

**ITEM 10. PROPERTY INVESTMENT STRATEGY – CITY’S INVESTMENT
PROPERTIES IN OXFORD STREET, DARLINGHURST**

FILE NO: X009837

SUMMARY

The City owns three commercial investment properties on the northern side of Oxford Street, Darlinghurst, with a combined lettable area of approximately 12,100 square metres and occupying just over 40 per cent of the street frontage between Oxford Square and Taylor Square.

The City’s Economic Development Strategy recognises that, as a land owner, the City can influence the quality, amenity and character of that neighbourhood. The amount of floor space and its strategic location under Council ownership means it can be a catalyst to the revitalisation of lower Oxford Street.

In late 2016, the City received two unsolicited offers to acquire a long-term leasehold lease, masterplan, redevelop and reposition these buildings with a range of land uses.

Optimising the commercial returns through the strategic management of its commercial/investment properties is a key action in ensuring the City of Sydney is financially sustainable over the longer term.

The current annual net income from these properties is below market, which can in part be attributed to the Council endorsed Oxford Street Creative Spaces Program, which activated under-utilised space with creative activity at affordable rentals. There are currently 22 spaces occupied by cultural and creative tenancies on subsidised rents.

Repositioning these assets requires a significant capital investment to address floor layouts and create a built environment with adaptability to maximise returns.

This private sector interest provides an opportunity for Council to identify a partner to fund, develop and manage the repositioning of these assets to integrate land use outcomes and encapsulate more efficiently the key actions from principal strategies, including the Creative City Cultural Policy, Retail Action Plan and OPEN Sydney Strategy and Action Plan. The integration of creative and cultural businesses within a future redevelopment of one or more of the City’s properties is a key objective.

This report seeks Council’s endorsement to conduct an Expression of Interest (EOI) to identify a development partner for the three investment properties in Oxford Street Darlinghurst: 56-76 Oxford Street, 82-106 Oxford Street and 110-122 Oxford Street.

The EOI process will formally identify entities with the expertise and resources to acquire a long-term leasehold interest, and implement and manage a successful transformation of these properties based on a masterplan developed in collaboration with Council and specialist contributors. The City has had success with long-term leaseholds over properties such as the Queen Victoria Building and the Capitol Theatre.

An external firm will be selected to develop the EOI, incorporating a probity plan and a diversified evaluation panel to include key internal stakeholders and an industry expert.

The EOI outcomes will be formally reported back to Council in due course, with CEO updates provided, as appropriate, in the intervening period.

RECOMMENDATION

It is resolved that Council:

- (A) note the private sector interest received to acquire, masterplan, reposition and manage the City's three main commercial properties in Oxford Street: 56-76 Oxford Street, 82-106 Oxford Street and 110-122 Oxford Street;
- (B) endorse an Expression of Interest to identify entities with the expertise and capacity to reposition these investment properties on a long-term ground lease; and
- (C) note that the criteria to identify suitable partners will be developed around:
 - (i) expertise, experience and resources to acquire, implement and manage a successful transformation of these properties based on a masterplan developed in collaboration with Council and the public;
 - (ii) demonstrated strong track record in successfully selecting, planning, implementing and managing redevelopment and/or adaptive re-use or refurbishment of heritage buildings and creating high quality land uses with unique destinational environments; and
 - (iii) preserving an amount of equivalent effective floor space for the 22 cultural and creative tenancies within any future redevelopment.

ATTACHMENTS

Attachment A: Identification Plan

Attachment B: Commercial Analysis (Confidential)

(As Attachment B is confidential, it will be circulated separately from the agenda paper and to Councillors and relevant senior staff only.)

