

**13.3 CBD - Strategic Property Purchase****File Number:** A14262004

**Author:** Gert van Staden, Senior Strategic Advisor  
 Mark Harrington, Business Analyst & Partner  
 Paul Davidson, Chief Financial Officer  
 Curtis Bones, Manager: Strategic Property & Commercial Facilitation

**Authoriser:** Paul Davidson, Chief Financial Officer

<b>Section under the Act</b>	The grounds on which part of the Council or Committee may be closed to the public are listed in s48(1)(a) of the <i>Local Government Official Information and Meetings Act 1987</i> .
<b>Sub-clause and Reason:</b>	s7(2)(b)(ii) and s7(2)(i) - The withholding of the information is necessary to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information and The withholding of the information is necessary to enable Council to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations).

**PURPOSE OF THE REPORT**

1. To approve the purchase of 160 – 176 Devonport Road, comprising three separate titles for the purpose of strategic property investment.
2. To signal a review of Council's Property Acquisition and Disposal policy, to potentially make provision for purchases such as the above property, which currently fall outside of the scope of the Strategic Acquisition Fund.

**RECOMMENDATIONS**

That the Council:

- (a) Receives the report "CBD - Strategic Property Purchase".
- (b) Resolves as follows:
  - (i) Approves the purchase of the properties at 160, 168 and 176 Devonport Road, for an amount up to \$11,000,000 as non-budgeted loan funded expenditure.
  - (ii) Delegates authority to the Chief Executive to complete due diligence, negotiate and execute the agreements required to purchase the properties.
  - (iii) Notes that a further report will be presented to Council to discuss redevelopment options or a potential joint venture/development agreement to fully activate the site.
  - (iv) Notes that a review of Council's Property Acquisition and Disposal policy will be initiated together with a comprehensive report on the treatment of future strategic and tactical property purchases.
  - (v) Approves a \$11m increase to the borrowing resolution for the 2022/23 financial year to enable debt funding of this purchase.
  - (vi) To retain resolution (b)(i) and (b)(v) and Attachment A in confidential, resolution (c)(i) and (c)(vi) to remain in confidential until such time as settlement occurs. Attachment A to remain in the confidential section indefinitely.

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## EXECUTIVE SUMMARY

3. Council has been approached by the owner of 160 – 176 Devonport Road, with the intent to gauge Council's interest in acquiring the properties, outside of a competitive market process.
4. The properties front Devonport Road as well as Second Avenue and is effectively the gateway into the inner CBD. The properties are tenanted and returns approximately 2.5% (gross) per annum, minimising holding costs, however, there is still a deficit of approximately \$411,000.00 per annum to be funded. There is scope to lower the holding costs, by reviewing the current rental amounts, leasing out two vacancies (currently on the market) as well as potential to create some on-grade carparking to increase the total return generated by the properties. The intention is that these options will be developed to maximise the return of the site to minimise any funding shortfall.
5. The properties are earmarked for commercial/mixed use redevelopment in Priority One's CBD blueprint, which forms part of Council's City Centre Action and Investment Plan.
6. With this property becoming available, staff have identified several facets of the Strategic Acquisition Fund which does not enable it to be used efficiently for acquisitions of this nature. Staff will review this policy, to enable it to be used more strategically and flexibly, while still retaining appropriate checks and balances.
7. Staff recommend that the acquisition be approved, debt-funded, as it represents an opportunity to secure prime landholdings, in line with the CBD redevelopment strategy.

## BACKGROUND

8. Council has been provided the opportunity to secure a prime landholding within the CBD, outside of a competitive market process. The properties are located at 160, 168 and 176 Devonport Road, approximately 180 metres South of the Regional Council building, and 250 metres South of the site for the new City Council offices.
9. Priority One has the site earmarked for quality office and retail space, ideally suited to larger corporates who desire a strong inner-city presence. The blueprint indicates that it can potentially offer around 4,000 square metres of space.
10. The current owners of the premises no longer require the property, as they have secured alternative accommodation, and wish to divest of this asset.
11. The property represents a prime opportunity for Council to obtain a significant landholding at a time where it finds itself with hardly any noteworthy inner-city property assets.
12. The current vendor has indicated that there are high level plans available to redevelop the property into a carpark, as a short-term holding option. As an alternative, the majority of the tenants are willing to stay on, meaning that there is an immediate return on investment minimising holding costs while redevelopment of the site is considered more fully.
13. Securing the property enables Council access to a prime piece of real estate. Should this go to the open market, there is real risk that the properties could be sold off as individual parcels to separate purchasers, compromising the overall level of potential redevelopment. There is also a risk that the properties, once sold, could be land banked indefinitely without any activation which is contrary to Council's City Centre Action Investment Plan, with these properties being identified as a catalyst development.
14. It is intended that there will be a reasonable due diligence period, to allow Council to properly assess this purchase and the opportunities it represents, prior to settlement taking place.

