

Confidential Report

TO: Council

FROM: Group Manager Economic Development and Property

MEETING DATE: 24 February 2014

SUBJECT: **SUPPLEMENTARY REPORT - ECONOMIC DEVELOPMENT**

SUMMARY

Further to the Council's consideration of the report from the Group Manager Economic Development and Property, at its meeting on 10 February 2014, it was resolved:

"That the report lie on the table pending a further report addressing the questions raised during the course of the meeting and be uplifted at the next Council meeting."

This supplementary report is provided in order to clarify various aspects of the proposal and to provide additional information as requested.

HISTORY OF WALL STREET COMPLEX

In order to provide Council with background information relating to the development of Wall Street, a summary of this is attached as Attachment 1.

HISTORY OF PENROSE BUILDING

In order to provide Council with background information relating to the acquisition of a share in the ownership of the Penrose Building, a summary of this is attached as Attachment 2.

TOTAL COST TO DCC OF REDEVELOPMENT FOR FISHER AND PAYKEL

Estimated Capital Costs

Capital cost of redevelopment of Wall Street Complex
(includes break through to Penrose Building)

Cost to upgrade Penrose Building (DCC direct capital cost)

DCC Share of relocation costs for existing tenants in Penrose Building

DCC (as part owner of the Penrose Building) 50% share of Golden Block Investments Ltd contribution of [REDACTED] towards relocation costs.

Total Capital costs to DCC

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Revenue Gains and Losses

Wall Street Complex additional rental
50% share of Net Revenue gain in Penrose Building
Less Rental Revenue from Citipark (loss of 18 car parks)

Net Revenue Gain

Initial Cash Return on Investment

Capital Gains

Crighton Anderson Ltd, Registered Valuers, have undertaken an analysis of the Capital Gains, taking into account added value as a result of longer term leases and the redevelopment.

A summary of this analysis is as follows:

	Wall Street	Penrose Building: only DCC share	Combined Investment
Cost of works			
Net gain in value			
Return on Investment			

CURRENT RETURN TO DCC

1. Wall Street Complex

- Current Market Valuation dated 30.6.13
(Crighton Anderson Ltd Registered Valuers) 32,500,000
- Net Cash Return (12 months to 31.1.2014) 2,103,775
- Net Return 6.5%

2. Penrose Building (50% share)

- Current Market Valuation dated 17.10.12
(Crighton Anderson Ltd Registered Valuers) 2,850,000
- Net Cash Return (12 months to 31.1.2014)
- Net Return

Note: There is no discount for the DCC 49% shareholding, due to equal voting rights of the shareholders

3. Properties Proposed for Sale and Returns

In the previous report to Council, for the meeting on 10 February 2014, two properties were identified for sale (refer page 4)

A query was raised as to the potential sale of additional properties to cover any shortfall in funds realised from the above sales.

Two additional properties have been identified for sale,

All properties have a number of risks relating to long term ownership.

(12 months to 31/1/2014)		
Current Market Valuation	Net Cash Return	Net Return \$
[REDACTED]		
[REDACTED]		
[REDACTED]		
[REDACTED]		

Note 1:

Note 2:

Note 3:

Note 4:

COMPARABLE MARKET RENTALS

Chapman Consultancy Otago Ltd, Registered Valuers, have provided details of rental rates for office and retail premises in Dunedin – refer to Attachment 3.

FUTURE LEASE RENEWALS AND SEPARATE OWNERSHIPS

[REDACTED]

There is no right of renewal at the end of the new longer term proposed of 2023. Therefore all parties will be looking to make a commercial decision at that time and the interests of the two landlords to continue to secure a long term tenant, who will also be considering their options, are almost certainly going to be aligned.

FISHER AND PAYKEL

In response to the Council's queries relating to the possibility of Fisher and Paykel leasing alternative premises off-site to accommodate their planned expansion, the Dunedin Site Manager, has provided further information relating to this – refer to Attachment 4.

