

Item 4.

Leasing Term for Business Innovation Space - Planning Agreement at Lendlease Circular Quay - Alfred Pitt Dalley and George Street Block

File No: VPA/2016/9

Summary

On 25 July 2016, Council resolved to enter into a Planning Agreement with Lendlease (Circular Quay) Pty Ltd as Trustee for the Lendlease (Circular Quay) Trust to deliver business innovation space as part of their redevelopment at Circular Quay as part of a suite of public benefits.

The business innovation space will be approximately 3,700sqm of net lettable area of office space within the lowest three floors of the commercial tower. The office space will be leased to the City to provide affordable rental space for Tech Startups or other innovative high growth businesses.

Under the terms of the Planning Agreement, the City is to elect to enter into an agreement for lease for the business innovation space on the basis of either a:

- (a) Short Term lease - 20 years rent free plus the cost of outgoings; or
- (b) Long Term lease - 99 years at a discount market rate plus the cost of outgoings.

The planning agreement terms were structured this way to allow Council sufficient time to investigate the long term implications of these options. These investigations are complete and the purpose of this report is to recommend Council resolve to elect the short term lease (20 years) option.

The 20 year lease is recommended due to the rapidly changing nature of the Tech Startup ecosystem which may mean space such as this is not required by the end of the lease term, and following consideration of the financial implications.

Recommendation

It is resolved that:

- (A) Council approve the election of the Short Term Lease (20 year) option on the terms described in clause 9(c), Schedule 3 of the executed Planning Agreement between Lendlease (Circular Quay) Pty Limited as Trustee for the Lendlease (Circular Quay) Trust and the City;
- (B) authority be delegated to the Chief Executive Officer to finalise negotiations, execute and administer the lease terms as detailed in the Planning Agreement; and

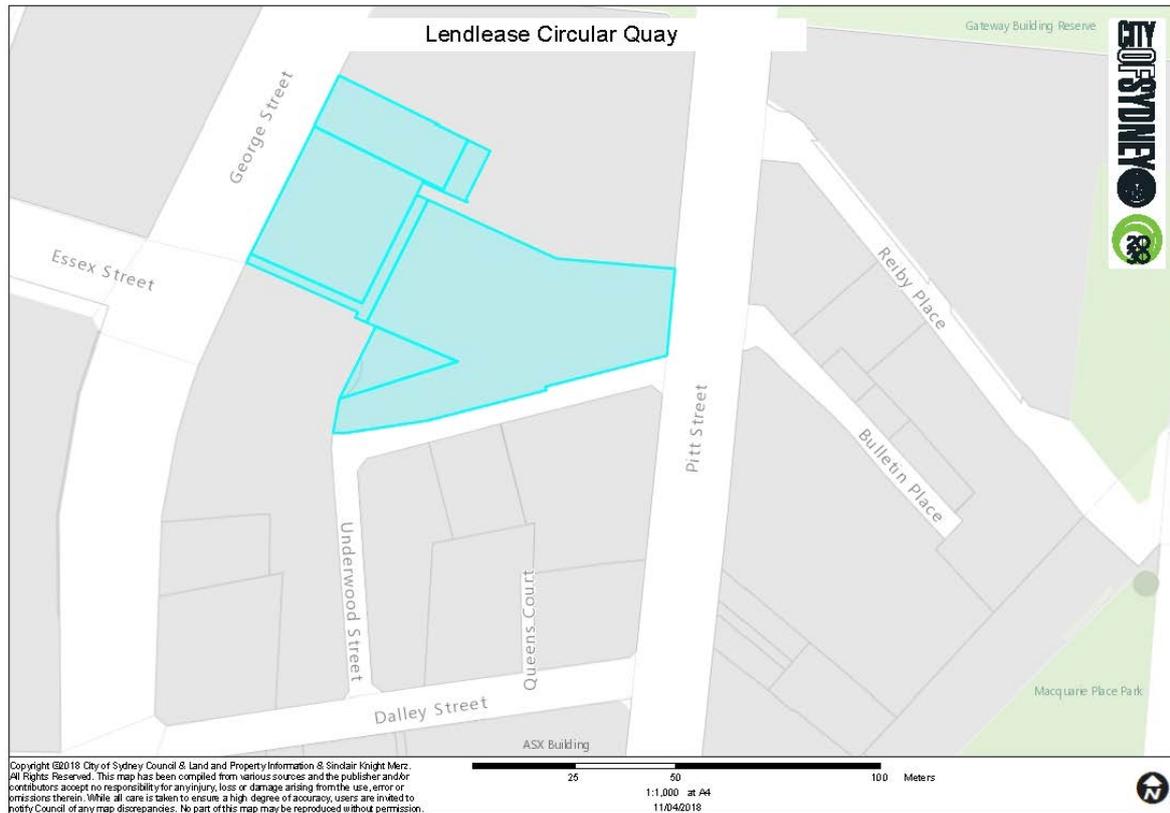
- (C) Council note that an agreement for lease for the business innovation space on the basis of Short Term Lease terms will be entered into as soon as practicable following the written notice of the election decision.