## Funding

15. This land purchase will not be funded from the strategic acquisition fund due to its quantum so will be loan funded outside of the current borrowing programme approval limits. The current borrowing resolution for the 2022/23 financial year as approved by council on 25 July

2022 is for \$184m. This land purchase will require an \$11m increase to this approved level for a borrowing limit of \$195m which would increase total gross debt to \$934m.

16. There is a likelihood of this amount being adjusted lower, as we are still awaiting our independent property valuation report.

## STRATEGIC / STATUTORY CONTEXT

17. Council is working towards the community outcomes of a well-planned city (Tauranga Tātai Whenua) and a city that supports business and education (Tauranga a Te Kura). Delivering on these outcomes requires efficient use of land with intensification of uses around town and neighbourhood centres, with a specific focus on areas in and around the CBD.

### Strategic Property

18. Property is a key enabler to the delivery of Council's strategy and objectives.
19. A significant driver for the acquisition of this property is to enable Council to have access to the right property at the right time. What is especially relevant is that these properties are situated in the CBD and supports the vision of a vibrant and attractive city centre.
20. It is imperative that Council have access to landholdings, both to provide for future need and to enable Council to operate in the property sector as a landowner, providing us with opportunities to influence and drive outcomes identified in our key policies and strategies, like the City Centre Action Investment Plan, which identified 160 – 176 Devonport Road as a catalyst development.
21. The subject properties can be utilised for a myriad of uses, which include redevelopment (potentially through a joint venture or development agreement) into office blocks or mixed commercial use.
22. The locale of the site directly supports Council's Urban Form and Transport Initiative (2020), in that its redevelopment will intensify existing urban areas, connect and strengthen the neighbourhood and provide for employment/housing in centralised locations. Intensification of existing areas also provides the community with more and/or alternative transport choices, which could lead to a greater uptake of public or alternative transport, easing congestion and the City's carbon footprint.
23. In line with the City Centre Action Investment Plan, the community's aspirations for the City can be supported by the redevelopment of this site, specifically the aspirations for increased housing choice, to see the City's potential realised and a supported city centre business community.
24. What makes the acquisition more attractive is that it currently returns approximately 2.5% (gross) per annum, minimising holding costs. There is also an opportunity to explore short to medium term carparking as a holding option, while redevelopment of the site is considered in more detail by the various Council Activities.

### Sub Regional Strategy

25. Council Urban Form and Transport Initiative (UFTI) (2020) sets out objectives for the sub-region, which include delivering on a connected centres programme. This work focuses on:
  - a. Intensifying existing urban and new growth areas
  - b. Encouraging strong local centres and connected neighbourhoods, through concentrating the provision of services, housing and employment in centralised locations across the city.
26. One of UFTI's objectives is to enable and shape a sustainable, vibrant, efficient, and more liveable urban form. The subject properties are strategically located, maximising the use of urban land and enhancing the vibrancy of the CBD.

### Government Direction

27. The National Policy Statement-Urban Development requires Council to enable density by removing restrictive planning rules, with the intent of enabling intensification surrounding centres and major public transport routes.
28. The Devonport Road properties have a proposed height limit of 48 metres in Plan Change 33, situated within the City Centre Business Zone, making it a prime candidate for redevelopment.

### Strategic Acquisition Fund (SAF)

29. The SAF enables Council to act expeditiously on acquisitions as they arise, allowing us to compete with the market, and even sometimes offer an early purchase option to vendors without the need to go to market. This competitive advantage has enabled us to secure properties on short notice and with a high level of efficiency.
30. This specific property falls outside of the scope of the SAF, as there is time to prepare a Council report to authorise the purchase and budget to go with it. The quantum of this purchase also requires separate treatment as it is excess of the amount contained in the SAF.
31. To provide for a more flexible use of the SAF, staff recommend that it be reviewed, to potentially make it a viable source of funding for these types of acquisitions. This will also offer increased budgeting capabilities for the SAF.
32. It is intended that the review will lead to two budget or funding streams, one for high-value landholding acquisition, like the subject of the report, and the other to serve as a funding source for more operational or tactical acquisitions, funded by Council's major activities through the Annual Plan or Long-Term Plan. Funding has been adjusted in the 2022/23 Annual Plan to reflect this approach within current budget constraints and a paper will be presented to Council in the new year outlining this approach in greater detail.

