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# Fit-out of new leased premises for the Department of Finance

2.1 The Department of Finance (Finance) seeks approval from the Committee to proceed with a fit-out of a new building which has been constructed at One Canberra Avenue, Forrest, Australian Capital Territory, to provide consolidated office accommodation for the Department.

2.2 The estimated cost of the project is $32.066 million, excluding GST.

## Conduct of the inquiry

2.3 Following referral, the inquiry was publicised on the Committee's website and via media release.

2.4 The Committee received one submission and three supplementary submissions from Finance. A list of submissions can be found at Appendix A.

2.5 The Committee conducted an inspection, public hearing and in-camera hearing on the project on 13 February 2015 in Canberra. The Committee held a second public and in-camera hearing on 20 March 2015. The transcripts of the public hearings and the public submissions to the inquiry are available on the Committee's website.[1]

2.6 This chapter will assess and report on the evidence relating to the referral—that being the fit-out of the new leased premises. However, at the end of the chapter the Committee will make some further observations about the Committee's remit[2] and about the quality of the evidence submitted by Finance.

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1 <www.aph.gov.au/pwc>.

2 Outlined in Chapter 1 above.

## Need for the fit-out

2.7 Finance informed the Committee that its current accommodation has the following shortcomings and pressures:

- Finance's workforce is distributed across numerous buildings, under six tenancy agreements. Some business groups are located across multiple floors and in separate buildings that are geographically dispersed. The dispersed nature of the current accommodation is perceived to be significantly impeding efficient and effective collaboration within the Department.
- The design and fit-out of the tenancies is old, and based on outdated technology and work practices. The layout is inefficient.
- Finance's leases are inefficient, expensive and costly to maintain. Small tenancies are costly to service and owner responsiveness can be lacking. Market conditions have changed considerably since Finance committed to its leases. As a result, Finance is paying above market rent.
- The buildings themselves are spatially inefficient, due to the size and nature of the building design and heritage overlay (in some cases). This translates to more space being leased than is needed.
- Current market conditions are highly favourable to tenants and the proposed move could yield significant short, medium and longer-term financial advantage to the Department.[3]

2.8 Finance told the Committee that it requires a dynamic and modern workplace that facilitates its business processes and supports it in attracting and retaining high quality professional employees who can successfully meet the Department's business needs.[4]

## Options considered

2.9 Finance claims that the range of accommodation options available to it is limited because it needs to be located in, or close to the Parliamentary Triangle. Proximity to Parliament House allows it to provide crucial support to its Minister and the Expenditure Review Committee (ERC) of Cabinet in the Budget process.[5]

2.10 In 2012, Finance undertook an Initial Business Case that identified and evaluated a range of options to meet its future accommodation requirements and to determine the best value for money solution for its operational needs beyond December 2016.

3 Finance, submission 1, pp. 3-4.

4 Finance, submission 1, p. 24.

5 Finance, submission 1, p. 7.

2.11 Option included:

- lease an existing building;
- pre-commit to lease a developer built building;
- build Own Transfer;
- Commonwealth Property Register – relocate to a vacant building with long term Commonwealth lease obligations;
- refurbish the John Gorton Building; or
- do nothing.[6]

2.12 Due to a change in business circumstances, Finance told the Committee that this initial process stalled. However, in 2014 Finance re-opened its consideration of accommodation options after receiving an unsolicited offer from the market for the tenancy at One Canberra Avenue.[7] At that time, the following four preferred options were identified:

- One Canberra Avenue, Forrest - Finance leases a new building from the private sector;
- build, own, transfer - Private developer builds property on Commonwealth land in the Parliamentary triangle. Finance pays back amortised construction costs over 20 years and amortised fit-out over 10 years. At end of a 20 year payback period, the asset transfers to Finance;
- refurbishment of the John Gorton Building to a recognized A grade standard - Full building refurbishment with a lease incentive from the Building Owner of 4 years rent free, but requiring a substantial capital investment by the Commonwealth; and
- do nothing - Finance to stay in current accommodation, including public and private sector leases. Assumed refurbishment and fit-out of the John Gorton Building and Treasury Building in 2018-19 requiring substantial capital investment by the Commonwealth.[8]

2.13 In its submission, Finance identifies One Canberra Avenue as the most cost effective option, stateing it is the option which best meets its Accommodation Strategy objectives and is the only vacant new development in the Parliamentary Triangle. Finance notes that this was endorsed by the Minister for Finance as the preferred option.[9]

2.14 At the first public hearing Finance summarised its consideration of the four preferred options:

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6 Finance, submission 1, p. 7.

