

4. CIVIC OFFICES ACCOMMODATION – BUILDING LIFECYCLE AND OPTIONS ANALYSIS

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The purpose of this report is to summarise the long term financial implications associated with refurbishing the existing Civic Offices building by comparison with those for a new custom-built facility. The report recommends a preferred option for the Council to consider.

1. CONTEXT

The background to this report is summarised in the report presented to the Property and Major Projects Committee on 21 November 2003 which outlined three options. Options 1 and 2 stayed with the current building but provided additional space on the roof (Option 1) or on an adjoining site (Option 2). Option 3 was for an entirely new facility on another site with the existing building converted to a car park.

Option 2, while comparable in cost to Option 1, did not include refurbishment of significant parts of the existing building and was viewed as a less than ideal option. Accordingly this option is no longer being pursued.

At the 21 November 2003 meeting the Property and Major Projects Committee strongly supported the option of vacating the existing Civic Offices building in favor of alternate new accommodation for staff and Civic functions. The report covered in some detail the capital requirements for the options, over the first 10 years, but did not address the potential for long term operational efficiencies and funding implications.

The lifecycle analysis, funding and options analysis, addressed within this current report, clarifies the funding implications, highlights the risks and opportunities inherent with the options and provides a strategic framework within which a commitment to one of the options can be made.

For the purpose of this report the two options being considered are as follows:

- Option 1 : Build additional space on roof, and refurbish all floors.**
- Option 3 : Build a new building on an different site.**

These options are outlined in Appendix 1 (attached).

A cost benefit assessment using the capital requirements and lifecycle analysis for each option has been completed, allowing officers to identify the steady state cost of owning and operating each of these options. The differential between the two options represents the likely additional ongoing impact on rates associated with developing a new facility and converting the existing building into car parking.

A number of significant drivers for each of the options are difficult to quantify in financial terms and accordingly an options assessment needs to consider the relative importance of these issues alongside the financial analysis as well as considering the risks associated with not pursuing either of the options detailed in this report.

If adopted by the Council, the recommendations signal the Council's intent to pursue one of the options so that financial provision can be made in the Council's Long Term Council Community Plan (LTCCP). The report also identifies what the next steps are proposed for the two options.

2. COUNCIL VISION AND COMMUNITY OUTCOMES

Over the last two years the Council has reviewed its vision for the city and the developed outcomes which support this vision. While the original rationale for considering the Council's future accommodation needs remain valid it is worthwhile putting them in context with the reviewed vision, outcomes statements and measures to ensure continued alignment with the Council's strategic direction.

The Council's new **Vision Statement** infers a custodial approach with the emphasis on holistic long term solutions that provide sustainable benefits for current and future generations. A number of key community outcomes in support of this vision are applicable when considering the Civic buildings. The Council wants Christchurch to have "**strong and inclusive communities**" with an "**excellent built and natural environment**" and be a "**sustainable**", "**well-governed city**".

To measure the achievement of these outcomes the Council has established a number of "indicators", some of which relate to the "look and feel of the city", residents' "pride in the city", the retention of heritage sites and reduced energy consumption.

In particular, under the "**well governed**" outcome, the concept of stewardship features strongly with the following aspects relating well to built assets such as this facility. For example:

- Use the Council's resources in a responsible, efficient and cost effective way.
- Manage operational and infrastructure assets to optimise their value and usefulness over the long term.
- Ensure that income and expenditure deliver best value for short and long-term city needs.
- Maintain asset and investment base and ensure appropriate levels of income match commitments.
- Use existing facilities and resources more efficiently.
- Develop facilities that are sustainable and flexible in their use over the longer term.

In considering the merit of building a new Civic Centre (by comparison with doing nothing or upgrading the existing Civic facility) the Council must consider:

the most prudent or optimal course of action, from a:

- risk management,
- financial and
- organisational perspective.

It must also consider the retention of a historic building and the opportunity to provide a new building that adds to and improves the built environment and represents a forward thinking Council concerned with the needs of both the current and future generations.

