Reference: 20160261

3 October 2016

Thank you for your Official Information Act request, received on 14 July 2016. You requested the following:

> *"Has Treasury received anything from the Ministry of Health on the final proposed lease agreement/proposal for 133 Molesworth, if so, can I please have copies of all advice, correspondence, reports, documents, briefings sent from the Ministry of Health and copies of all emails and documents that Treasury has sent in response.*
>
> **Since my last OIA requests on 10 and 21 June 2016."*

On 26 July we transferred part of your request to the Ministry of Health. This response relates to the remainder of the request, for "*all emails and documents that Treasury has sent in response*" on the final proposed lease agreement/proposal for 133 Molesworth.

On 4 August we extended the time limit for deciding on your request by an additional 40 working days.

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Proposed Action
1.	22 June 2016	Email: Re: Ministry of Health Head Office Approval	Release in part
2.	24 June 2016	Email: Re: 133 Molesworth Street paper	Release in part
3.	8 July 2016	Email: Re: Revised MoH 133 Molesworth Joint Ministers paper May 16	Release in part
4.	8 August 2016	Aide Memoire: Ministry of Health Head	Release

		Office Accommodation Renegotiated Commercial Terms	in part

We propose to release the documents listed in the above table, subject to information being withheld under the following sections of the Official Information Act, as applicable:

- personal contact details of officials, under section 9(2)(a) – to protect the privacy of natural persons, including deceased people, and
- commercially sensitive information, under section 9(2)(i) - to enable a Minister of the Crown or any department or organisation holding the information to carry out, without prejudice or disadvantage, commercial activities.

While formally outside the scope of your request, I have also included an Aide Memoire which sets out the Treasury's advice to the Minister of Finance on the Ministry of Health's proposal for 133 Molesworth Street, to provide additional context in response to your request.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This fully covers the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Ben McBride
Manager, Health

Information for Release
TOIA 20160261

From: Davin Hall [TSY]
Sent: Wednesday, 22 June 2016 4:42 p.m.
To: 'Fergus_Welsh@moh.govt.nz'; Ben McBride [TSY]
Cc: Daniel Comber; david.white@pmcoe.govt.nz; duncan.p.scott@nz.pwc.com; Stephen_O'Keefe@moh.govt.nz
Subject: RE: Ministry of Health Head Office Approval
Attachments: Tsy Comments - MoH_133 Molesworth_Joint Ministers paper_May16_draftv05 (002)

[IN-CONFIDENCE]

Hi Ferg,

Treasury comments on your paper are tracked in the attached document. Happy to discuss.

In order to facilitate corporate centre advice once the paper is submitted, can we please have a copy of the proposed development agreement and lease?

Thanks,
Davin

From: Fergus_Welsh@moh.govt.nz [mailto:Fergus_Welsh@moh.govt.nz]
Sent: Monday, 20 June 2016 12:27 p.m.
To: Ben McBride [TSY] <ben.mcbride@treasury.govt.nz>
Cc: Daniel Comber <Dan.Comber@pmcoe.govt.nz>; david.white@pmcoe.govt.nz; Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>; duncan.p.scott@nz.pwc.com; Stephen_O'Keefe@moh.govt.nz
Subject: RE: Ministry of Health Head Office Approval

Hi Ben

Please find atatcehd a revsied joint paper, which hopefully addresses the questions you had over the ealrier draft.

Happy to discuss further

Thanks
Ferg

Fergus Welsh
Finance and Performance
Ministry of Health
Mobile: s9(2)(a)

Fax: 04 496 2344

http://www.health.govt.nz
mailto:Fergus_Welsh@moh.govt.nz

From: "Ben McBride [TSY]" <ben.mcbride@treasury.govt.nz>
To: "Fergus_Welsh@moh.govt.nz" <Fergus_Welsh@moh.govt.nz>,
Cc: Daniel Comber <Dan.Comber@pmcoe.govt.nz>, "david.white@pmcoe.govt.nz" <david.white@pmcoe.govt.nz>, "Davin Hall [TSY]" <Davin.Hall@treasury.govt.nz>, "duncan.p.scott@nz.pwc.com" <duncan.p.scott@nz.pwc.com>
Date: 14/06/2016 04:02 p.m.
Subject: RE: Ministry of Health Head Office Approval

[UNCLASSIFIED]

Thanks for the update Ferg, I assume we have to have it to Ministers in the next few weeks before the end of the month?