### 160 – 176 Devonport Road

33. The subject site is well-located and a strategically sound purchase, as indicated by the above assessment against key documents and national direction. The properties have a cumulative Capital Valuation of \$15,200,000, with the vendor's valuation report indicating a market value of \$10,500,000. Council's valuers are progressing an independent valuation report which will guide Council's negotiation strategy for this acquisition, if approved.
34. A Geotechnical Investigation Report has been commissioned for this site, based on a 1,500sqm office building, basement carpark and a two-storey carpark building. It was noted that the sea-facing cliff to the east of the site does not provide any slope stability risk.
35. There are numerous options for redevelopment, some which include short-term holding options, while detailed design is considered more fully. There are also alternative options, one which is to purchase the site, and then on-sell to a developer who is amenable to activate the site in terms of Council's strategy for a vibrant and attractive CBD. Attachment A contains concept drawings for an office block.
36. The properties are currently tenanted, with three of the four agreements being monthly arrangements, with the final agreement expiring 31 July 2023. When assessed against the market valuation, the gross return on investment is approximately 2.5%, which excludes the two vacancies. Net return is around the 1.4% mark.
37. The buildings have been assessed to be in average condition, considering their use and age, without any significant maintenance requirements.
38. Taking into account the nature of the properties, the immediate rental return mitigating holding costs as well as the redevelopment options, staff recommend acquiring the properties subject to Council being satisfied with due diligence.

## OPTIONS ANALYSIS

### Option 1

Approve the purchase of 160 – 176 Devonport Road (recommended).

Key risks: Increased expenditure and holding costs. Holding costs are mitigated by the current rate of return.

Financial impact: \$11m increase in debt costs, annual opex costs of \$125,000 and a return of 2.6% gross per annum. After interest and depreciation expense are included an annual deficit of \$411,000 is generated, which will require rates funding in the absence of alternative funding being explored to minimise this deficit.

### Advantages

Provides an opportunity to:

Obtain strategic property in the heart of the CBD.

Acquire property without the uncertainty and potential competition associated with an auction or tender.

Ability to intensify use of key properties, as opposed to the private sector which may landbank indefinitely or deliver outcomes not in line with Council's strategy.

### Disadvantages

Additional borrowing costs and impact on debt.

Rates increase to cover the funding of 0.2% however it is expected that this will reduce based on increased tenancies, parking charges, etc

## Option 2

Reject the acquisition of the properties.

Key risks: No ability for Council to acquire the properties in one transaction, potential of the properties being parcelled off individually at auction and not being activated or activated contrary to Council's strategy for the CBD.

Financial impact: No financial impact

### Advantages

No additional funding required

### Disadvantages

A dwindling stock of strategic properties within the CBD

No guarantee that the properties may come to market again or be developed appropriately if sold to the private market.

Land banked indefinitely by the private market.

## FINANCIAL CONSIDERATIONS

39. Council intends to fund this purchase by additional borrowing, which for new debt is set at 4.8%.
40. Taking into account the estimated operational expenditure, including rates, depreciation and interest, the properties return around 1.4% net, meaning that some rates funding is required, in the amount of \$411,775 per annum (representing the elements which are rates funded).
41. The financial impact currently shows a deficit of the site to cover holding costs. Further work will be undertaken to look for rental return from the two vacancies and rates payable by all of the tenants, together with a total transaction cost for the properties closer to the valuation amount, the rates funded deficit can be lowered to 0.106%, or approximately \$244,825.00 per annum. This increases the gross return to approximately 3.5% and the net return to 2.8%. At grade parking will also be investigated given the added advantage of increased parking stock together with increased revenue.
42. As part of the due diligence process, the lease terms and estimated operational expenditure will be confirmed to gauge the viability of the acquisition in the short term, along with options for the site's redevelopment, feedback to Commissioners will be provided on an ongoing basis.
43. Funds in the Strategic Acquisition Fund is not sufficient to cover the purchase costs, nor is the policy associated with this fund set up for acquisitions of this nature. There is no budget which can be brought forward from other activities, as the intention is to hold the property for a yet to be determined final purpose.
44. The asset will be held by Council's Strategic Property Activity, until such time as it can be transferred to another Council activity, like Spaces and Places or City Redevelopment and Partnerships, who will then reimburse the Strategic Property Activity, with funding coming from the Activity to which the asset is transferred.
45. The amount proposed to be raised in the resolution is based on the valuation report obtained by the vendor, however, our valuers are in the process of delivering an independent report which will guide Council's negotiation strategy for this acquisition.