3. **COMPARATIVE METHODOLOGY**

To determine the optimal course of action from a financial perspective requires a methodology that as much as possible compares "apples with apples". It is difficult to achieve this with the analysis to date due to the disparity in terms of age and the quality of accommodation between the two facilities, the pre-existing investment in the existing Civic building and the difference in capital for each of the projects. While the Council may be interested in achieving certain asset values in terms of its investment in property the primary purpose for the Council in owning or renting an asset is to aid in the delivery of the Council's services over time. Property investment outcomes are secondary to this, not the primary driver. Accordingly, methodology that simply considers maximising asset value at a given point in time should not be the determinant of what is considered optimal.

The Council's greater focus in property should be to deliver a solution (to providing appropriate accommodation for the Council's activities) that:

- minimises the cost of owning and operating the facility over time,
- reduces risk for the organisation and
- adds value to the delivery of the services the Council provides from the built asset.

The first of these, operational efficiency and funding, needs to be contemplated over the life of the asset to ensure adequacy of funding for the anticipated costs of owning and operating the service. Renewal items like the replacement of a lift, renewing a roof or painting the building may or may not be capitalised, but in reality they are simply large long term operational costs.

For a new office building 50 years is considered to be a reasonable economic life. The physical structure will in many cases have a longer life than this. However, the rising value of land, the differential between renewal costs and the cost of building a new building, the availability of certain component materials, legislative requirements and the expectations of customers are all likely to impact on the viability of retaining a particular building beyond this age. Accordingly, both capital and operational costs of each option have been forecast for a holding period of 50 years.

It is not possible to negate the difference in age between the two proposals or to achieve a standard of accommodation that is truly comparable, due to the design constraints inherent in the existing building. Even with significant expenditure on improving the component parts, systems and internal layout the existing building will remain in the lower half of the second tier of office accommodation within Christchurch. What officers can compare on an "apples with apples" basis is the operational cost associated with the two options over the economic life and along side this the operationalised cost of funding the two respective options.

The other advantage of viewing the capital investment, required for the two different options, as a loan is that it also reflects the gradual consumption of the asset by multiple generations and attributes cost over all of those generations. This more appropriately reflects inter-generational equity in that it avoids one generation paying a significant premium followed by subsequent generations receiving an effective discount in their rates (relative to the services they receive).

4. **DCF (DISCOUNTED CASH FLOW) OPERATIONAL OPTIONS ANALYSIS**

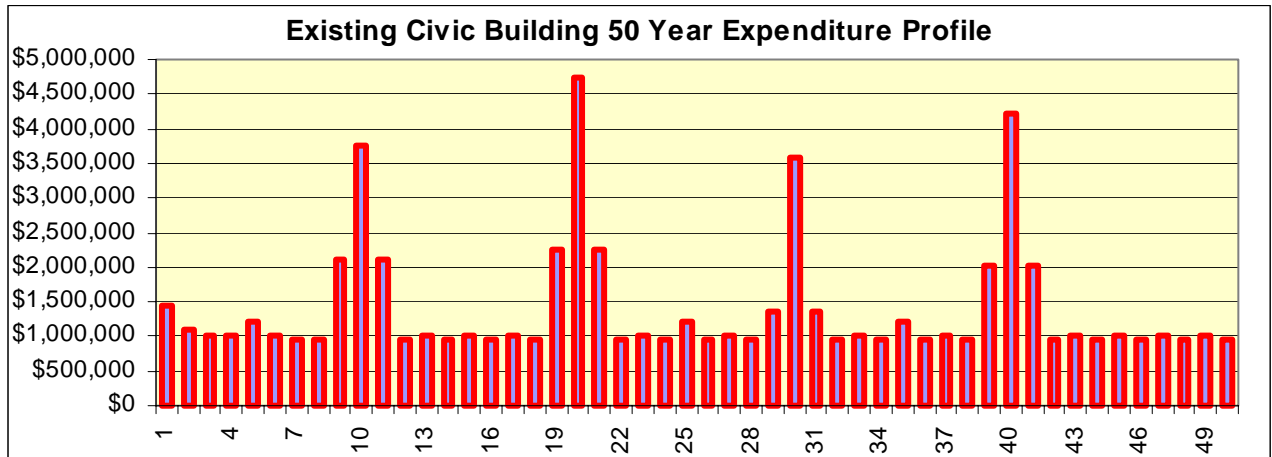
The operational and renewal costs have been based on a composite of historical performance for the existing Civic building and other buildings, industry averages, known renewal costs for components parts and systems (driven by forecast physical obsolescence), cyclic redecoration and renovation based on anticipated customer expectation and expected organisational change. Rawlinsons have worked with the Council's officers in deriving these lifecycle costs. In an attempt to optimise the way works are completed, the many factors driving expenditure are aggregated in the model into cyclic renovation work. This also captures significant renewal cycles so that economies of scale, minimised disruption and other efficiencies are achieved. Minor repairs and maintenance are included in a more constant annualised budget, which also includes other operational costs such as service agreements, energy consumption, insurance and management costs. Organisational change is anticipated on a regular basis with small sums budgeted on a biennial basis. However, larger sums are factored into the 10/20 year refurbishment cycles to reflect both organisational change and the logistics of a works programme.