Ben McBride
Manager, Health, **The Treasury**
+64 4 917 6184 | s9(2)(a) | ben.mcbride@treasury.govt.nz

From: Fergus_Welsh@moh.govt.nz [mailto:Fergus_Welsh@moh.govt.nz]
Sent: Tuesday, 14 June 2016 3:44 p.m.
To: Ben McBride [TSY] <ben.mcbride@treasury.govt.nz>
Cc: Daniel Comber <Dan.Comber@pmcoe.govt.nz>; david.white@pmcoe.govt.nz; Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>; duncan.p.scott@nz.pwc.com
Subject: RE: Ministry of Health Head Office Approval

Hi Ben

We have been working on addressing the feedback you provided on the earlier draft.

I am sharing the near final draft with Stephen O'Keefe and should get the revised draft back to you in the next day or two so we can progress this to joint Ministers.

Thanks
Ferg

Fergus Welsh
Finance and Performance
Ministry of Health
Mobile: s9(2)(a)

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****

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****

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Security classification: In-Confidence

MINISTRY OF HEALTH
MANATŪ HAUORA

Database number: 8 digit number
~~**Treasury Report number:** T2015/xxxx~~

File number: [generated by Records Help]
Action required by: date

Ministry of Health – Head Office Accommodation Renegotiated Commercial Terms

To:	Hon Dr Jonathan Coleman, Minister of Health Hon Bill English, Minister of Finance
Copy to:	Hon Paula Bennett, Minister of State Services

Purpose

The purpose of this paper is to report back on the renegotiation of the final commercial terms for the Ministry of Health (MoH) Wellington head office accommodation solution, and to seek your joint authority for the Chief Executive of MoH to execute the development agreement.

A copy is provided to the Minister of State Services for her information.

Key points

- In March 2014 [paper reference], Joint Ministers (Minister of Health and Minister of Finance):
  - Approved final commercial terms of the development agreement (including the deed of lease) negotiated for MoH's Wellington head office accommodation solution; and
  - Delegated to the Director-General of the Ministry of Health the authority to execute the final commercial terms of the development agreement.
- A major component of the head office accommodation solution is the fit-out of the re-developed and enlarged building situated at 133 Molesworth Street site. In the collective head office accommodation business case, prepared by the Government Property Management Centre of Expertise (PMCoE) in November 2012, it was agreed that MoH would purchase the hard fit-out and fund the resulting capital expenditure (budgeted at $12.9 million) from cash reserves on its balance sheet.
- However, subsequently the MoH's Budget 2015 four year planning process indicated that the mechanism for funding the fit-out approved by Cabinet in November 2012 and agreed by Joint Ministers in March 2014 was no longer the best option for MoH or the Crown. The proposed solution to fund the capital investment for fit-out assets from MoH's existing cash reserves would have significantly restricted MoH's ability to deliver priority IT projects for at least two years, and could have placed its working capital at risk.
- In March 2015, the Director-General of the Ministry of Health commissioned a review to establish whether the mechanism for funding the fit-out agreed in 2012 remained the best option for MoH and the Crown, and if not, to identify and assess alternative funding mechanisms.
- The conclusion of the review was that an alternative funding mechanism, whereby the risks and rewards of ownership of the fit-out assets would be transferred to the private sector, provided the best option for MoH and the Crown. Under this alternative funding mechanism, the hard fit-out assets would be provided as part of the rental agreement with the landlord.

Commented [DH[1]: We disagree with this characterization of event and would suggest that this opportunity be used to outline to Ministers the failings that occurred within the Ministry in relation to this bid – ie, the money was spent despite being committed.

