



MINISTRY OF
SOCIAL DEVELOPMENT
Te Manatū Whakahiato Ora

Date: 31 October 2013

Security Level: IN CONFIDENCE

Report to: Minister of Finance
Minister for Social Development

HEAD OFFICE ACCOMMODATION FINAL COMMERCIAL TERMS – MINISTRY OF SOCIAL DEVELOPMENT

Purpose of the Report

1. The purpose of this paper is to report back on the final commercial terms negotiated for the Ministry of Social Development (MSD) Wellington head office accommodation solution and seek authority for the Chief Executive of MSD to execute the Development Agreement. The business case and procurement process was led by the Government Property Management Centre of Expertise, working closely with MSD 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 Social Development, supported by the Property Management Centre of Expertise (PMCoE), has negotiated a Development Agreement for its Wellington head office accommodation solution	AGREE / DISAGREE
2. note that authority to agree to the final investment decision for this solution was delegated to Joint Ministers (Minister of Finance and Minister for Social Development) by Cabinet on 13 November 2012 (SEC Min (12) 21/2 refers)	AGREE / DISAGREE
3. note that despite projected increases for property-related costs across the 20 year appraisal period, the negotiated solution a) does not require additional Crown funding; and b) achieves cost avoidance of \$6.10 million compared to the projected status quo (see Appendix 1)	AGREE / DISAGREE
4. note that MSD will have effectiveness and efficiency gains from re-locating from the three buildings into one building	AGREE / DISAGREE
5. note that the negotiated accommodation solution offers a building with appropriate levels of safety and standards that provide good staff protection and mitigate risk to business continuity	AGREE / DISAGREE

6. note that the Crown's legal services provider has certified that the Development Agreement (including the Deed of Lease) reflect the agreements reached between the parties during the negotiations and accordingly, are in order for execution	AGREE / DISAGREE
7. note that the Ministry will achieve a reduction of 13% in its property footprint (from 27,788m ² to 24,255m ²) to a density of 12.8m ² per person	AGREE / DISAGREE
8. note the Government's Property Management Centre of Expertise will work with MSD to mitigate any over or under supply of office space that might arise as a result of this accommodation solution	AGREE / DISAGREE
9. approve the final commercial terms of the Development Agreement (including the Deed of Lease) negotiated for MSD's Wellington head office accommodation solution	AGREE / DISAGREE
10. delegate the Chief Executive of the Ministry of Social Development the authority to execute the final commercial terms of the Development Agreement (including the Deed of Lease) negotiated for MSD's Wellington head office accommodation solution	AGREE / DISAGREE