### LEGAL IMPLICATIONS / RISKS

46. Should Council decide to not pursue this purchase, there is a likelihood that the risks mentioned in Option 2 may come to pass. This is especially likely given the low confidence in the development industry at present, the EBOSS 2022 Construction Industry Confidence Report shows confidence has dropped significantly with 59% of builders and 46% of architects predicting the sector to deteriorate — almost double 2020 figures.
47. Considering the strategic location and size of the property, coupled with the overall low risk of property purchases (can be on-sold in future years if required), an acquisition of this site aligns with future vision and plans for the CBD.

### CONSULTATION / ENGAGEMENT

48. The proposed purchase is for properties identified in Council's City Centre Action and Investment Plan, which has been consulted on. It forms part of Priority One's blueprint for the CBD as a catalyst redevelopment.
49. Additionally, Council's recently adopted Long Term Plan Amendment specifically notes that the city centre is transitioning from being a traditional retail/service centre to becoming the major civic, cultural, business, educational, residential and commercial hub of our region. This purchase represents an opportunity for Council to play an active role in seeing the strategic direction for the City become a reality.
50. In terms of the net financial impact, while the purchase is loan funded, the revenue associated with the holding costs minimises the total financial impact to Council. However, it does acquire an amendment to the borrowing resolution to fund the acquisition.

### SIGNIFICANCE

51. The Local Government Act 2002 requires an assessment of the significance of matters, issues, proposals and decisions in this report against Council's Significance and Engagement Policy. Council acknowledges that in some instances a matter, issue, proposal or decision may have a high degree of importance to individuals, groups, or agencies affected by the report.
52. In making this assessment, consideration has been given to the likely impact, and likely consequences for:
  - (a) the current and future social, economic, environmental, or cultural well-being of the district or region
  - (b) any persons who are likely to be particularly affected by, or interested in, the matter.
  - (c) the capacity of the local authority to perform its role, and the financial and other costs of doing so.
53. In assessing the matter against the policy, officers are of the opinion that it is of High significance, taking into account the value of the proposed purchase price.
54. In accordance with the considerations above, criteria and thresholds in the policy, it is considered that the matter is of high significance, based on the above assessment.

## ENGAGEMENT

55. Taking into consideration the above assessment, that the decision is of high significance, engagement and consultation is required under Council's Significance and Engagement Policy.
56. However, the nature of the decision renders consultation impractical and/or inappropriate, based on the timeframes within which the vendor requires an offer to be made. Should engagement and consultation take place, there is a high likelihood that the properties would have been sold by the time that engagement/consultation concludes, leading to a missed opportunity.
57. Officers are therefore of the opinion that paragraph 5.7 of the Significance and Engagement Policy applies, particularly that maintaining confidentiality is of paramount importance so as not to prejudice Council's negotiating position.
58. Additionally, the rate of return offered by the properties offsets a fair portion of the rates-funded elements of the purchase with minimal impact to ratepayers.
59. It should also be noted that the properties can also be on-sold, making the decision relatively easy to reverse and that a thorough due diligence will identify any potential issues with the acquisition, mitigating the risks associated with the decision.
60. Council's Property Acquisition and Disposal Policy makes provision for unscheduled acquisitions and is defined as "an acquisition that either is not contemplated by and in accordance with the long-term plan or annual plan or occurs ahead of the financial year within which it was planned and budgeted for".
61. It also states that unscheduled acquisitions allow council to acquire property on a proactive and efficient basis, ensuring that council can take advantage of market opportunities. Unscheduled acquisitions support council to:
  - i. Deliver improved economic, environmental, social or cultural outcomes; and
  - ii. Meet its future operational requirements, by allowing for the advantageous purchase of property not anticipated for in the current financial year.
62. Based on the reasons above, staff consider that despite the decision being of high significance, that it is not appropriate to consult and that the Significance and Engagement Policy provides adequate direction for the decision to forego engagement and consultation.

## NEXT STEPS

63. Negotiate a sale and purchase agreement.
64. Undertake due diligence and investigate feasibility of redevelopment and/or holding options.

#### **ATTACHMENTS**

1. **Attachment A - renders - A14262966**