Item 6.1

CITY OF MARION
AUDIT COMMITTEE MEETING
19 May 2011

CONFIDENTIAL REPORT RELATING TO:
A leader in the delivery of the Community Vision

Originating Officer:	**Julia Smethurst, Strategic Projects Officer**
Director:	**Jeff Rittberger, Director Governance**
Subject:	**City Services Redevelopment - Section 48 Prudential Report**
Reference No:	**AC190511R6.1**
File No:	**16.37.1.4**

If the Committee so determines, this matter may be considered in confidence under Section 90(3)(d) of the Local Government Act 1999 on the grounds that the report details commercial information of a confidential nature.

Mark Searle
Chief Executive Officer

1. Pursuant to Section 90(2) and (3)(b) of the Local Government Act 1999 the Council Committee orders that all persons present, with the exception of the following Mark Searle, Jeff Rittberger, Kathy Jarrett, Adrian Skull, Linda Graham, Jaimie Thwaites, John Valentine and Julia Smethurst, be excluded from the meeting as the Committee receives and considers the City Services Redevelopment report in relation to the City Services site upon the basis that the Committee is satisfied that the requirement for the meeting to be conducted in a place open to the public has been outweighed by the need to keep the receipt / discussion / consideration of the matter confidential as disclosure of the information could confer a commercial advantage on a person with whom the council is conducting or proposing to conduct business.

STRATEGIC OBJECTIVES:

Excellence in Governance – EG3 A great place to work
Service Quality – SQ2 – Perception of value

REPORT OBJECTIVE AND EXECUTIVE SUMMARY:

The purpose of this report is to provide the Audit Committee with background on ongoing negotiations with the owners of land adjoining the City Services depot at 935 Marion Road, Mitchell Park and investigations and consideration of available alternatives for any identified land that is surplus to requirements.

RECOMMENDATIONS:

That the Audit Committee:

1. **Note the report.**

DUE DATES:

Recommendation 1:	19 May 2011

BACKGROUND:

The following report provides the Audit Committee with some background information and financial analysis that will enable the Section 48 Report prepared on the City Services project to be fully considered. The two sections discussed under this confidential report relate to:

A. History of negotiations with an adjacent land owner regarding a potential land exchange; and

B. Information on potential financial outcomes arising from the treatment of any surplus land that may be identified following the redevelopment.

DISCUSSION:

A. NEGOTIATIONS WITH ADJACENT OWNER

In April 2010 the current owners of 919-929 Marion Road, Mitchell Park (Cantor) approached the City of Marion to enquire whether a possible exchange of land may be of interest.

The approach by the owners of 919 Marion Road, Mitchell Park resulted in the project being reassessed in light of an option to relocate City Services to the adjoining premises. Council were advised of this proposal and have been regularly updated on the assessment.

Valuation reports were prepared by a licenced valuer acting for Council and cost estimates prepared by architects and quantity surveyors to make the property fit for purpose. The valuation report indicated the additional 7,860 square metres of land of Council that would be exchanged would have a value of around $3.2 million.

Chronology of offers made by Cantor

A number of offers/options have been proposed by Cantor:

Date	Land exchange	Plus cash
9 June	Council **28,860** square metres for Cantor 14,000 sq m land + buildings (leaving Council with 14,000 m^2 operational footprint)	$2,556,000
9 June	Council **28,860** square metres for Cantor 14,000 sq m Plus Council **leaseback** 7,000 square metres	$2,556,000
9 June	Council **21,860** square metres for Cantor 14,000 sq m	Nil
20 July 2010	Council **21,860** square metres for Cantor 14,000 sq m	$500,000
15 December 2010	Council **21,860** square metres for Cantor 14,000 sq m	$3.45 million
1 March 2011	Council **21,860** square metres for Cantor 14,000 sq m	$4.3 million

At the Elected Members Forum on 3 August 2010, Members were advised that three options were being analysed to determine which would provide the best long term value for money:

1. redevelop; or
2. refurbish the existing site; or
3. relocate to 919 Marion Road

The fit for purpose analysis revealed that the proposed relocation to the adjoining land did not provide value for money due to the extensive works required. The offers provided to date have not been better than a redevelopment by Council of its own site.