Cost savings are generated from a new building - through the efficiency gains in operational expenditure and lower renewal costs for components over the life of the facility. Design features contribute to the energy and operational efficiency of a building but where change is anticipated the design can allow for more efficient change management practices. Examples of efficiencies include energy saving technology and design but also such features as sub-floor service cavities, improved access to all services, modular units that reduce the cost and improve the speed of renewal and refurbishment work and modern design for mechanical and other services that also improve the levels of service. Some of these efficiencies can be achieved by a retro-fit of the existing building but in many cases the payback is diminished by the additional costs involved in a retro-fit and the actual performance being less than optimal within a larger building system that is not fully integrated.

The following two graphs show the operational and renewal costs associated with each of the two remaining options over a 50 year period, without the impact of the initial capital expenditure on the cash flow.

The cyclic expenditure for the existing Civic building (Graph 1) shows relatively consistent expenditure of just over \$1 million per year in today's dollar values. This comprises energy consumption, repairs and annual maintenance contracts. On a cyclical basis officers have modelled two modest expenditure spikes and two significant expenditure spikes to account for the refurbishment and renewal commitments. All four spikes are spread over three year periods due in part to the less efficient nature of the building design and additional churn costs associated with refurbishment works. The total for the two smaller spikes amounts to approximately \$7.75 million and \$6 million – respectively. The two more substantial refurbishments amount to approximately \$9.5 million and \$8.25 million respectively. It is assumed that organisational change occurs on a regular basis with associated churn costs but that most of these churn costs occur within the 10 and 20 year refurbishment cycles.