Contacts:	Stephen O'Keefe, Chief Financial Officer, Ministry of Health	s9(2)(a)
	Fergus Welsh, Acting Group Manager Financial Advice and Control	

Database number: 8 digit number

- The final commercial terms of the development agreement have now been renegotiated in accordance with the alternative funding mechanism, and the proposed approach has been agreed with the Ministry's external auditors.
- The required changes to both the commercial terms and to the MoH's financials are sufficiently material to require Joint Ministers' approval.
- Due to the nature of the transaction and the flows of capital we seek your approval to increase the forecast Ministry of Health – Capital Expenditure PLA in 2016/17 only, by up to $xxx million. This capital expenditure will be offset by the sale of the assets on completion and has no impact on the Crown's debt.

Commented [DH[2]: This is not reflected at all in the recommendations or the body of the paper. No explanation provided of why this is required.

Recommendations

The Ministry recommends that you:

		Minister of Health	Minister of Finance
a)	**Note** that authority to agree to the final investment decision for this solution was delegated to Joint Ministers (Minister of Finance and Minister of Health) by Cabinet on 13 November 2012 (SEC Min (12 21/2 refers)	**Yes / No**	**Yes / No**
b)	**Note** that the Ministry of Health (MoH), supported by the Government Property Management Centre of Expertise (PMCoE), has renegotiated the development agreement for its Wellington head office accommodation solution	**Yes / No**	**Yes / No**
c)	**Note** that the changes negotiated transfer the risks and rewards of ownership of the fit-out to the re-developed and enlarged building situated at 133 Molesworth Street without affecting the expected outcomes as agreed by Joint Ministers in March 2014 (paper reference)	**Yes / No**	**Yes / No**
d)	**Note** that despite a small increase of * [redacted]% in total property-related costs across the 20 year appraisal period, the renegotiated solution does not require additional Crown funding	**Yes / No**	**Yes / No**
e)	**Note** that MoH's external legal advisors have confirmed that the renegotiated development agreement (including the dead of lease) reflect the agreements reached between the parties during the negotiations and accordingly are in order for execution	**Yes / No**	**Yes / No**
f)	**Note** that MoH's external auditors have reviewed the renegotiated solution and have confirmed that the solution is consistent with the requirements of the Public Finance Act 1989 and the relevant accounting standards	**Yes / No**	**Yes / No**
e)	**Note** that the changes renegotiated constitute a material change to the final commercial terms of the development agreement (including the dead of lease) approved by Joint Ministers in March 2014 (paper reference)	**Yes / No**	**Yes / No**
f)	**Approve** the renegotiated final commercial terms of the development agreement (including the deed of lease) negotiated for MoH's Wellington head office accommodation solution	**Yes / No**	**Yes / No**

Commented [DH[3]: According to table 3, the total occupancy cost has increased by * [redacted] with a corresponding increase in cost per FTE when compared to the capital funded scenario agreed by Ministers in 2014. Ministers need to be clear that this is a more costly solution, but that it mitigates the need for additional crown capital. There is nothing in the paper to say how these additional costs will be absorbed by the Ministry.

* = withheld under s9(2)(i)

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g) **Delegate** to the Director-General of the Ministry of Health the authority to execute the renegotiated final commercial terms of the development agreement (including the deed of lease) negotiated for MoH's Wellington head office accommodation solution — **Yes / No** — **Yes / No**

Chai Chuah
Director-General
Ministry of Health

~~Ben McBride~~
~~Manager~~
~~**The Treasury**~~

Dr Jonathan Coleman
Minister of Health signature
Date:

Hon Bill English
Minister of Finance signature
Date:

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Ministry of Health – head office accommodation renegotiated commercial terms

Background

The approved Wellington head office accommodation solution (November 2012)