IMPACT IF DEVELOPMENT DOES NOT PROCEED

1. City's Perspective

Fisher and Paykel have stated that they require contiguous space for their operation. If the proposed extension is not proceeded with, there is a very real possibility that they will, over time, relocate their operation away from Dunedin to their Auckland Head Office, which, Fisher and Paykel Dunedin tell us, has the ability to expand to accommodate their needs.

Compounded by other recent businesses being lost to the City, such a signal would likely cause significant damage to Dunedin's reputation as a 'business friendly' environment, keen to attract new businesses to the city. Further, the City's Economic Development Strategy and Partnership is actively trying to retain such businesses while attracting new ones.

A key project of the Economic Development Strategy is Project Shanghai and China, which is looking to strengthen business, tourism and educational links with consequential benefits to the City. The President of Haier has recently commented that the Dunedin Fisher and Paykel facility is regarded as one of Haier's key product development sites. If the expansion was not to proceed, then there is risk that damage could be done to an important and growing relationship that is likely to benefit the city further in the future.

The separate economic impact assessment attached to the original report puts the potential total economic impact for the city at \$11 million/year. A substantial portion of this would likely be lost if the proposed expansion was located in Auckland.

2. Landlord's (DCC) Perspective

Impact on the Landlords substantial investment in Wall Street and the Penrose Building. The additional lease periods and space commitments make both properties more valuable and desirable to potential purchasers. If the proposal does not proceed, this will have a detrimental impact on maximising potential future sales values.

With regard to Wall Street, should Fisher and Paykel vacate their leased space, there is a very real risk that we would not be able to re-lease the premises at the rental rates currently being achieved. Whilst it is difficult to assess with certainty the likely costs to convert the space to a retail tenancy, it would not be viable for small retail tenancies and a large format retailer of the ilk of Rebel Sports or Briscoes would almost certainly require a substantial fitout contribution and/or a rent holiday. Physical works to the building to facilitate access and visibility would almost certainly be required as well, in order to make it viable for large format retail. These costs, although difficult to estimate, should be considered in the event that Fisher and Paykel were allowed to exit their lease. These could be potentially offset through a lease exit payment from Fisher and Paykel but Council would need to determine whether that was sensible in terms of its relationship with Fisher and Paykel, Haier, and other stakeholders, and also how it might potentially affect Fisher and Paykel's decision to further invest in the city.

With the loss of 223 people on-site, it is reasonable to expect a negative impact on the retail turnover of Wall Street and the adjacent retail malls and local businesses.

TIMING OF PROPOSAL FOR COUNCIL CONSIDERATION

This is a complex proposal, which required considerable investigation to ascertain the viability to complete the project, ie cost estimates, design issues, potential relocation of tenants etc.

Until such time as we had this information to hand, the proposal was not at the stage where it could be presented with any real confidence as to our ability to complete the project.

Also, Fisher and Paykel had requested that they be given sufficient time to gain the various 'in principle' approvals that they required, prior to the proposal being put before the full Council. In December 2013, the CEO of Fisher and Paykel gave approval to the Dunedin Manager to progress the proposal with DCC with the intention of ensuring their ability to extend their accommodation on the existing site.

There is an 'agreement in principle' with Fisher and Paykel relating to the details of the proposal with regard to both Wall Street and the Penrose Building. This is **subject** to all parties, ie DCC, Fisher and Paykel and Golden Block Investments Ltd, obtaining all the necessary approvals to proceed.

Although no written agreements are in place for existing tenants to relocate from the Penrose Building, possible alternative accommodation has been identified which would meet their needs.

Prepared by:

Approved for submission by:

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Robert Clark
**Group Manager Economic Development
and Property**

Approved by: Tony Avery
General Manager Infrastructure and Networks

Date report prepared: 17 February 2014

Attachments

1. Background information relating to the development of Wall Street Complex.
2. Background information relating to the acquisition of the Penrose Building.
3. Market Rental details from Chapman Consultancy Otago Ltd.
4. Fisher and Paykel information relating to planned expansion.