BACKGROUND

1. On 27 June 2011, the Lord Mayor tabled a Minute proposing new directions for lower Oxford Street. It was resolved, in part, that Council:
 - (a) request that the CEO investigate options for activating Oxford Street, including:
 - (b) utilising City-owned properties to help achieve the objectives of the Oxford Street Cultural Quarter Plan, including the provision of affordable creative spaces;
 - (c) utilising City-owned properties to achieve a greater diversity in Oxford Street's mix of commercial and retail businesses to support the daytime economy;
 - (d) encouraging and engaging private property owners to work with the City to help achieve Council's objectives for Oxford Street, including:
 - (i) a diverse and robust daytime economy;
 - (ii) a significant village centre for Darlinghurst and Surry Hills; and
 - (iii) an important focus for cultural and creative activity.
2. Council further resolved, on 22 August 2011, to undertake a range of short and medium-term activation projects in the implementation of these new directions.
3. One of these projects was the leasing of 1-5 Flinders Street, which became inactive when on 29 February 2016 Council resolved to endorse in principle the disposal of 1-5 Flinders Street. The Chief Executive Officer was asked to conduct an EOI to identify suitable proponents to acquire, refurbish and use the property at 1-5 Flinders Street consistent with City's objectives of urban renewal and report back to Council on the outcomes of this process and recommendations. This process is currently underway and a report will be presented to Council shortly.

Strategies - Economic Development and Creative City

4. The City's Economic Development Strategy has the ongoing commitment to the Oxford Street Precinct as one of its three major village projects, and recognises that, as a major property owner within a small area, the City can influence the quality, amenity, economy and character of that neighbourhood.
5. As part of efforts to revitalise the Oxford Street precinct, the City's Economic Development Strategy includes a number of short, medium and long-term initiatives arising from the August 2011 Lord Mayor's Minute.
6. The Council also recognised the importance of achieving a greater diversity in the precinct's mix of commercial and retail business. To that effect, Council approved the development and implementation of business mix principles to identify gaps in the current offering and ways to diversify into the future.
7. To encourage the growing creative industry and a more vibrant day time economy on Oxford Street, the City provided its own properties as affordable work spaces to over 150 artists and creative entrepreneurs.

8. The Creative City Cultural Policy includes a culture-led revitalisation of the Oxford Street precinct, including curated creative retailing, affordable creative spaces, cultural and community events, pop-up retail, public art, open studios and establishment of the Oxford Street Creative Precinct.
9. Most notable is the Oxford Street Creative Spaces Program that commenced in 2011 by activating under-utilised space with creative activity at affordable rentals to help rebuild Oxford Street as a dynamic cultural precinct.
10. Currently, just over 20 per cent (2,300 square metres) of the combined total gross floor area of the three buildings is occupied by 22 cultural and creative tenancies, of which 55 per cent (12) are office-based and the balance 45 per cent (10) occupy retail at either ground floor Oxford Street or Foley Street. Some of these uses include object design, web design, architecture, transmedia, film, visual arts, contemporary performance, contemporary music, social enterprise, literature and animation.
11. Since the program began, these tenants have attracted more than 79,000 visitors to the area and held 585 events including artist talks, workshops or masterclasses, VIP customer nights, industry gatherings, exhibition opening nights and meet-ups.
12. The tenants and their customers are eating and shopping locally with an estimate of \$2.2 million (\$47,000 per month) spent on local goods and services since the program commenced.

Private Sector Interest

13. In mid to late 2016, the City received two unsolicited offers from very experienced entities to acquire either a freehold interest or a long-term leasehold interest in the City's three commercial properties.
14. The formal offers received from private sector entities contain high level indicative commercial terms, high level master planning objectives with indicative potential land uses and market categories.
15. Each offers aims to reposition the properties to collectively become a significant catalyst in revitalising Lower Oxford Street.

Revenue Growth - City's Investment Property

16. The Long Term Financial Plan's strategy of continuing financial sustainability relies in part on optimising commercial returns from the investment/commercial properties through strategic management.
17. The City's Oxford Street properties are clustered in a strategic location with a quantity of total floor space that has the potential capacity to achieve a critical mass and be a catalyst for change and transformation.
18. Reconfiguring the internal spaces within these buildings to provide greater efficiency, adaptability and functionality to meet the needs of commercial, cultural, creative and retail businesses. The buildings' condition and configuration require a significant capital investment to address heritage, compliance and floor configuration issues, and establish a destinational environment to maximise returns.