7 Mr Steve O'Loughlin, Finance, transcript of evidence, 13 February 2015, p. 1.

8 Finance, submission 1, p. 8.

9 Finance, submission 1, p. 9.

> … the four options considered as a result of the One Canberra Avenue offer were for One Canberra Avenue in Forrest, where we have market conditions highly favourable to Finance, very low financial and construction risk to Finance and no requirement for extra funding from the budget. It is a timely solution which meets Finance's business needs. A build-own transfer option we found to be a complex solution with financial risk which would not deliver a timely consolidation response. The refurbishment of the John Gorton Building to a recognised A-grade standard, given the nature of Finance's business, for example, delivery of the budget and financial reporting, would be an unacceptable disruption to the ongoing operations of Finance staff located in the building, and the other major tenant, the Department of the Environment, while construction was staged over a multi-year period. In terms of the do-nothing option, with Finance to stay in current accommodation including public and private sector leases, it was not considered acceptable as it failed to respond to any of the deficiencies in the current office facilities or our business circumstances.[10]

2.15 The Committee questioned the rationale for presenting the One Canberra Avenue as the best value for money, particularly as Finance's own Cost-Benefit Analysis indicates that on a whole of Government and whole of life basis it would be less expensive to refurbish the John Gorton Building.[11]

2.16 In response Finance emphasised that cost considerations were one component of assessing overall value for money. The Committee was told that other factors include consolidation of most staff into a single location, and the certainty in terms of cost and timeframes associated with the One Canberra Avenue option:

> … in terms of a business need to consolidate our staff in the parliamentary triangle—there may be an opportunity to actually build a building that would accommodate us in the parliamentary triangle or near to it. Whether or not the market would respond to that would be a risk, which would remove it as an option in terms of timeliness. The One Canberra Avenue building, for example, is already built; there is certainty for Finance, if we were to move into that building, about the costs of that to Finance. A build-own transfer would have with it all of the inherent construction and financial risks, so there is a big risk element that would come into

10 Mr Steve O'Loughlin, Finance, transcript of evidence, 13 February 2015, p. 2.

11 Finance, submission 1, p. 12.

> our value-for-money consideration. The summary value for money is really around the certainty—the prospects of that ever happening, and the certainty around the costs or otherwise of that occurring and then the results of the cost-benefit analysis.[12]

2.17 In correspondence received after the first hearing, Finance revised the Cost Benefit Analysis figures that it provided in its submission, advising:

> The Department would like to clarify that the information at page 12 of the Public Submission to the Committee is incomplete. The notes to Table 1 indicate that the option to remain in a refurbished John Gorton building is a superior outcome on a Whole of Government basis. This is incomplete information because rental income, even in the non-refurbished premises currently occupied by the Department, would add approximately $120 million to Commonwealth revenue in this scenario, where these buildings are re-tenanted should Finance vacate.
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> … the inclusion of this new rental income from other Commonwealth agencies means that the relocation proposal for One Canberra is also superior on a Whole of Government basis. Further, the do nothing option is more expensive for the Department than either relocating to One Canberra Avenue or refurbishing the John Gorton Building.[13]

2.18 During the second public hearing the Committee sought more information about the $120 million figure which was omitted from Finance's original evidence. The Committee was told:

> … The primary reason [figures] were incomplete is that these flow measures that we were talking about, which represented a $66 million difference, were basically showing the gross effects of the leasing transaction in the case of Finance relocating to One Canberra Avenue and effectively the gross effects of a refurbishment of the John Gorton Building. So the first point is that the numbers are comparing fundamentally different things. One is a leasing flow and the other, the refurbishment of the John Gorton Building, is basically the cost of the refurbishment. It is money leaving the general government sector, so it is effectively a discounted cash flow.
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> What the numbers did not reflect—and this is the reason why we say it was an incomplete analysis—was this. It showed those gross effects; it did not show the net effect of things that are very likely

12 Mr Steve O'Loughlin, Finance, transcript of evidence, 13 February 2015, p. 10.

13 Finance, submission 1.2, p. 1.

> to happen as result of that. In the case of One Canberra Avenue, it did not show the effect of the Department of the Environment moving into the space that we are vacating, which would provide a significant offset to that flow number, and there are excellent prospects for that occurring towards the end of this year. Basically, Environment would take all of the space that Finance would vacate in the John Gorton Building.
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> The other scenario, the renovate-John-Gorton-Building scenario, did not take into account the effect of Environment moving out of the building, which is part of that proposal, in that Finance would consolidate in the building; Environment could not stay in the building. And it did not model the effect of Environment moving out and then renting privately, which they would inevitably do because there is not that level of space available. When you factor those net effects into account, the numbers reverse in terms of the flow.[14]

