Date: 17 July 2014

Report to: Minister of Finance
          Minister of Education

HEAD OFFICE ACCOMMODATION FINAL KEY COMMERCIAL TERMS – MINISTRY OF EDUCATION

Purpose of the Report

1. The purpose of this paper is to report back on the final key commercial terms negotiated for the Ministry of Education (MoE) Wellington head office accommodation solution and seek authority for the Secretary for Education to execute the Redevelopment Agreement. The business case and procurement process was led by the Government Property Management Centre of Expertise, working closely with MoE staff.

2. A copy is provided to the Minister of State Services for his information.

Recommended Actions

We recommend that you:

1. note that the Ministry of Education (MoE) and the Government Property Management Centre of Expertise (PMCoE) have negotiated a Redevelopment Agreement for the majority of MoE's Wellington corporate accommodation solution

2. note authority to agree to the final investment decision for this solution was delegated to Joint Ministers (Minister of Finance and Minister of Education) by Cabinet on 13 November 2012 (SEC Min (12) 21/2 refers)

3. note that despite projected increases for property-related costs across the 20 year appraisal period, the negotiated solution does not require additional Crown funding

4. note MoE will have effectiveness and efficiency gains from re-locating the majority of its staff into one building

5. note that the Crown's legal services provider will be required to certify that the Redevelopment Agreement (including the Deed of Lease) reflects the agreements reached between the parties during the negotiations and accordingly, will be in order for execution

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6. **note** that the Ministry will have a reduction of 17% in its property footprint (21,336m² to 17,678m²) for the total MoE Wellington corporate accommodation solution

7. **approve** the final key commercial terms of the Redevelopment Agreement (including the Deed of Lease) negotiated for the majority of MoE’s Wellington corporate accommodation solution

8. **delegate** to the Secretary of Education of the Ministry of Education the authority to execute the Redevelopment Agreement (including the Deed of Lease) negotiated for the majority of MoE’s Wellington corporate accommodation solution

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Brendan Boyle  
Chief Executive  
Ministry of Social Development  
Date: 21 July 2014

Peter Hughes  
Secretary for Education  
Ministry of Education  
Date:

Hon Bill English  
Minister of Finance  
Date

Hon Hekia Parata  
Minister of Education  
Date
Executive Summary

1. The Ministry of Education (MoE) participated in a collective head office accommodation business case during 2012 as it has leases with terms due to expire in the Wellington Central Business District. The business case was prepared by the Government Property Management Centre of Expertise (PMCoE), 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 five participating agencies was approved by Cabinet on 13 November 2012. MoE was identified to occupy a building to be re-developed, situated at 33 Bowen St, Wellington (current Ministry of Business, Innovation and Employment [MBIE] head office location for approximately half their staff). This would see MoE moving its staff out of St Pauls Square, Justice Centre (19 Aitken St), Public Trust building and the Freyberg Building.

3. The building at 33 Bowen Street will accommodate a maximum of 1,100 workpoints.

4. MoE and PMCoE jointly progressed the negotiation for 33 Bowen St, supported by a Tenant Advocate (specialist property negotiator) and other external technical services such as legal, architects and engineers.

5. 33 Bowen St (in its current state) has lease expiry in 2017 (two floors) and December 2019 (nine floors). As MBIE is departing to Stout St in September 2014 for its new head office relocation there is a long 'lease tail' until the final expiry in 2019. This has reduced the Crown's leverage in the negotiations with the landlord. The building is currently providing an adequate level of accommodation quality for MBIE however deficiencies are increasing, reflecting the age and condition of key plant and services. The building also has notable seismic strength deficiencies that need to be addressed for a new long-term lease tenure. The most critical of these was the internal fire stairs and MBIE undertook these upgrade works while in-situ to provide for the safety of its staff. The landlord needs the building vacated to carry out a major redevelopment of the site including the addressing of the other seismic deficiencies of the building.

6. Operating costs for property generally are forecast to rise significantly over the longer term. The November 2012 business case total occupancy cost was $168.11 million. The final negotiated solution for 33 Bowen St sees this cost reduce to $155.65 million, representing a 7.4% decrease. The average total property cost per FTE has also reduced from $9,848 to $8,199, representing a 16.7% reduction. The whole-of-life project cost (discounted) stood at $95.10 million over the 20 year period. The final negotiated solution for 33 Bowen St sees this marginally rise by $1.69 million to $96.79 million, representing a 1.7% increase.

7. Due to the long lease tail and the requirement for major works to be completed on the building, the Crown will be required to pay double rent for a period of time for the 33 Bowen Street and other MoE buildings, while MoE transitions to the new building.

8. The key commercial terms from the Redevelopment Agreement are as follows:
   - **Landlord.** Talavera Property Limited (TPG). TPG is a New Zealand-based subsidiary of a larger Australian private investment property company called Vinta Group.
   - **Space occupied.** 13,178m² @ 11.98m² per workpoint.

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- Costs.
  - Capital Fit-Out: $23.00 million

- Sublease and Assignment. The Crown has the 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.
  - Upgraded lifts to ensure adequate services
  - Full upgrade of Heating, Ventilation and Air-Conditioning system (HVAC)
  - Open plan floors with minimal walls and enclosed meeting rooms
  - Internal open staircase to provide improved access and collaboration between floors
  - Upgraded bathroom facilities

9. Specialist external expertise was used to support the negotiation process. The Crown’s legal services provider during the negotiation (Greenwood Roche Chilsmail) will be required to certify that the Redevelopment Agreement (including the Deed of Lease) reflects the agreements reached between the parties during the negotiations and accordingly, will be in order for execution.