19. The City has an opportunity to explore alternative market-driven opportunities to secure long-term transformation and through a long-term leasehold interest, such as a 99-year ground lease similar to the Queen Victoria Building, to retain ownership and maintain a level of control.

Oxford Street - Land Uses

20. Oxford Street faces many challenges created by complex factors arising over several decades, including the development of major retail centres at Bondi Junction and in the CBD, and online retail, as well as government decisions such as the introduction of the clearway and restrictions on licence trading.
21. The potential scale offered by the City's property ownership gives a critical mass for significant change.
22. Demographic and specialist land use consultants engaged by the City have all concluded that the retailing environment must have the capacity to change and adapt over time, responding to consumer needs.
23. The findings from commissioned studies in 2014 and 2016 by Location IQ and an intercept survey in 2014 by Directional Insights identify and support:
 - (a) a destinational food and beverage cluster;
 - (b) speciality food and groceries;
 - (c) mini-anchors and essential services;
 - (d) destinational non-food and beverage retailers and creative industries; and
 - (e) entertainment and leisure elements.
24. Securing unique and eclectic independent operators of high quality is critical to maintaining the authenticity of the Oxford Street strip, and differentiating it from the likes of CBD and suburban shopping centres.
25. The retail studies support efficiently integrating creative and cultural retailers. Currently, just over 20 per cent (2,300 square metres) of the combined total gross floor area of the three buildings is occupied by 22 cultural and creative tenancies, of which 55 per cent (12) are office based, and the balance of 45 per cent (10) occupy retail at either ground floor Oxford Street or Foley Street.
26. The City would ensure that an equivalent amount of floor space for the 22 cultural and creative tenancies is preserved as part of a balanced business mix.

Preliminary Financial and Risk Assessment

27. The City commissioned property consultants, Charter Keck Cramer to provide advice, including a preliminary risk assessment on potential delivery options and financial assessment. Information relevant to this report is summarised in confidential Attachment B.

28. The information within confidential Attachment B is commercial information of a confidential nature that would, if disclosed, prejudice the commercial position of the City. Disclosure of the information may also confer a commercial advantage on persons with whom the City may conduct business in the future, to the City's detriment.

Expression of Interest

29. Notwithstanding the proponents are both capable of successfully delivering on the City's strategic objectives through their proposals, conducting an EOI to test the wider market will provide other entities an opportunity and ensure through this process the City has secured the optimum partner.
30. The City will engage a specialist property transaction manager to develop content in conjunction with the City and administer the EOI process.
31. The governance framework for this EOI is to include consideration of an independent industry expert on the evaluation panel.
32. The key criteria in the EOI will focus on identifying capacity including financial resources, expertise, development strategies, development and specialist partners. These attributes will be supported through demonstrated previous experience that reveal a strong track record in successfully selecting, planning, implementing and managing redevelopment and/or adaptive re-use or refurbishment of heritage buildings and creating high quality land uses.
33. The key criteria in this EOI will be focused on expertise, delivery capacity and experience in:
- (a) master planning of mixed developments with integrated land uses;
 - (b) acquiring, planning and adapting heritage properties with a value in excess of \$50 million, including acquisition costs;
 - (c) sourcing and securing funding for acquisitions and construction, including exit strategies;
 - (d) building and maintaining partnerships and forging collaborations with specialist development professionals and food and beverage providers;
 - (e) building and maintaining partnerships and forging collaborations with community, cultural and creative entities, including retention of the current space dedicated to such uses; and
 - (f) strategic management and growth of unique retail and commercial environments and its contributory influence on surrounding property.
34. The applicants to the EOI will be requested to outline indicative commercial terms, including a financial offer for a 99-year ground lease. Proponents will also be required to demonstrate their commitment to heritage values, sustainability and environment.
35. The outcomes of the EOI will be formally reported back to Council in due course, with CEO updates provided in the intervening period.