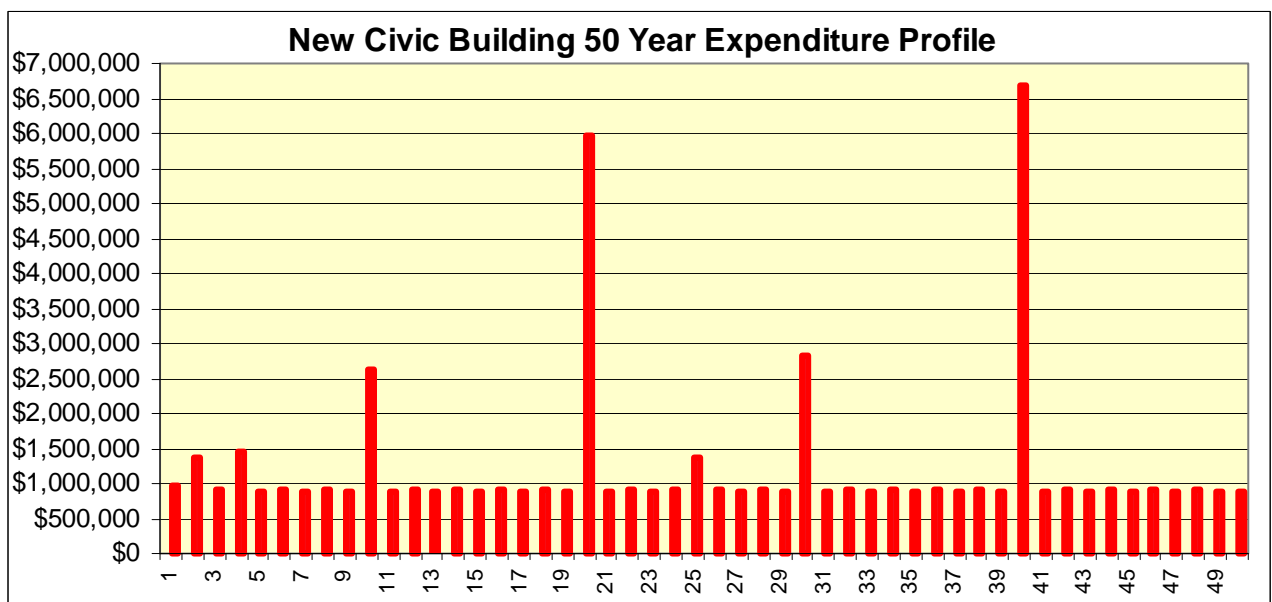
Graph 1



The cyclic expenditure for the new building (Graph 2) shows relatively consistent expenditure of approximately \$900,000 per year in today's dollar values. The energy consumption, repairs and annual maintenance contracts show significant savings. However, these are in part offset by additional costs associated with operating the car park building. It is also assumed that organisational change occurs in the new building on a biennial basis but at a lower cost and faster than with the Civic Offices.

Cyclical expenditure for refurbishment, renewals and churn costs occurs in similar expenditure spikes as for the existing building. However, the total costs for each of these four anticipated refurbishment programmes is significantly lower and occur within shorter time frames. Separate to the building costs associated with refurbishment and renewal work there can be a significant impact on productivity of staff from noise, relocation and services being out of action. Officers have not calculated the differential in terms the impact on staff productivity but the efficiencies incorporated into a new building will reduce the impact and therefore improve productivity.

Graph 2



In considering the two options it is clear that the most efficient in terms of operational expenditure, including renewal and refurbishment work, is the new building. This holds true whether you apply a discounted cash flow to a 50 year period or review it in 10 year intervals or on rolling five year averages. However, this analysis only contemplates expenditure and does not account for the disparate initial capital outlay. To do this we need to account for the funding stream required to finance both the operational and capital requirements of the two options over the 50 years.

The capital expenditure has therefore been amortised over the full 50 year holding period so that all the generations consuming the asset (receiving benefits from the facility) contribute on an equitable basis. In effect this is a long term table mortgage loan spanning the economic life of the building. This is likely to be put into effect through a series of loans rolled over until the capital has been paid off in 50 years time.

Option 1: When officers applied this methodology to the cash flow required for the **existing Civic building** the discounted cash flow showed that this option cost an additional **\$57,000** per annum, when compared to the existing 10 year budget provision for the Civic building (which was also analysed using a discounted cash flow). This in effect is the net annual impact on rates on an ongoing basis for Option 1.

Option 3: When officers applied this methodology to the cash flow required to **build a new building**, the additional annual loan payment required is deducted from the operational cost savings achieved by the new building to get an effective net annual cost of the new building option. On average the net cost increase or differential between continuing with the existing Civic facility and building a new one amounts to **\$1.34 million** per annum over the 50 year period. This equates to an effective averaged **one off increase in rates** of approximately **0.67%**. The net difference between the two options amounts to \$1.28 million per year on an ongoing basis.

It is important to note that this methodology averages out the rise and fall of the impact over time and takes a much longer view than current funding protocols anticipate. The result therefore varies from year to year and from decade to decade. Financial Services have provided an analysis of the impact over the first 10 years and this is detailed in section 6.

5. OPTIONS ANALYSIS – FACTORS TO CONSIDER

In providing a business accommodation solution a number of criteria have been referred to earlier.