 Brendan Boyle
 Chief Executive
 Ministry of Social Development

Date: 1 November 2013



 Hon Bill English
 Minister of Finance

12/11/13

 Date



 Hon Paula Bennett
 Minister for Social Development

4/11/13

 Date

Executive Summary

1. The Ministry of Social Development (MSD) currently occupies the Bowen Campus. Bowen Campus has a final lease expiry of March 2017 and this reflects the end of the site's economic viability. The landlord needs the building vacated to carry out a full redevelopment of the site. The current low quality of the building correlates to the low rent rate that MSD is currently paying. This level of rent is unsustainable for a fit-for-purpose enduring office accommodation solution in the Wellington region.
S 9(2)(b)(ii) Commercially Sensitive
2. Given the upcoming lease expiries, MSD participated in a collective head office accommodation business case during 2012. The business case was prepared by the Government's Property Management Centre of Expertise (PMCoE), hosted at MSD, pursuant to the functional leadership mandate delegated from the State Services Commissioner to the Chief Executive of MSD.
3. A preferred solution for the five participating agencies was approved by Cabinet on 13 November 2012. MSD was identified to occupy 19,654m² of office space at 56-66 The Terrace (the current Unisys building) based on an October 2011 planning assumption of 1,635 work points at an average of 12.0m² per work point. In the intervening two years the number of national office staff has continued to fluctuate as MSD implements a varied work programme which includes Welfare Reform, the Children's Action Plan, Investing in Services for Outcomes, and the transfer of the Social Housing Needs Assessment function from Housing New Zealand. MSD currently has around 1,900 staff, including temporary project staff, based at its national office. National office staff numbers are expected to continue to expand and contract according to project demands.
4. Subsequent work also revealed that the optimal density for the 56 The Terrace is lower than expected at 12.8m² as a result of space inefficiency inherent in the building. On this basis an extra 4,600m² of office space is required - 1,160m² as a result of space inefficiency and 3,440m² as a result of the revised staff number. The total office requirement is now around 24,300m² - a 13% (3,533m²) reduction in MSD's current footprint. PMCoE and MSD have therefore agreed that the Ministry should lease all the office space in building, which totals 24,255m².
5. During the lease period MSD staff numbers at national office will continue to fluctuate as our work programme changes and staff numbers may also reduce as saving initiatives are implemented. If staff numbers do reduce during the tenure of the lease then PMCoE will work with MSD to find government co-location partners to mitigate any oversupply risk.
6. The negotiation for 56-66 The Terrace was led on MSD's behalf by a specialist property negotiator and supported by PMCoE, legal advisors, architects and engineers in order to achieve the most favourable terms and conditions for the Crown and maximise value for money. The Crown's legal services provider during the negotiation (Kensington Swan) has certified that the Development Agreement (including the Deed of Lease) reflects the agreements reached between the parties during the negotiations and is in order for execution.
7. The fundamental points from the Development Agreement and the draft Deed of Lease are:
 - **Landlord.** Kiwi Property Holdings Limited of Kiwi Income Property Trust (KIPT); New Zealand's largest listed property trust which, as a landlord presents, a very low risk to the Crown for long-term tenure at 56-66 The Terrace.
 - **Lease terms.** Gross lease with an initial term of 18 years, with three rights of renewal based on a term of 6 years followed by two terms of 3 years. The target lease commencement date is 31 July 2016.

- **Space occupied.** 24,255m² at 12.8m² per work point.
- **Costs.**

§ 9(2)(b)(ii) Commercially Sensitive

§ 9(2)(b)(ii) Commercially Sensitive

- **Sublease and Assignment.** The Crown has the automatic right to assign its leases 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.**
 - New façade with high performance glazing system.
 - New air conditioning system.
 - Structural upgrade to a minimum of 90% the New Building Standard (NBS).
 - On-floor interconnecting stairs.
 - Lobby redesign.
 - Lift refurbishment.
 - New ceilings, lights and carpets.
8. The whole of life cost of the negotiated solution is higher than the November 2012 estimate as a consequence of taking more space, but remains lower than estimated under the status quo. The overall cost per FTE and per square metre has decreased compared to the November 2012 estimates.
9. Over the 20 year appraisal window, the additional cost (over and above existing funding provisions) to lease 56 The Terrace is § 9(2)(b)(ii) Commercially Sensitive. This additional cost has been factored into the Ministry's financial planning processes, including the Four Year Plan. It will be considered alongside other cost pressures and managed through key savings initiatives such as Simplification and a new operating model.
10. The key outcomes of the negotiated solution to MSD and the Crown are as follows.
- No additional funding required for property costs over the forecast 20 year period.
 - Projected property cost avoidance of \$6.10 million over the appraisal period.
 - An efficient footprint (12.8m² per work point down from the current 15.4m²) with a 13 percent reduction in office space.
 - Good building safety and business continuity capability.
 - Enhanced agency effectiveness through a single building solution.
 - A single move with minimal staff disruption, business risk and legacy lease tails.

Background

11. MSD 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 Out of Scope.
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.
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 MSD was identified to occupy a majority of the building situated at 56-66 The Terrace (19,654m²) and to vacate the Bowen Campus that it currently occupies. This was based on a planning assumption of 1,635 work points at an average of 12.0m² per work point. The work point number was based on October 2011 figures. In the intervening two years the number of national office staff has continued to fluctuate as MSD implements a varied work programme which includes Welfare Reform, the Children's Action Plan, Investing in Services for Outcomes, and the transfer of the Social Housing Needs Assessment function from Housing New Zealand. MSD currently has around 1,900 staff, including temporary project staff, based at its national office. National office staff numbers are expected to continue to expand and contract according to project demands.
14. Subsequent work also revealed that the optimal density for the 56 The Terrace is lower than expected at 12.8m² as a result of space inefficiency. On this basis an extra 4,600m² of office space is required - 1,160m² as a result of space inefficiency and 3,440m² as a result of the revised staff number. The total office requirement is now around 24,300m². PMCoE and MSD have therefore agreed that the Ministry should lease all the office space in building, which totals 24,255m².
15. As noted above, during the lease period MSD staff numbers at national office will continue to fluctuate as our work programme changes and evolves. Staff numbers may also reduce as saving initiatives are implemented. If staff numbers do reduce during the tenure of the lease then PMCoE, under its Functional Leadership Property mandate, will work with MSD to find other government agencies to co-location with them to mitigate any oversupply risk (refer to paragraph 21).
16. MSD utilised external specialist property negotiation services (Wareham Cameron + Co) and legal services (Kensington Swan) to support the negotiation of the Development Agreement and the Deed of Lease. PMCoE supported MSD through this process to ensure that the Crown's needs were met and to assist in achieving greater commonality and consistency across government.
17. The accommodation solution for MSD enables a reduction in footprint of 13% (3,533m²).