10. The key outcomes to MoE and the Crown are as follows:
- No additional funding required for property costs over the forecast 20 year period
- Very efficient footprint adopted (11.98m² per work point down from 14.4m²) with a reduction of 3,658 m² of office space (17% reduction)
- Enhanced agency effectiveness through a recuction in buildings occupied
- Minimal legacy lease tails

Background and Outcome

11. MoE participated in a collective head office accommodation business case during 2012 as it has leases due to expire in the Wellington Central Business District. Other agencies involved were the [REDACTED], and the Property Management Centre of Expertise (PMCoE), 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.

12. The agencies were at various stages of business case and procurement processes, all of which were merged into the PMCoE-led process in June 2012. This centrally-led procurement and business case process for Wellington head office accommodation resulted in a preferred solution which was approved by Cabinet on 13 November 2012.

13. As part of the preferred solution MoE was identified to occupy a building to be re-developed situated at 33 Bowen St, Wellington (current Ministry of Business, Innovation and
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Employment [MBIE] head office location for approximately half their staff). This would see MoE moving its staff out of St Pauls Square, Justice Centre (19 Aikken St), Public Trust building and the Freyberg Building. This property project will represent a 17% (3,658m²) reduction in MoE’s footprint from its original position in November 2012.

14. Consolidating MoE into fewer buildings provides greater efficiencies for the Ministry than being spread over four sites, as has been the case for some time. Space efficiency will be achieved by having fewer support functions such as the reception and waste management services. 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 as often between buildings for meetings.

15. MoE expects its national office staff number to continue to expand and contract according to project demands. If MoE’s staff numbers do reduce during the tenure of the lease then PMCoE will work with MoE to find other government agencies to occupy the space to mitigate any oversupply risk.

16. The Crown utilised external specialist property negotiation services (Twenty Two) and legal services (Greenwood Roche Chisnall) to support the negotiation of the Redevelopment Agreement and the Deed of Lease. PMCoE jointly negotiated this agreement with MoE to ensure that the Crown’s needs were met and to achieve greater commonality and consistency across government.
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Final Commercial Terms

17. The finalised cost-benefit analysis, and KPIs of MoE's negotiated solution, as compared to the November 2012 business case are as follows:

Table 1: CBA of MoE's negotiated solution

<table>
<thead>
<tr>
<th>Appraisal period (20 yrs)</th>
<th>Nov 12 Preferred Solution</th>
<th>July 14 Bowen Solution</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2012/13 to FY 2031/32</td>
<td>962</td>
<td>1,100</td>
<td>+ 138</td>
</tr>
<tr>
<td>Planning Headcount / Workpoints</td>
<td>13.00</td>
<td>11.98</td>
<td>- 1.02</td>
</tr>
<tr>
<td>Planning Density m²/pp</td>
<td>12,500</td>
<td>13,178</td>
<td>+ 678</td>
</tr>
<tr>
<td>Total Occupancy ($ million)</td>
<td>168.11</td>
<td>155.65</td>
<td>- 12.46</td>
</tr>
<tr>
<td>Capital costs ($ million)</td>
<td>19.67</td>
<td>23.00</td>
<td>+ 3.37</td>
</tr>
<tr>
<td>Whole of life costs (Real Terms) ($m)</td>
<td>150.91</td>
<td>146.41</td>
<td>- 4.50</td>
</tr>
<tr>
<td>Net Present Value (NPV @ 6.5%) ($m)</td>
<td>95.10</td>
<td>96.79</td>
<td>+ 1.70</td>
</tr>
<tr>
<td>Shortfall / Surplus against future funding provisions</td>
<td>(11.63)</td>
<td>5.82</td>
<td>+ 17.45</td>
</tr>
</tbody>
</table>

18. The key commercial terms from the Redevelopment Agreement and the draft Deed of Lease are as follows:

- **Landlord.** Talavera Property Group Limited (TPG). TPG is a New Zealand-based subsidiary of a larger Australian private investment property company called Vinta Group. Vinta Group are substantial investors and developers of shopping centres in Australia. TPG own three significant buildings within Wellington.

- **Space occupied.** 13,178m² @ 11.98m² per workpoint.
Costs.

- Capital Fit-Out: $23.00 million

Sublease and Assignment. The Crown has the 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.

- Structural upgrades to the building to bring the building above 97% NBS.
- Upgraded lifts to ensure adequate services
- Full upgrade of HVAC
- Open plan floors with minimal hard fitout
- Internal open stair case to provide improved access and collaboration between floors
- Upgraded bathroom facilities

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

a. Time. Delays through the negotiation process have created pressure on the lease expiry dates at MoE’s existing sites and have created a very tight programme for the works at 33 Bowen St. Any further delays to the practical completion date for works to 33 Bowen St will result in PMCoE and MoE needing to renegotiate short-term extensions with potential cost escalation to the rent as well as a double rent situation with the ongoing lease still needing to be paid at 33 Bowen St. Any delays which are attributable to the default of Talavera will require them to meet any additional direct costs passed on to the Crown from this risk up to a capped amount of [redacted].

b. Cost. Rent costs increases are not a risk as the rent per square metre has been agreed under the negotiated draft Deed of Lease. The risk of cost increases exist around capital works and fit-out including normal procurement risk escalations and where MoE may request additional specifications not previously agreed within the Redevelopment Agreement. Any additional capital costs will be met internally by MoE and will only be undertaken 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 shorter-term accommodation at historically higher cost or having an oversupply of space if space requirements reduce. This risk will be mitigated by PMCoE, under its Functional Leadership Property mandate, undertaking a strategic portfolio approach to property management. This enables PMCoE to identify other appropriate agencies that can
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backfill surplus space in MoE's buildings as it becomes available or to locate additional or surplus space in other government-tenant buildings if more footprint is required.

Financials

20.

21.
24. The financial summary for MoE over the 20 year appraisal period, as compared to the status quo, is attached at Appendix 1.