Any proposed relocation will attract additional significant costs for stamp duty, land division costs, legal and holding costs.

Cantor have offered to meet all costs of stamp duty, transfer and legal costs. The proposal however would still attract a licence fee (payable to Cantor) for the construction period based on Cantor's holding costs for the land which include all rates, taxes, insurance and debt servicing ($577,000 per annum) – the total estimate 'fee' payable under the licence to occupy would be in the vicinity of $650,000 per annum (approximately $975,000 for the 18 month licence term). Council would also meet the cost of land division (approximately $50,000).

The latest offer is similar to the expected net proceeds from Council disposing any surplus land after development. The Cantor offer of $4.3 million – less $975,000 'licence fees' equates to approximately $3.3 million net. Land division costs would be applicable under both the Cantor proposal or if Council disposed of the land post-development.

The proposal restricts the amount of land available to Council to redevelop at 21,000 square metres (919 Marion Road site of 14,350 plus 6,650 m^2 retained from existing site).

The current Cantor offer potentially represents similar financial position to Council developing on its own site, however it exposes significant risks, particularly if construction cannot be completed within the proposed 18 month licence to occupy. The complexity of the legal arrangements required to facilitate this proposal also adds risk to the project.

The possibility for the adjoining owners to purchase any surplus land following the redevelopment of 935 Marion Road has been explored and Cantor have expressed a strong interest in this land should it become available.

B: OPTIONS FOR SURPLUS LAND

The project provides an opportunity to make the operational footprint of City Services more effective and efficient and provide an opportunity to convert the excess land to a more productive use. This could involve a partial disposal of land either by sale or lease.

There is the potential to generate a commercial return on either the sale or lease of the land, and perhaps resultant benefits to be gained upon the conversion of this surplus land into rateable properties,

Three scenarios have been identified as options to consider for the treatment of any surplus land:

1. Disposal of land;
2. Retain and lease to third party; or
3. Retain for own use.

1. Sale

At the completion of the project, the surplus land could be disposed of in accordance with the provisions of the Acquisition & Disposal of Land Assets policy. A sale at the end of the redevelopment process would be preferable as it minimises disruption and allows continuation of operations during construction.

Based on recent sales evidence in the area a sales figure in the order of $550-$600 per square metre could reasonably be expected. The price would be dependent on the final size of the parcel being offered. On a disposal of approximately 6,000-7,000 square metres, the sale would be expected to net in excess of the additional $3 million required to fund the project (after land division and disposal costs).

Disposal of surplus land would reduce Council's borrowing on the project back to the original level of $6 million.

In close proximity to the site, there are a range of new bulky good developments including:

Address	Occupier(s)	Development size (approx)
800-802 Marion Road	Nick Scali	4000 m^2
804-814 Marion Road	Barbeques Galore / Plush / Officeworks Freedom Furniture	12,200 m^2
822-836 Marion Road	Harvey Norman	17,000 m^2

A commercial real estate specialist has indicated that the opportunity for the sale of a parcel around 7000 square metre on Marion Road should be well received. They advised that the general location has taken on a more commercial aspect and is an attractive location for bulky goods retailers, service centres and commercial users. The opportunity for an owner occupier or developer to acquire a position in the area has been limited. The size of site allows for a reasonable development (by Adelaide standards) and would be affordable to many. The specialist is aware of several retail groups still actively looking for new sites but with little suitable opportunity and limited owners to deal with and were currently searching in the area for a site suitable for an Insurance group wanting to develop a motor vehicle assessment centre. They believe that, assuming the land had no major impediment to development, good interest could be expected for any potential sale.

The 6,200 m^2 site Minister for Health site at 816-820 Marion Road was recently sold by public tender. The Land Management Corporation handled the transaction and advised that although the site generated good interest, the main interest was from the two adjoining property owners. The land was purchased by the owner of 804-814 Marion Road for a price close to $600 per square metre.