Final Commercial Terms

18. Table 1 shows that the average total property cost per FTE, the average total property cost per square metre and the total capital cost per square metre have all decreased compared to the original business case. Table 2 shows that the final cost-benefit analysis of the

negotiated solution compared to the indicative figures in the November 2012 business case. The increased whole of life cost reflects the extra office space to be leased.

IS 9(2)(b)(ii) Commercially Sensitive

19. The fundamental points from the Development Agreement and the draft Deed of Lease are as follows:

- **Landlord.** Kiwi Property Holdings Limited of Kiwi Income Property Trust (KIPT). KIPT is New Zealand's largest listed property trust, with a diversified portfolio of prime office and retail assets located throughout New Zealand. KIPT as a landlord presents a very low risk to the Crown for long-term tenure at 56-66 The Terrace.
- **Lease terms.** Gross lease with an initial term of 18 years, with three rights of renewal based on a term of 6 years followed by two terms of 3 years. The target lease commencement date is 31 July 2016.
- **Space occupied.** 24,255m² @ 12.8m² per workpoint.
- **Costs.**

IS 9(2)(b)(ii) Commercially Sensitive

- **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.**
 - New façade with high performance glazing system.
 - New air conditioning system.
 - Structural upgrade to a minimum of 90% the New Building Standard (NBS).
 - On-floor interconnecting stairs.
 - Lobby redesign.
 - Lift refurbishment.
 - New ceilings, lights and carpets.
20. The Crown's legal services provider during the negotiation (Kensington Swan) has certified that the Development Agreement (including the draft Deed of Lease) reflect the agreements reached between the parties during the negotiations and, accordingly, is in order for execution.
21. Three key risks that will need to be monitored carefully during implementation are as follows:
- a. **Time.** A significant delay to the practical completion date for works to 56-66 The Terrace could place pressure on the lease expiry date at Bowen Campus by requiring a short-term extension to be negotiated with potential cost escalation to the rent. Any delays caused by KIPT 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 where MSD may request additional specifications not previously agreed within the Development Agreement. Any additional capital costs will be met internally by MSD 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 PMCoE, 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 PMCoE to identify other appropriate agencies that can backfill surplus space in MSD's building as it becomes available or to locate additional or surplus space in other government-tenanted buildings if more foot print is required.

Financials

22. Operating costs for property generally are forecast to rise significantly. The following graph compares the occupancy cost of the proposed solution in relation to the status quo, the November 2012 business case, and the current funding arrangements.

(S 9(2)(b)(ii) Commercially Sensitive)

23. Table 3 compares the 20-year whole-of-life funding arrangements for the negotiated solution with the status quo and the November 2012 business case. The whole of life cost has increased compared to the November 2012 estimates as a consequence of taking more space, but remains lower than estimated under the status quo. The overall cost per FTE and per square metre has decreased compared to the November 2012 estimates.
24. Over the 20 year appraisal window, the additional cost (over and above existing funding provisions) to lease 56 The Terrace is S 9(2)(b)(ii) Commercially Sensitive. This additional cost has been factored into the Ministry's financial planning processes, including the Four Year Plan. The Ministry's Four Year Plan acknowledges that the Ministry has a number of cost pressures and outlines the savings initiatives, including Simplification and a new operating model, which the Ministry will need to implement to meet these pressures.

S 9(2)(b)(ii) Commercially Sensitive