HISTORY OF WALL STREET COMPLEX

1. Development Background

At its meeting on 28 February/1 March 2007, the Council gave consideration to the redevelopment of its site in George Street, Dunedin, purchased by Council in December 1988, formerly occupied by the DEKA and Bond and Bond stores.

The Council resolved:

- "1. *That after having received an independent Peer Review of the Wall Street proposal, and that review confirming the development's viability, provided that all necessary contractual commitments are met, the Council provide formal authority to invest in and construct the smaller Wall Street retail development, that being:*
 - *Ground floor retailing*
 - *First floor car parking (capable of conversion to retail)*
 - *Second floor car parking.*
2. *That the Mayor and Property Manager be authorised to release the Council's decision to proceed with the Wall Street retail development."*

The Council elected to develop this site into a retail complex, for the following reasons:

- ~ Provide a long term higher yielding property investment.
- ~ Strengthen the Councils District Plan by further securing George Street as the central business retail area.
- ~ Provide employment:
 - Short term - Construction
 - Long term - Retail based employees
- ~ Provide additional rates funding (currently \$270,000 plus GST)
- ~ Allows Council to influence the aesthetic look of George Street via frontage construction.
- ~ Provide a link between George Street, St Andrew Street, Filleul Street and the Golden Centre (District Plan objective).
- ~ Reinforce confidence in the Dunedin economy.

The Council set several objectives for the "Wall Street Project" these being:

Viable Investment

- Annual market yield on funds invested (greater than leasehold land).
- Capital gain on investment over time.
- Built on time/within budget.

Design Innovation

- Innovative design which creates a point of difference from standard mall designs.
- Design to adopt viable green design principles to minimise energy consumption.
- Exterior design to fit into George Street environment and fabric.
- Design to create tomorrow's heritage.

Economic Benefit

- Create short and long term employment/growth opportunities.
- Secure the retail heart of the city.

- Assist city funding:
 - New ratepayers
 - Property investment returns.

Construction work commenced in July 2007 and the Complex was open to the public on 21 March 2009.

Fisher and Paykel closed their operation in Mosgiel in April/May 2009. In November 2008, they approached Dunedin City Council to provide premises for their International Design Centre. They required 3,000 m² of office and product design space in the Central City specifically designed to their needs, no later than July 2010 as this was the settlement and vacation date under their Sale and Purchase Agreement with Fonterra. They identified Wall Street as their preferred option due to its location and the ability to meet the very short timeframe required.

At its meeting on 20 April 2009, the Property Subcommittee considered a report from the Manager City Property regarding entering into a lease with Fisher and Paykel for accommodation, to be developed at Wall Street, to ensure that 150 jobs remained in Dunedin.

The Property Subcommittee resolved:

"That the Agreement to Lease between the Council and Fisher and Paykel Appliances be confirmed."

2. Costs of Development

– Stage One – Retail and Car Park	28,056,149
– Stage Two – Fisher and Paykel Offices	5,131,060
Total	33,187,209
– Less contribution from Fisher and Paykel	690,173
Total Cost to DCC	32,497,036

3. Total Cost of Wall Street Complex

– Cost of land:	
▪ DEKA	2,400,000
▪ Portion of Penrose Building	800,000
	3,200,000
– DCC Costs of Development	32,497,036
Total Wall Street Costs	35,697,036

4. Return to DCC on Investment

▪ Current Market Valuation dated 30.6.13 (Crighton Anderson Ltd Registered Valuers)	32,500,000
▪ Net Cash Return (12 months to 31.1.2014)	2,103,775
▪ Net Return	6.5%

HISTORY OF PENROSE BUILDING

1. Acquisition Background

In October 1995, the Penrose Department Store, located on the corner of George and St Andrew Streets, ceased trading and the building was sold to a syndicate of local investors. This syndicate approached the Council, as owner of the adjoining "DEKA" site, to ascertain whether the Council wished to be involved in the syndicate (who had an ownership of the Golden Centre) with up to a 50% share.