The sale option also provides potential for both sale income and future rates revenue. A sale would remove Council of any ongoing risk over the land and allow the capital to be used to complete the redevelopment project without reliance on additional borrowings.

2. Lease

A disposal of land by leasehold would enable the retention of the capital value of the land with a moderate return on the investment that could be used to offset additional borrowing to complete the redevelopment project.

A lease option would retain ownership of the land enabling future use by Council if required, however it may not be readily available due to any lease commitments entered into. A minimum lease term of 5 years must be offered to any tenant and the Local Government Act limits the maximum term of any lease to 21 years.

When assessing the leasing option, two potential scenarios were identified, either a ground lease or lease of a developed site.

Although these options were identified, a lease of a developed site (where Council undertake the capital development of the site and lease to a tenant) was discounted as it would be an unacceptable risk and not recommended for consideration.

For any possible ground lease arrangement (where the site only is leased and any capital improvements is undertaken by the lessee or a third party developer) the likely financial return would be in the vicinity of $10-$12 per square metre per annum (on say 7,000 square metres a potential return of $70,000-$84,000 per annum).

The servicing (principal + interest) of an additional $3 million in borrowings would be expected to be in the vicinity of $490,000 per annum (based on 8% per annum). Any potential lease income on a ground rent basis would therefore only cover approximately 15% of the additional repayments associated with borrowing the additional $3 million

This option would require Council to borrow an additional $3 million to deliver the project, with lease revenue offsetting a portion of the borrowing costs.

3. Retain for own use

This option would provide Council with additional space to accommodate future growth. However, there is currently no identified use for the land and growth has been factored into the proposed redevelopment. The remaining site also provides for future intensification of land use through vertical development (above or below ground). The relocation of some services from Marion Road to other Council sites may be a future possibility if operational requirements change, for example, relocation of the nursery services.

This option would require Council to borrow an additional $3 million to deliver the project.

Option Comparison

The effect on Council's financial position from the three options is summarised in the table below:

City Services Redevelopment - Options						
	Average Interest Per Year $	Average Principal Per Year $	Total Average Borrowing Cost Per Year $	Additional Revenue Per Year $	Impact on Operating Position Per Year $	Impact on Funding Position Per Year $
Option 1 (Sale of Land) - $6m Borrowing + Rates	326,962	556,018	882,980	28,936	**298,026**	**854,044**
Option 2 - $9m Borrowing + Lease Rental	490,443	834,027	1,324,470	70,000	**420,443**	**1,254,470**
Option 3 - $9m Borrowing	490,443	834,027	1,324,470	0	**490,443**	**1,324,470**

If Council chose to redevelop its own site and dispose of the surplus land, the final sale price may be higher or lower than the estimated price. The risk of finding an end buyer would also remain if disposal was to occur at the end of the development.

The cost estimates received for the development ($9 million) would be applicable on either site, although redevelopment on the Cantor site may be higher due to additional cabling required, unknown contamination and any loss of opportunity to reuse existing infrastructure from the City Services site.

	Develop on City Services existing site	**Develop on adjoining site (Cantor)**
Cost to Develop	$9 million	$9 million
LESS proceeds from Land Sale	($3.9 million)	($4.3 million)
PLUS Additional costs	$50,000 (land division)	$1.025 million* (licence fee & division)
Net cost	$5.15 million**	$5.72 million

***** Figure based on cost estimates provided by Cantor.
**Option 1 and 2 are based on land sales of 7,860 square metres.

CONCLUSION

PART A:

The purpose of this report is to inform the Audit Committee on the Cantor proposal in light of the redevelopment project.

PART B:

The different financial outcomes from the three options available for dealing with the surplus land need to be assessed and a recommended position put to Council for consideration.

A disposal of land at the conclusion of the redevelopment would provide the following benefits:

- Ability to maintain operations during construction;
- Ability to match operational footprint to need, rather than to available space (as would be the case if a sale was agreed prior to completion);
- Opportunity to fund other community projects would not be lost due to increased debt position for City Services (as debt would reduce back to original $6 million or lower).