Attachments

- Attachment A.** Excerpt from executed VPA - Business Innovation Space Detailed Lease Terms

Background

1. The Lendlease Circular Quay site is located within the Alfred, Pitt, Dalley and George Streets (APDG) block close to Circular Quay. A plan showing the development site is below.



2. The site is a collection of properties with frontage to Pitt, Underwood and George Streets.
3. On 25 July 2016, the City executed a planning agreement with Lendlease (Circular Quay) Pty Limited as Trustee for the Lendlease (Circular Quay) Trust.
4. The planning agreement relates to a planning proposal to amend Sydney Local Environmental Plan 2012 (SLEP 2012) to facilitate a taller commercial tower with reconfigured publicly accessible open space and activated laneways.
5. On 25 July 2016, Council approved the planning proposal and, subsequently, the amendment to SLEP 2102 was made on 23 November 2016.
6. The planning agreement includes the following public benefits:
 - (a) Land dedication and embellishment of approximately 30sqm for road and footway widening to Underwood Street.
 - (b) Land dedications to no less than 1,800sqm and embellishment of public plaza spaces and laneways.
 - (c) Development and installation of public art to the public plaza space.

- (d) Lease in stratum of nominally 3,700sqm of net lettable area of office space for the purpose of business innovation space.
 - (e) Monetary contribution of \$2,200/sqm by net lettable area estimated at \$8,140,000 for the fitout of the business innovation space.
 - (f) Dedication in stratum and embellishment of 677sqm of a public cycle facility.
 - (g) Land dedication in stratum and construction and fitout of a small plaza edge building.
 - (h) Land transfer to the Developer of 395.6sqm for building development.
 - (i) Easements and covenants to the commercial tower to deliver commercial floor space.
 - (j) Covenants for the protection of small scale retail adjacent to the laneways.
 - (k) Commitment to environmental sustainable development in the commercial tower.
7. The planning agreement includes the provision of a lease of approximately 3,700sqm of net lettable area of office space within the lowest three floors of the commercial tower to the City to provide affordable rental space for tech startups or other innovative high growth businesses. The draft terms of the Long and Short Term Lease are at Attachment A. The lease of the space is on the basis of either:
- (a) Short Term - 20 years rent free plus the cost of outgoings; or
 - (b) Long Term - 99 years at a discount market rate plus the cost of outgoings.
8. In addition to the above, a one-off monetary contribution estimated at \$8,140,000 is to be provided to the City for the fitout of the business innovation space. This money may be spent in the first fitout, or retained in part for future fitouts to the space.