2.19 The Committee noted that in Finance's letter (submission 1.2) provided subsequent to the first public hearing, Finance mentioned that the additional rental income Finance would receive from the space it will vacate, will add approximately $120 million net to Commonwealth revenue although some costs may be incurred for renovations. Finance was asked to confirm that this is correct and responded:

> Yes. It is a figure that does not include renovation costs. It may be that, if there is the scenario we are expecting—that Environment move into the building—there will obviously be the need for renovations to maintain the building at its current standard over the course of, say, a 10- or 15-year lease.[15]

2.20 Being satisfied that the figure of $120 million which was initially omitted from Finance's Cost Benefit Analysis figures was adequately explained in the second public hearing, the Committee then asked the Secretary of Finance if she could assure it that the proposed lease and fit-out are the most efficient and cheapest cost to the taxpayer and she replied 'Correct. So, this is the best value for the taxpayer, absolutely.' [16]

14 Mr John Edge, Finance, transcript of evidence, 20 March 2015, p. 2.

15 Mr John Edge, Finance, transcript of evidence, 20 March 2015, p. 2.

16 Ms Jane Halton, Finance, transcript of evidence, 20 March 2015, p. 13.

## Scope of the fit-out

2.21 The proposed fit-out works are to be undertaken in a new building at One Canberra Avenue, Forrest, adjacent to the Parliamentary Triangle.

2.22 The base building has been constructed to reflect current best practice in workplace design. According to Finance all elements of the building's fabric, services and layout have been carefully considered with regard to supporting:

- modern workplace mobility and flexibility;
- efficient work point densities which substantially better current Australian Government requirements;
- equality of access for the disabled and mobility impaired;
- emerging Information Technology systems;
- environment sustainability;
- continuity of operation through services redundancy;
- future services upgradability; and
- minimised future tenant churn costs. [17]

2.23 The fit-out design will reflect the objectives stated within Commonwealth Government advisory documents:

- Flexible and Efficient Workplace Design Guidance; and
- Property Management Planning Guidance (Financial Management Guidance No 18).[18]

2.24 The planning and design concepts which will guide the design of the fit-out include:

- deliver a modern, contemporary tenancy that aligns with Commonwealth standards (including Australian Government workspace density targets of a maximum of 14 m$^2$ per occupied work point) and current best practice for office accommodation;
- provide an office fit-out that utilises to the maximum extent practical energy efficient and environmentally friendly and sustainable materials and goods and services. The fit-out will achieve the minimum overall tenancy rating of National Australian Built Environment Rating System 4.5 star and self-assessed 4 green star rating, and will reduce waste and use recyclable materials where practicable;
- design to an occupational density of approximately 12m$^2$ per person which will also allow Finance to provide some contingency space

17 Finance, submission 1, p. 15.
18 Finance, submission 1, p. 24.

within its accommodation. This is consistent with the Property Management Planning Guidance.[19]

2.25 Proposed fit-out works include the integration with base building services including electrical, mechanical, communications, security, fire and hydraulic services; and, office fit-out which will conform to Finance's operational requirements.[20]

## Cost of the works

2.26 On the basis of the current conceptual design, Finance has established an indicative budget of $32.066 million (excluding GST) for the proposed fit-out of its new office tenancy.

2.27 This budget includes provision for contingencies, cost escalation and associated professional fees. It also provides a provision to pay out existing lease tails, thereby offsetting the "double rent" on current leased office accommodation.[21]

2.28 Funding for this initiative will be met, in major part if not in whole, from a lease incentive towards fit-out and associated fees and the covering of outstanding lease tails, with any additional costs to come from funds appropriated to Finance.[22]

2.29 Finance provided further detail on the project costs in the confidential submissions and during the in-camera hearing.

2.30 The Committee considers that the cost estimates for the fit-out have been adequately assessed by Finance and the Committee is satisfied that the proposed expenditure is cost effective.

2.31 The Committee reminds Finance that it must notify it of any changes to the project scope, time and cost. The Committee also requires that a post-implementation report be provided within three months of completion of the project. A report template can be found on the Committee's website.

2.32 Having regard to its role and responsibilities contained in the Public Works Committee Act 1969, the Committee is of the view that this project signifies value for money for the Commonwealth and constitutes a project which is fit for purpose, having regard to the established need.

19 Finance, submission 1, pp. 24-25.
20 Finance, submission 1, pp. 25-26.
21 Finance, submission 1, p. 33.
22 Finance, submission 1, p. 33.