1. The Ministry of Health (MoH) participated in a collective head office accommodation business case during 2012 as it had leases due to expire in the Wellington central business district. Other agencies involved were the Ministries of Business, Innovation and Employment, Social Development, Education and the Crown Law Office. The business case was prepared by the Government Property Management Centre of Expertise (PMCoE), hosted at the Ministry of Social Development (MSD), pursuant to the functional leadership mandate delegated from the State Services Commissioner to the Chief Executive of MSD.
2. The agencies were at various stages of business case and procurement processes, all of which were merged into the PMCoE led process in June 2012. This centrally-led procurement and business case process for Wellington head office accommodation resulted in a preferred solution which was approved by Cabinet on 13 November 2012.
3. As part of the preferred solution MoH was identified to occupy a re-developed and enlarged building situated at 133 Molesworth St, Wellington (providing 15,311 m^2 in space). This would see MoH moving its staff located at 133 Molesworth St to the Freyberg building for a two-year period while 133 Molesworth was re-developed, then returning to this site as well as vacating from the current site occupied at 3 The Terrace.

Negotiation and approval of the final commercial terms (March 2014)

4. MoH led the negotiation for 133 Molesworth St, supported by PMCoE, a tenant advocate (specialist property negotiator) and other external technical services such as legal, architects and engineers. The key outcomes for MoH and the Crown of this negotiation were as follows:
   - No additional Crown funding required for property costs over the forecast 20 year period
   - Very efficient footprint adopted (12.6 m^2 per work point down from 15.6 m^2) with an overall reduction of 3,566 m^2 of current office space usage
   - Enhanced agency effectiveness through a single building solution
   - Good building safety and business continuity capability
   - Minimal legacy lease tails.
5. Joint Ministers (Minister of Finance and Minister of Health) delegated authority to agree to the final investment decision for the Wellington head office accommodation solution (SEC Min (12 21/2 refers). Joint Ministers applied this authority to approve the negotiated development agreement (including the deed of lease) in March 2014 (paper reference).

Office fit-out: the need for an alternative funding mechanisms (February 2015)

6. A major component of the head office accommodation solution is the fit-out of the re-developed and enlarged building situated at 133 Molesworth Street site. The estimated cost of this fit-out is $17.9 million. In the collective head office accommodation business case it was agreed that MoH would purchase the fit-out assets and fund the resulting capital expenditure from cash reserves on its balance sheet.

7. However, the MoH's Budget 2015 four year planning process undertaken in October 2014 indicated that the mechanism for funding the fit-out approved by Cabinet in November 2012 and agreed by Joint Ministers in March 2014 was no longer the best option for MoH or the Crown. The proposed solution to fund the $17.9 million capital investment for fit-out assets from existing cash reserves would have significantly restricted MoH's ability to deliver priority IT projects for at least two years, and could have placed its working capital at risk.

~~8.~~ As a consequence of this work, in ~~February 2015,~~December 2014 MoH submitted a request to the Treasury for a capital injection of $18.0 million to fund the fit-out costs as part of the Budget 15 process. ~~It became apparent that the governance and quality control processes over the development and submission of this request were unacceptably weak, and as result, alternative funding mechanisms for funding the fit-out were not explored prior to making the submission, and as a consequence, at the time the budget submission was withdrawn.~~

9. In response, the Director-General commissioned an investigation into what occurred and a review to identify and assess a full range of alternative funding mechanisms.

Commented [DH[4]: This statement is not accurate. The initiative was considered through the 2015 budget process and rejected.

Commented [DH[5]: As per the comment on page 1, we would not agree with this characterization of events and suggest that you use this opportunity to brief on the failings identified in the PWC inquiry into the matter. Fundamentally, the Ministry did not front up about the lack of available funding with the Treasury or Ministers and submitted a budget bid to obtain the money without disclosing that Ministers had agreed to proceed on the basis that it would be funded from cash flows and that the money was not available when Ministers signed off because it had been committed to other projects.

