

27 August 2008

The Research Director
Public Works Committee
Parliament House
George Street
BRISBANE QLD 4000

Dear Sir,

Re: Proposed Stage 2 – William McCormack Place, Cairns

I refer to the Public Works Committee's (PWC) *Inquiry Information Paper - William McCormack Place Stage 2*.

The Chamber submits the following comments in response to the Terms of Reference:

a) Purpose of the Work

It would seem that the primary purpose of the William McCormack Place Stage 2 project (McCormack2 project) would be to provide consolidated office space for State Government departments variously located around Cairns. Our advice suggests that this may amount to something like a half of the proposed 9,600m² of space. Given it is not a core function of Government to provide commercial office space to the private sector, one can only question why the need for the additional space.

b) Necessity for, and Advisability of, the Work

Notwithstanding the apparent excess of space identified above, it is also relevant to consider the available supply of office space in the marketplace. At present there is approximately 40,000m² of A-grade office space in the Cairns CBD; hence the McCormack2 project represents a 25% increase on current supply. Worthy of consideration by the PWC is the recent completion of Citi Central (Cnr Sheridan & Spence Streets) by the private sector – in which most of the approximately 4,000m² will be occupied by State Government departments; as well as the proposed Cairns Global Tower, which, if it proceeds, will add another 11,500m² of space. In a market where the private sector is already providing A-grade space to meet the stringent Government office quality standards and feature the latest in innovative energy and efficiency design, it is questionable why the Government would consider investing in a project that is unnecessary.

c) Suitability of the Work for its Purpose

There is probably no doubt that the part of the project could indeed be suitable for the proposed purpose, but with the apparent excess space which will presumably remain vacant within the building, or get put on the market at subsidised rates (see comments below), on balance, the work would not then appear suitable.

d) Cost, Recurrent Costs, Revenue & Value for Money of the Work

At a cost of \$79.5 million for 9,600m², McCormack2 has a *development* cost of over \$8,000 per square metre. Industry sources suggests this is more than twice the rate than for similar private sector projects recently completed in Cairns, such as Citi Central, and the GHD building on Spence Street. Both projects have had a *sale* price in the order of \$4,600/m² (that is, fitted out and tenanted). Clearly, the proposed McCormack2 project is well in excess of what can be achieved in the private sector, and hence would represent extremely poor value for money for the Government.

Recurrent costs are unknown, but it may be a fair assumption that these will reflect the inflated development cost, exacerbated by the likely vacancy. In this case, the building will still need to be maintained, yet as an underutilised asset, will cost more per occupied square metre to do so.

Presumably, departments will be paying market rates for space, which will be around \$350/m² based on the current market. This will be more than that being paid by those departments in their existing tenancies (in lower grade space). But this becomes a circular argument, because as rent

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paid (revenue to Government) goes up, so will departmental budgets. What's more important is that the total cost to Government goes up. Not only this, but the presumption of \$350/m² in rent represents a low return on investment (approximately 4%) for the Government, particularly against industry benchmarks of around 7.5%. Additionally, if the building is not to be fully occupied by Government offices, there must be some intention to lease space to the private sector – and again, the private sector will also only pay market rents.

By any financial measure, McCormack2 does not appear to represent value for money.

e) Impact of the Work on the Community, Economy & Environment

The key matter of concern here is the impact on the economy, summarised as:

- Excess office space in McCormack2 is likely to get put onto the market for private sector take-up – thereby competing with other private sector office space. This will have a negative impact on the office space market, leading to a potential downwards pressure on prices, and threatening the viability of existing private sector space as well as further undermining the financial return for McCormack2.
- McCormack2 will create an oversupply in the market when considered in the light of new and proposed private sector space.

f) Procurement Methods for the Work

The Chamber is not aware of any irregularities in the procurement method.

g) Balance of Public and Private Sector Involvement in the Work

The Chamber is not submitting comments in this regard – the main issues arise in the justification for the work, as detailed above.

h) Performance of the Constructing Authority, Consultants & Contractors for the Work

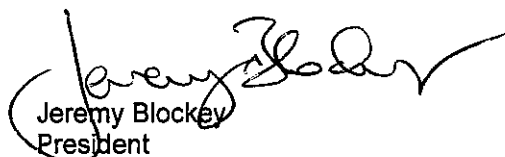
The Chamber is not submitting comments in this regard – the main issues arise in the justification for the work, as detailed above.

Please note that the Chamber wrote to the Minister for Public Works back in May (copy attached), with a request as follows:

"I would appreciate details of the research and feasibility analysis that the Department of Public Works might have done prior to committing to this project, as well as any analysis that has been done to assess the impact on the private sector office rental market."

To date, a reply from the Minister's office has not been forthcoming. The Chamber remains concerned about the feasibility and necessity of this project, all the more so, now that it appears construction contracts have been let.

Yours sincerely



Jeremy Blockey
President

Cc: Desley Boyle, MP

Attachment: Chamber letter to Minister for Public Works, 29 May 2008.

29 May 2008

Hon Robert Swarten MP
Minister for Public Works, Housing and
Information & Communication Technology
GPO Box 2457
BRISBANE QLD 4001

Dear Minister,

Re: Proposed Stage 2 – William McCormack Place, Cairns

The Chamber has noted that the State Government has included \$40.5 million in its 2008/09 Budget to construct a government office building in Cairns, believed to be Stage 2 of William McCormack Place on Sheridan Street.

The building is to consist of approximately 9,500m² of A-grade offices. It is understood from industry sources that tenancies to occupy the new building are likely to include those government offices currently housed in 36 Shields Street, and others from around the city; however, it appears unlikely that these will fully occupy the new building, even taking into consideration some modest growth in demand by its opening in 2010.

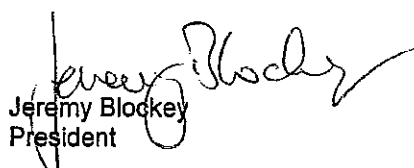
The Chamber has a few key concerns:

1. **Office Oversupply:** The new building is set to add in the order of 20% of the existing A-grade CBD office space. This, at a time where the private sector already has significant additional office space onto the market – either being completed, being constructed or committed. This is likely to leave some of this A-grade office space vacant for some time, as well as leaving significant vacancy rates for the older stock that will be vacated. This is likely to depress market rentals across the board.
2. **Excess Government Office Space:** Further to the comments above on general oversupply issues, if the Government is looking to offer the spare capacity in the new building to the private sector there is concern that this will be creating additional spare 'private' sector space that is not required in the marketplace at this time, bearing in mind other new premium space currently coming on stream or within similar timeframes as Stage 2.
3. **Market Rentals:** There is some indication that the new building will be constructed at a higher rate per square metre than current private sector projects, which may have one of two solutions – either Government will have to drive up rental rates to get a return on their investment, or Government will have to 'subsidise' the rental. Neither outcome is perhaps satisfactory.

The crux of these issues seems to be that by constructing such a significant amount of additional space at this time, when the private sector is already committed to provide space, the State Government will in fact be in direct competition to the private sector in the delivery of A-grade space.

I would appreciate details of the research and feasibility analysis that the Department of Public Works might have done prior to committing to this project, as well as any analysis that has been done to assess the impact on the private sector office rental market.

Yours sincerely



Jeremy Blockey
President

Cc: Desley Boyle, MP