Investigation of Leasing Options

9. In 2015, at the time of consideration of the public benefit offer made by the Developer, the City's Property Unit undertook a review of the two leasing options, focusing on the financial implications of each.
10. The report investigated several scenarios comparing the costs to the City wherein, under the terms in the VPA, the short term lease required payment only of outgoings, while the Long Term Lease would include outgoings and a reduced rent of \$200/m² of NLA.
11. The review was subsequently revised in 2018 to ascertain a more current position. This analysis identifies that the financial risks associated with the long term lease (99 years) included:
- (a) rental cost of \$200/m² of NLA plus outgoings effectively doubles the amount the City would need to recover through subletting compared to the Short Term Lease;
 - (b) 4% annual rental increase and 10 yearly reviews increases financial risk over such a long lease;

- (c) upward pressure on outgoings is exacerbated over 99 year term with limited capacity for the City to influence;
 - (d) as the space is required to be used for Business Innovation, demand for this use may reduce over time, creating a risk in terms of subletting the space for Business Innovation; and
 - (e) requirement for future capital renewal/s and need to recover associated expenditure.
12. The analysis concluded the short term lease (20 year) option was favourable.
 13. The innovation sector by its nature is rapidly changing and evolving and the startup ecosystem in Sydney is still relatively new. It is envisaged that the needs of the sector will change over time, including the need for, or location of, low cost space. By selecting the shorter term option, the City's support can also change and adapt over time.
 14. The operating model of the business innovation space is to be determined, with a number of options being explored, including a leasing arrangement option under an accommodation grant.
 15. While Council has accepted the public benefit offer, it must be acknowledged that there are risks in providing work space with this growing sector. The key risk is the potential for oversupply in the near term should the sector not grow at the pace space is being made available by new entrants.
 16. The inclusion of the two options in the planning agreement has allowed further consideration of these market forces and the implications of a short or long term lease.
 17. Recent examples of similar government and non-government office space provisions include:
 - (a) Sydney Startup Hub - In February 2018, an initiative of the State Government's Jobs for NSW was launched at 11-31 York Street Sydney for the provision of subsidised rents and fitouts for office space to innovation startups, with 17,000 square metres across 11 floors. The State Government has entered into an initial five year lease for this work space.
 - (b) The Sharing Hub - Launched in April 2017, office space at 55 Pyrmont Bridge Road Pyrmont is being leased by 28 startups. Leases vary depending on the needs of the startup, varying from a year to a month-to-month basis.
 18. The Short Term Lease is recommended, given the financial impact over time and the ability for the City to ensure success of the office space for this purpose.

Key Implications

Strategic Alignment - Sustainable Sydney 2030 Vision

19. 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 1 - A Globally Competitive and Innovative City - The business innovation space will provide affordable office space to encourage new businesses and entrepreneurship within Central Sydney.
 - (b) Direction 6 - Vibrant Local Communities and Economies - The creation of the business innovation space broadens the range of job opportunities for people of diverse skills, experiences and attributes.
 - (c) Direction 9 - Sustainable Development, Renewal and Design - The office space will be fostering innovation and continual improvement within a building achieving environmental sustainable targets.
 - (d) Direction 10 - Implementation through Effective Governance and Partnerships - This public benefit is being delivered as work-in-kind as part of a Planning Agreement between the City and Lendlease (Circular Quay) Pty Limited.
20. In June 2016, the City adopted the Tech Startups Action Plan which outlines how the City can work with partners to create an environment that enables technology entrepreneurs to start and grow successful businesses. The Tech Startups Action Plan complements the City's Economic Development Strategy 2013 which built on and updated the broad economic themes in Sustainable 2030.
21. The Tech Startups Action Plan proposes that, to increase the density of the tech startup ecosystem, the City will:
- (a) use planning regulations to encourage more innovation spaces and/or affordable office spaces; and
 - (b) create affordable work spaces.
22. The planning agreement gives effect to these actions and provides the opportunity for the City to secure well located, leased workspace to support fledgling and innovative high growth businesses, such as Tech Startups.

