market rent reviews. Having market reviews is important to mitigate against rising property costs, as Wellington’s office accommodation market is expected to soften considerably in the foreseeable future. This is based largely on the Crown’s reduced footprint achieved through both the WAP1 and WAP2 process.

- **Sublease and Assignment.** The Crown has the automatic right to assign its lease to another Crown organisation without the Landlord’s consent. This provides flexibility for the government to meet changing requirements over time.

- **Building Performance Specifications – Key Outcomes.**
  - Energy efficiency including thermal insulation, sensor lighting control and efficient, modern HVAC equipment
  - Structure rated at a minimum of 90% New Building Standard (NBS) on commencement, and must not fall below 80% NBS for the entire term of the lease, including renewals
Space efficient and contiguous floor plates, including inter-connecting tenancy stairs connecting levels ground to level 3. Upgrading the lifts, including the installation of a fifth lift between Ground and Level 3

Lobby redesign to provide an enhanced experience for staff and customers

New ceilings, lights and carpets.

Other benefits not included within DIA's cashflows include:

Efficiencies that will be gained from a reduction in time spent by staff moving between buildings.

The waiving of the make good and lease tail obligations. Moved into from St Pauls in January 2016. The forecast make-good obligation stood at approximately with a final lease expiry of 31 March 2016. Using the leverage gained via the centralised procurement process, GPG, on behalf of has been able to negotiate a settlement for the make-good liability and also to remove the rent payable obligation for the months of February and March 2016.

Specialist external expertise was used to support the negotiation process in order to achieve the most favourable terms and conditions for the Crown.

Three key risks that will need to be monitored carefully during implementation are as follows:

a. Time. A significant delay to the completion date for works to St Pauls could place pressure on the lease expiries at 26, 46 Waring Taylor Street, requiring short-term extensions to be negotiated, with potential cost escalation to the rent. The final lease expiry at 109 Fowsteron Street is 28th February 2018. The building manager, also , has indicated that no extensions after the final lease expiry date will be possible due to a new tenant taking occupation. Any delays caused by will require them to meet any additional costs passed on to the Crown from this risk.

b. Cost. Rent costs are not a risk as the rent per square metre has been agreed under the negotiated draft deed of lease. The only risk to cost will exist around capital works and fit-out when may request additional specifications not previously agreed within the Development Agreement. Any additional capital costs will be met internally by DIA and will only be done where it supports greater long-term value for money to the Crown.

c. Changing requirements. A common risk to property is managing increases or decreases to accommodation requirements while locked into a long-term fixed contractual arrangement. This risk translates into needing to secure additional short-term accommodation at historically higher cost or having an oversupply of space if numbers reduce. This risk will be mitigated by GPG, under its Functional Leadership Property mandate, having an ongoing strategic All-of-Government approach to the procurement and management of the Crown's property portfolio in Wellington. This enables GPG to identify other appropriate agencies that can backfill surplus space at St Paul’s as it becomes available or to locate additional or surplus space in other government-tenanted buildings if more footprint is required.

The Landlord has the right to re-negotiate the commercials if the Development Agreement is not executed by 10th June 2016.
Financials

22. As directed by Cabinet Paper, GPG has been working with individual agencies and the Treasury to determine the overall funding requirements.

23. DIA, along with the other WAP2 participants, were requested to identify any funding shortfalls relating to participation in WAP2, as part of their most recent Four-year Plan (4YP) process.

24. On the 25th April Cabinet agreed new capital and operating funding as part of the Budget 2016 package. This new capital and operating funding was placed in a tagged contingency and authority delegated to Joint Ministers to appropriate funding into the relevant WAP2 participating agency as necessary. The tagged contingency contains sufficient capital and operating to meet DIA’s additional funding requirements as described in paragraphs 25 and 29 below.

31. The financial summary for DIA over the 20 year appraisal period, as compared to the status quo, is attached at Appendix 1.

32. Assurance. The following assurance certificates have been provided:
   - Legal (the Development Agreement and Deed of Lease)
   - Engineering (the Building Performance Specification)