In considering this offer, it was agreed that with retail development proceeding in the immediate area, if Council wished to keep maximum development flexibility (as owner of the adjoining "DEKA" site), achieve both maximum capital gains and rental revenue possibilities, it should proceed with becoming a joint venture partner in the ownership of the Penrose building.

It was considered that the Council would find it difficult to find an equal investment that provided:

- ~ Prime location.
- ~ Immediate capital gain.
- ~ Local, high profile, secure tenant (Arthur Barnett Ltd had entered into a lease of the Penrose building for a period of four years).
- ~ Enhanced development potential for the Council's adjoining property.

At its meeting on 18 September 1995, the Council resolved:

- "1. That the Council appoint a Subcommittee of Councillors with Property staff to conclude the purchase of a 50% shareholding in the Penroses building for the sum of \$1,957,500 plus GST if any, and including confirmation of valuation and a minimum of 50% occupancy being confirmed.
2. The purchase price of \$1,957,500 being payable as \$500,000 deposit upon the sale and purchase contract becoming unconditional, and the balance of the purchase price \$1,325,000 being payable as at 1 February 1997, and \$132,500 interest payable in four equal instalments between 1 February 1996 to 1 February 1997.
3. That the Council's joint venture ownership of the Penroses building be by way of a partnership with the property development/ownership syndicate.
4. That the details of the Penroses building purchase remain confidential until the sale and purchase contract become unconditional."

Subsequent to further investigations into the appropriate ownership structure to enable the purchase of the building to proceed and to enable the Council to receive tax free income derived from the Penrose building, the Council's Corporate Resources Committee at its meeting on 21 November 1995 resolved:

- "1. That the Council approves the establishment of a property company to hold ownership of a half share of the Penroses building.
2. That the General Manager, Dunedin City Holdings Limited be invited to act as the Secretary of the Company.
3. That Management of the property itself shall be provided by the Property Business Unit."

A joint venture company, Golden Block Investments Limited was subsequently formed.

Note that in all financial dealings of the company, there is no discount attributable to the Council's 49% shareholding. This is due to the shareholders having equal voting rights.

Directorship: Robert Clark – Chair
Syd Brown – Director
Ken Cummings – Director
Tony Clear – Director
Jason La Hood – (alternate Director for Ken Cummings)

Golden Block Investments Ltd is administered by City Property.

2. Return to DCC (50% share)

- Current Market Valuation dated 17.10.12
(Crighton Anderson Ltd Registered Valuers) 2,850,000
- Net Cash Return (12 months to 31.1.2014) [REDACTED]
- Net Return [REDACTED]

Note: There is no discount for the DCC 49% shareholding, due to equal voting rights of the shareholders

Fisher & Paykel Dunedin Site Expansion

February 11 2013

This letter is in response to questions asked in a recent city council meeting, regarding alternative options for expanding our Dunedin premises. To answer these questions, it is necessary to re-iterate the key objectives of our expansion.

- Maintaining an open-plan, contiguous office space.
- Ensuring an attractive and creative work environment.
- No disruption to the execution of our product and technology plan.
- Minimal disturbance to our existing services and facilities.
- Execution at a fast pace consistent with our growth.
- Capital investment from F&P within budget.

A vital aspect of our operation is the need for all of our activities to be accommodated in one building. We have a number of areas such as compliance testing, electronics development and prototyping that are shared across all projects, and it is necessary that these are within close proximity to both office and development workshops.

Our current plan to expand the Wall Street facilities causes minimal disruption to our product development plans. We have been able to plan around leaving vital facilities intact while we expand, and to avoid moving facilities that take time to commission, and therefore represent a risk to our projects.

Expanding into buildings that are not part of a contiguous space is not an option for us, it will not result in a satisfactory facility. The current site meets our needs well and we are not interested in shifting in the foreseeable future. Our ongoing product development plan is based on growth of employee numbers and facilities. If we cannot achieve our planned expansion with minimal disruption, in the required timeframe, then our product plans are at risk. This is an unacceptable situation to us, and a risk to our business.



Richard Butler
Product Design Manager,
Dunedin Site Manager