5.1 Minimise the cost of owning and operating the facility over time

Option 3 provides the most efficient solution in terms of operating costs, as detailed in the cash flow analysis. However, when the ownership or funding costs are accounted for additional costs of approximately \$1.34 million (or 0.67%) are required for this option, making it the less optimal solution.

5.2 Reduce risk for the organisation

The earthquake requirements for Option 1 (the existing Civic building) have been met within the refurbishment programme. However, the likelihood that earthquake strengthening requirements will be tightened forcing an upgrade at some point in the future appear to be high. The extent and timing of this is difficult to quantify. However, the potential that this could add significantly to the future financial commitment and therefore viability of this building is high. A new facility by comparison would have a relatively low likelihood of being affected by such a legislative change. Separate to this a business continuance risk is associated with the existing building if it were to be badly damaged by an earthquake. This risk would be substantially mitigated with a new building.

Another risk associated with remaining in the existing building is that in 10 or 20 years a future council may choose for aesthetic or operational reasons to abandon this building in favour of a new one. This would nullify the financial advantage expressed above of choosing Option 1. In effect the \$20 million capital investment, currently spread over 50 years in this analysis, would be spread over a far shorter time frame increasing the cost recovery required from ratepayers. It is not possible to assess the chance of this scenario, although it is certainly a potential risk that needs to be considered.

5.3 Add value to the delivery of the services the Council provides from the built asset

Both options represent an improvement in terms of both the quality of accommodation and improvement of operational efficiencies. These are greater in Option 3 where the working environment for the public, Councillors and officers would also be significantly enhanced with better natural light and services and modern facilities.

The new building cost profile is based on a well designed, efficient, comfortable building allowing flexibility to account for change. This is represented in lower refurbishment, renewal and churn costs and less disruption for staff at times of change. These factors combined reduce the financial and management barriers associated with change, allowing the Council to more easily adapt its organisational groupings to meet changing needs. These benefits along with a more positive staff morale are difficult to quantify in terms of financial outcomes. However, it is reasonable to expect some level of productivity gain from staff located in a modern, efficient building. This may be represented in less sick days, more productive work practices and lower turnover of staff. However, such measures are complex and influenced by many variables. Hypothetically a 1% productivity gain for 1,000 staff members on an average salary of \$35,000. represents a \$350,000. saving per year. Both options represent improvements in terms of energy efficiency and sustainability. However, the improvements achieved in Option 1 are relatively modest compared to those for Option 3.

Both options preserve the existing building and thereby help to achieve some of the outcomes referred to in Section 2. Each option represents a compromise in terms of the heritage value of the existing building, one by building on the roof and the other by potentially removing the glass from the windows and converting its use to a car park.

Separate to the more tangible financial benefits the Council may achieve from a new building it also needs to consider the effect Option 3 might have on achieving an appropriate "look and feel" for the city. This is intended to be measured by the residents' response in terms of their satisfaction with the "look and feel" of the city and their feeling a "sense of pride in their city". It is inevitable that the building of a new Civic Centre will generate strong public opinion, with some for and some against. The aesthetic merit of either of the options is also likely to be strongly debated. However, the building of a new facility certainly represents an opportunity to add to the existing "look and feel" of the city and could represent a positive contribution.

Given the non-financial variables needing to be considered in any analysis of the two options, it is not possible to provide a definitive answer to the choice that needs to be made. The Council will need to consider the likelihood of risks and opportunities represented by each of the options coming to fruition. Management is generically tasked with minimising risk and maximising opportunities in the delivery of services to Christchurch residents. Accordingly, officers have recommended that the Council proceed with Option 3 as it represents the most risk averse option and the one with the greatest potential to effect improvements in service delivery. Balancing this is the additional cost associated with this option and Councillors' responsibility to balance current ratepayers' needs or desires with what may be best for the city over multiple generations.