Organisational Impact

23. The City's Economic Strategy Unit is developing operating model options for the Business Innovation Space and the resources required to oversee the implementation of the actions under the Tech Startups Action Plan.
24. The City's Property Unit and Legal Services Unit will manage the operation of the lease.

Risks

25. The provision of the work space is an excellent opportunity to contribute to the Tech Startups Action Plan, the first the City has adopted. This Action Plan is intended to be dynamic, changing as the needs and priorities of the business ecosystem change. It is highly aspirational in its support of the industry and, owing to the nature of the sector, the City acknowledges the need to adopt a "lean startup" approach so it can change, cancel or add programs as quickly as possible.
26. The election of the Short Term Lease (20 years) over the Long Term Lease (99 years) recognises this approach to the sector and the City's ability to ensure the success of the business innovation space.

27. With the unpredictability of a dynamic business sector, there is a risk of the work space being underutilised. This is exacerbated in the long term as other affordable workspace comes onto the market.
28. To ensure the work space remains relevant in the market, particularly in consideration of the entrepreneurial target industry, the fitout of the Business Innovation Space will require to be periodically updated and adapted. The monetary contribution provided by Lendlease under the planning agreement will contribute towards this ongoing refurbishment. As above, the election of the Short Term Lease mitigates the ongoing cost to the City.
29. The Lease terms define such matters as the extent of outgoings, maintenance and repair, make good obligations, insurance, access, termination and the like, providing certainty to the City's liability.

Budget Implications

30. The Business Innovation Space is being delivered as part of the suite of public benefits for the development of the Lendlease Circular Quay site.
31. The Developer is required to provide approximately 3,700m² of NLA of office space on the lowest three floors of the commercial tower as a base building (warm) shell.
32. A one-off monetary contribution calculated as \$2,200/m² of NLA (estimated as \$8,140,000, excluding GST) is to be paid to the City for the fitout of the Business Innovation Space.
33. The monetary contribution is anticipated to provide more than one fitout over the leasing period of the space, however, refurbishment of the facility will need to be factored in on a periodic basis.
34. Under the terms of the lease, the City will be responsible for its proportion of all rates, taxes, assessments, charges, duties and fees imposed by any Government Agency (except GST) in respect of the premises and for its proportion of any services, including electricity, water supply, drainage, sewerage, cleaning, building management, insurance, telecommunications connected to the premises, repairs and maintenance (other than structural or capital costs) and all other reasonable and proper costs which are attributable to the City's use of the premises.
35. The assumptions under both lease scenarios is that the space is operated in a "cost neutral" manner to the City. This may involve the appointment of an operator to administer the subletting of the space, with rentals obtained being sufficient (at a minimum) to cover the City's expenditure commitment as tenant.

Relevant Legislation

36. Environmental Planning and Assessment Act 1979; Environmental Planning and Assessment Regulation 2000; and the City of Sydney Act 1988.

Critical Dates / Time Frames

37. The VPA requires that the City provide written notification to the Developer as to whether it elects to enter into an agreement for lease based on the Detailed Lease Terms for the Business Innovation Space Long term Lease or the Business Innovation Space Short Term Lease.
38. The deadline for this decision has been agreed by the City and Lendlease as by 31 May 2018.
39. The commencement date of the Lease is proposed to be six weeks after the date the Occupation Certificate is issued for the commercial tower.
40. City staff are working with Lendlease to have the fitout of the business innovation space completed as close as possible to the commencement of the lease.

Options

41. The alternative option is to elect the Long Term Lease (99 years), which is not recommended.

Public Consultation

42. Industry group consultation was undertaken in 2015 and has informed this recommendation.
43. The planning agreement, including the terms of the two leasing options, was exhibited for 28 days in accordance with the requirements of the Environmental Planning and Assessment Act 1979.
44. No submissions were received relating to the Business Innovation Space.

GRAHAM JAHN, AM

Director City Planning, Development and Transport

Brett Calcar, Senior Project Manager - Planning Agreements