KEY IMPLICATIONS

Strategic Alignment - Sustainable Sydney 2030

36. *Sustainable Sydney 2030* is a vision for the sustainable development of the City to 2030 and beyond. It includes 10 strategic directions to guide the future of the City, as well as 10 targets against which to measure progress. This report is aligned with the following strategic directions and objectives:
- (a) Direction 6 - Resilient and Inclusive Local Communities and Economies – creating opportunities to ensure a dynamic business mix in local precincts, as well as attracting new visitors and money to the area, supports vibrant and resilient local communities and economies.
 - (b) Direction 7 - A Cultural and Creative City – providing affordable creative work space for creative enterprise fulfils a major goal within the recently endorsed Creative City Cultural Policy, including contributing to sector sustainability.
 - (c) Direction 10 - Implementation through Effective Governance and Partnerships – strategic management of the investment portfolio properties is needed to optimise commercial returns. Continued diversification of income streams underpins the City's financial sustainability over the long term.

Organisational Impact

37. There are unlikely to be any impacts on service levels, staffing or other internal impacts to the organisation in conducting the EOI.

Risks

38. Appointment of an industry expert will assist in managing risk associated with the financial modelling and delivery of value for reinvestment, while balancing community expectations.
39. Development of a communications plan will play a significant role in managing expectations and informing purpose and outcomes prior to and beyond the EOI, and at specific stages.

Social / Cultural / Community

40. Preserving space within any future development to implement initiatives arising from the Creative City Cultural Policy secures the opportunities for retail creatives and creative workplaces.

Environmental

41. The EOI will help to establish the potential opportunities and challenges with heritage properties, and help inform the Sustainability/Environmental criteria in a select Tender.

Economic

42. Council's commitment to the ongoing, successful activation and occupation of its properties demonstrates its support of, and contribution to, the revitalisation of the Oxford Street precinct.
43. The influx of creative tenants, both living and working in the area, assists in revitalisation through the enhancement of local commercial and retail economies, creating opportunities that develop knowledge, skills and organisational capacity, and offers opportunities for learning and collaboration that enhances sustainable economic practices.
44. A high-quality retail experience plays a role in the social interaction of Sydney's population, provides a focus for events that enliven the city, and is a source of employment for people from across the socio-economic spectrum.

BUDGET IMPLICATIONS

45. The estimated cost of undertaking the EOI for the sale of the City's Oxford Street investment properties on a 99-year ground lease (leasehold) has not been included in the draft 2017/18 budget or future forward estimates. It is not anticipated that the EOI cost will be significant and will, in the first instance, be absorbed into the City's Property Strategy budget.
46. No estimate of funds that would result from any long-term ground lease has been included, nor has the loss of any rental income. Such funds upon receipt would be 'reserved' for future investment purchases to deliver commercial property income.

RELEVANT LEGISLATION

47. The two commercial submissions received from the private sector entities expressing interest in the City's Oxford Street properties contain information on master planning objectives, potential uses, including partners and collaborators, and indicative commercial terms.
48. Attachment B contains confidential information that would, if disclosed, prejudice the commercial position of the entity who supplied it. Disclosure of the information would also confer a commercial advantage on persons with whom the City may conduct business in the future, to the City's detriment. The identity of the proponents and content of their offer will therefore be kept confidential in accordance with sections 10A(2)(c) and 10A(2)(d)(i) of the Local Government Act 1993.

CRITICAL DATES / TIME FRAMES

49. Subject to Council endorsing the recommendations in this report, it is expected that the outcomes of the EOI would be reported back to Council in early 2018.

OPTIONS

50. The Council could determine not to proceed to conduct an EOI. This would set aside an opportunity to further explore the interest received from the private sector in the open market.

PUBLIC CONSULTATION

51. There is no public consultation required to implement the recommendations to Council in this report.

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