Office fit-out: development of an alternative funding mechanism

Options identification and appraisal (July 2015)

10. MoH identified and explored the following options for funding the fit-out of 133 Molesworth Street:
    a. Fund the expenditure from existing balance sheet cash reserves and capitalise the costs (the original option).
    b. Seek a Crown capital injection to fund the fit-out and then capitalise the expenditure.
    c. Enter into a sale and leaseback arrangement whereby MoH would purchase the fit-out assets, sell them to a leasing company who would then lease the assets back to the Ministry, with the leasor assuming all ownership responsibilities for the assets.
    d. Enter into an agreement with a leasing company, whereby the leasing company would lease the fit-out assets to MoH, with the leasor assuming all ownership responsibilities for the assets.
    e. Enter into a full fit-out rental agreement with the landlord, with the lessor assuming all ownership responsibilities for the assets.
    f. Seek an alternative accommodation solution.

11. Each option was assessed against the following criteria:
    - Value for money: the option delivers outcomes that are consistent with the business case at a materially similar project whole-of-life cost).
    - Financial viability: the option is affordable within current baseline expenditure and cash flow constraints.
    - Strategic alignment: the option does not adversely affect the funding of MoH's other strategic priorities.
    - Technically viability: the option is compliant with Public Finance Act and accounting standards requirements.
    - Stakeholder alignment: the option is consistent with the expectations of the Treasury and PMCoE.

Confirming the preferred option (August 2015)

12. The conclusion of the option assessment was that an alternative funding mechanism for the hard fit-out assets should be negotiated. Under this option, the risks and rewards of ownership of the hard fit-out assets would be transferred to the private sector. This was the only option that satisfied all of the assessment criteria and the option that provided the best outcomes for MoH and the Crown.

13. The hard-fit elements of the accommodation project are consistent with the approved collective head office accommodation business case, as is the total budgeted cost of $12.4 million. The main components of the hard fit-out are:
    - Assets (including partitions, doors, floors, ceilings, floor coverings, joinery, plumbing, electricity wiring and lighting, IT cabling outlets)
    - Professional fees (including designers, engineers, health & safety, insurance and project managers)
    - Consultants and contractors
    - Project contingency.
14. For the remaining 'soft fit-out' assets (such as furniture, IT cabling and audio visual equipment), MoH will continue with existing funding mechanisms: the assets will be purchased by the Ministry and capitalised or, where it makes commercial sense to do so, be leased from a third party. The maximum budgeted value of these soft fit-out assets is $5.6 million.
15. Discussions were held with stakeholders including the landlord, PMCoE and the Treasury during the assessment process to confirm their support for the preferred outcome. The Director-General confirmed his support for developing the preferred funding option, and for renegotiating the development agreement, in August 2015

Renegotiation of the development agreement (December 2015)

16. The final commercial terms of the development agreement have now been renegotiated in accordance with the preferred funding mechanism. MoH utilised external specialise property negotiation services (Twenty Two) and legal services (Buddle Findlay) to support the renegotiation of the development agreement and the deed of lease. PMCoE supported MoH through this process to ensure that the Crown's needs were met and to assist in achieving greater commonality and consistency across government agencies.
17. The renegotiation process was completed satisfactorily in December 2015, and MoH's legal advisors have confirmed that the renegotiated development agreement (including the dead of lease) reflect the agreements reached between the parties during the negotiations and accordingly are in order for execution.

Auditors' review of the funding and accounting approaches (March 2016)

18. MoH's external auditors (Audit New Zealand) have reviewed the renegotiated development agreement and the proposed funding and accounting approaches that underpin the preferred funding mechanism. Audit New Zealand have written to MoH to confirm that they are satisfied that the preferred funding mechanism is consistent with the Public Finance Act and with the relevant accounting standards.

Implications of the renegotiated development agreement

Benefits realisation and other expected outcomes

19. The expected benefits and other outcomes of the Wellington head office accommodation solution remain consistent with those detailed in the business case and were reconfirmed in the March 2014 paper to Joint Ministers. The renegotiated development agreement:
    - Will not result in any material changes to these expected benefits or other outcomes of the Wellington Accommodation project.
    - Will enable MoH to invest a further $12.4m of its available capital funding into priority IT-related projects, and maintain an appropriate level of working capital for an agency of its size.