**Recommendation 1**

2.33 **The Committee recommends that the House of Representatives resolve, pursuant to Section 18(7) of the *Public Works Committee Act 1969*, that it is expedient to carry out the following proposed work: Fit-out of new leased premises for the Department of Finance, Australian Capital Territory.**

## Other Issues

2.34 Inevitably, when the Committee examines the need for a fit-out, leasing arrangements will be raised and discussed. However, the Public Works Committee's Act does not extend to the Committee authority to make recommendations in relation to leasing arrangements. At times, the Committee has found it frustrating to operate within these constraints but is mindful of the necessity not to exceed its authority.

2.35 On this occasion, however, the Committee found the evidence about leasing arrangements to be, in part, of poor quality and the Committee therefore feels obliged to make some observations about the inadequacies it identified.

2.36 As mentioned above, Finance's initial Cost Benefit Analysis indicated that on a whole of Government and whole of life basis it would be less expensive to refurbish the John Gorton Building than to make the move to One Canberra Avenue.[23]

2.37 After the first public hearing, Finance subsequently revised[24] the initial Cost Benefit Analysis figures provided in its first submission, advising that the information was incomplete:

> … because rental income, even in the non-refurbished premises currently occupied by the Department, would add approximately $120 million to Commonwealth revenue in this scenario, where these buildings are re-tenanted should Finance vacate.[25]

2.38 At the second public hearing, when pressed on the issue, the Secretary of the Department said that:

> … to the extent that … the evidence was incomplete, of course there is an apology from the department. If that distracted the

23 Finance, submission 1, p. 12.
24 Finance, submission 1.2.
25 Finance, submission 1.2, p. 1.

> committee, that is very unfortunate. It should not have happened.[26]

2.39 That Finance could overlook an amount of $120 million from its Cost Benefit Analysis is a matter of concern, particularly as this is core business for Finance.

2.40 The second observation which the Committee wishes to make is that the evidence presented strongly implies that in arriving at its decision to lease One Canberra Avenue, Finance did not test the market in accordance with Commonwealth Procurement Rules.

2.41 In its first submission, Finance defended its decision to pursue the preferred option for One Canberra Avenue without engaging in a formal and competitive market testing process through Austender because "it was known and understood that within Finance's required locational precinct and timescale such a process would not attract any realistic alternative proposals".[27]

2.42 The Committee suggested to Finance that it had truncated normal procurement procedures but Finance told the Committee that it had been able to leverage off a recent process where another Department had approached the market and had short-listed One Canberra Avenue:

> We took account of a Customs and Border Protection approach to the market that had taken place in late 2012, of which, One Canberra Avenue was a shortlisted provider—with the offerings in and around the Parliamentary Triangle at the moment being very limited and not meeting the business need nor even being in a position where that business need could be met within that area until at least 2018. However, the proposal for One Canberra Avenue meets that need within a very short time. It also does not carry with it any of the risk that other options would have carried, in terms of whether they ever eventuated.[28]

2.43 Finance gave the Committee strong and unequivocal assurances of the probity of its processes in relation to the selecting of One Canberra Avenue.

26 Ms Jane Halton, Finance, transcript of evidence, 20 March 2015, p. 2.

27 Finance, submission 1, p. 9.

28 Mr Steve O'Loughlin, Finance, transcript of evidence, 20 March 2015, p. 6.

## Committee comments

2.44 The Committee notes that under its establishing legislation the definition of 'a work' limits it to reviewing, in this case, the proposed fit-out of new leased premises. It has no mandate to review the decision that Finance has taken to relocate to newly-built leased premises at One Canberra Avenue. However, while the Committee has no authority to make recommendations in relation to Finance's decision to re-locate, it felt compelled to make some observations about the quality of evidence and procurement processes.

2.45 Regarding the fit-out, the Committee did not identify any issues of concern with Finance's proposal and is satisfied that the fit-out has merit in terms of need, scope and cost.

2.46 The Committee acknowledges that Finance apologised for deficiencies in some evidence which may have unintentionally misled the Committee.

2.47 The Committee accepts Finance's apology. Notwithstanding, the Committee could reasonably have expected Finance to demonstrate the highest standards in terms of compliance with frameworks that the Department itself is responsible for and administers.

2.48 The evidence the Committee received during the course of the inquiry highlights the need for a whole-of-government approach to leasing office accommodation with greater ministerial oversight.

2.49 The Committee is concerned that there appeared to have been no formal discussions between the Department of Environment and the Department of Finance to coordinate this process before the Department of Finance decided on the move. It is concerning that multi-million dollar decisions may be made independently by departments rather than in a whole-of-government manner. The important principle, that needs to be protected, is that decisions on leasing premises should not be made based on the interests of individual departments alone, but rather on the costs and benefits for the whole of government.

Senator Dean Smith

Chair

10 April 2015