6. FINANCIAL IMPACT ON CURRENT TEN YEAR FORECAST

Financial Services officers have provided an analysis of the impact on rates of each option over the first 10 years. Given that existing capital and operational budgets exist for this period, these sums have been deducted from the cash flows of each option to give a net impact on rates in each year and cumulatively for the 10 year period. The Long Term Financial Strategy, adopted in July 2001, requires that at least 57% capital expenditure be rates funded. This policy differs from the rationale applied in our discounted cash flow but is driven by a legitimate objective of optimising operating surpluses in any given year. In effect this is taking into account multiple cash flow requirements beyond the scope of this one project.

Option 1, has a cumulative impact in rates over 10 years of approximately 2.13%. This varies from year to year but on average the impact is 0.213% per year. By comparison Option 3 has a cumulative impact of 3.76% over 10 years. This also varies each year but equates to an average increase of 0.376% per year.

7. ACTIONS FOLLOWING THIS DECISION

As advised in the 21 November 2003 report, a number of development options are available to the Council for the development of new or refurbished office space. These include:

- Ownership
- Lease
- Lease with guaranteed buyback
- Lease with CCC as developer
- Partnering

Before an analysis can be made on which option is preferable for the Council, it must first be decided whether to proceed with refurbishing the existing building, or to plan for the construction of a new building.

Once this decision is made, it is intended that the following actions will occur:

- Confirm number of staff to be accommodated
- Consider development options
- Develop a design brief
- Proceed with implementation of the preferred development option

The latter step may involve seeking a range of submissions from the market for various ways of delivering the building. The documentation at this stage would define the Council's functional requirements as well as addressing such issues as providing for maximum flexibility in the amount of accommodation which the Council may require.

8. LIKELY TIMING OF CAPITAL FUNDING REQUIREMENTS FOR NEW BUILDING OPTION

If the new building option is adopted, the likely timing of the required capital funds is detailed in the table below, together with the amounts presently provided for in the annual plan.

Year	Proposed	Present Provision
04/05	2,274,970	6,280,000
05/06	7,994,970	8,390,000
06/07	13,032,500	200,000
07/08	13,280,000	
08/09	14,936,980	
09/10	2,200,000	
Total	53,719,420	14,870,000

9. CONCLUSIONS

The Council has agreed that the standard of office space for its officers, elected representatives and the visiting public needs to be improved, and this report details two options which would achieve this aim.

While not specified here as a named option, the Council could choose to spend only that capital currently provided for in the existing budget or less. However, a significant proportion of the work detailed in Option 1 is renewal expenditure that the Council would be committed to, separate to the development proposal. The cost analysis shows that over time Option 1 is relatively cost neutral in relation to the impact on rates. The benefits in terms of improved working conditions, rationalising external leases, bringing staff to one site, accounting for the potential for some growth and improved building efficiencies make the do nothing option unviable.

Option 1, involving the upgrade of the existing building, incurs total capital costs of just over \$20 million and if this is financed and analysed over a 50 year period the impact on rates in the first 10 years is negligible, given that approximately \$15 million is already budgeted. The existing building carries with it a higher risk factor in terms of changing legislation and customer expectations which could lead to a future council choosing to overturn a commitment to the building for a 50 year period. This would in effect result in the Council having to write off the investment currently being contemplated, which would significantly impact on the financial analysis referred to above and in effect increase the rating burden on future generations.

Option 3, a new building on an adjacent site, will have a capital cost of just over \$50 million and this equates to a net increase in rates of \$1.34 million or 0.6% if financed and analysed over a 50 year period. The impact on the first 10 year period totals 3.76% or an average of approximately 0.376% on an annual basis.

A new building will have a number of non-financial benefits related to image, productivity and staff morale. It will also have reduced operating and churn costs throughout its life compared with upgrading the existing building, and in particular achieves a significant reduction in energy consumption.

Staff

- Recommendation:**
1. That Option 3, build a new building on an adjacent site, be adopted as the preferred option and that officers develop a design brief and prepare a report on development options available.
 2. That a recommendation be made to the Annual Plan Subcommittee that financial provision for Option 3 be included in the LTCCP at a total capital cost of \$53.7 million.

Chairman's

- Recommendation:**
- That the above recommendation be adopted and that the Committee note this is a first step forward in providing the Council with the opportunity to respond with greater flexibility to its changing needs.