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Commercial implications

20. The renegotiated development agreement will result in changes to the commercial terms as compared with the agreement reached in March 2014. The main change is that the development agreement has been amended to include the provision of the hard fit-out assets and the associated fit-out rental. Under this amendment, the additional fit-out rental:

- Is payable over the first ten years of the 15 year development agreement.
- Is to be calculated at * per annum + GST per * (or part thereof) of the fit-out sum paid.

21. On the basis that the total hard-fit out sum to be paid is * million, the additional fit out rental will be * million + GST per annum. The full additional fit out rental will be * million over the life of the development agreement.

22. The impact of the amendment to the development agreement compared to the agreement negotiated in March 2014 is as follows:

Table 1: Updated cost benefit analysis of MoH's renegotiated solution

Appraisal period (15 years) FY 2016/17 to FY 2030/31	March 2014 negotiation	December 2015 renegotiation	Difference	
Area leased (m^2)	15,311	15,311	No change	
Total operating expenditure ($ million)[1]	*			
Capital costs ($ million)[2,3]	18.267	0.000	(18.267)	(100.0%)
Shortfall (-) against future funding provision	*			

[1] Total operating expenditure (including depreciation and capital charge) over the 15 year life of the renegotiated rental agreement; [2] Maximum capital costs exclude $5.558 million capital expenditure already incurred relating to the decant building fit-out; [3] Some elements of the soft-fit out may be capitalised if it makes commercial sense to do so (maximum value of $5.697 million)

23. There are no other substantive changes to the commercial terms included in the development agreement compared to the agreement negotiated in March 2014.

Financial implications

24. The total operating expenditure (in nominal terms) over the 15 years of the re-negotiated solution (commencing October 2016) now stands at * million. This compares to the March 2012 estimate of $1* million. As a result of this increase, the overall funding position sees a movement from a shortfall of * million to * million over the 15 year period.

25. As outlined in table 2 below, the increase in the shortfall * million) is due to the additional operating expenditure to be incurred as the result of moving from an ownership to lease model for the hard fit-out assets (* million) offset by net savings realised elsewhere in the project (* million).

Table 2: Funding arrangements for MoH

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Expense type	March 2014 negotiation	December 2015 renegotiation
Operating ($m) - Building rental costs - Depreciation - Other operating expenditure	*	
Sub-total		
Existing operating provision		
Shortfall (-) to be funded from baseline		
Capital - Main contract and hard fit-out - soft fit-out & contingency	*	 0.000 0.000
Total to be funded from cash reserves	**18.129**	**0.000**

26. The whole of life funding shortfall of * million will be spread over the 15 years of the development agreement at an average of * million per annum. This additional operating expenditure will be met from existing MoH departmental operating expenditure baselines. The source of these reprioritised resources will be through efficiency savings.

Delegated authority and approval

27. The renegotiated head office accommodation solution does not require additional Crown funding.

28. The required changes to both the commercial terms and to the MoH's financials as set out in this paper are sufficiently material given the change in funding model, to require Joint Ministers' approval of the renegotiated development agreement.

Comparison with the ~~November 2012~~Approved terms (February 14 Preferred Solution) ~~business case~~

Commented [DH[6]: The comparison should be to the final commercial terms in the 2014 report that Ministers signed off on rather than the business case. The reference back to the business case ignore the revisions in 2014 and does not provide a clear comparison to what Ministers previously agreed.

Comparative cost-benefit analysis and other KPIs

29. The finalised cost-benefit analysis of MoH's renegotiated solution, as compared to the ~~November 2012 business case~~Final commercial terms agreed to by the Minister of Health and Minister of Finance, is as follows:

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Table 3: Cost benefit analysis of MoH's negotiated solution

Appraisal period (20 years) FY 2012/13 to FY 2031/32	~~February 2012 Preferred option~~2014 Preferred Solution	December 2015 renegotiation	Difference	
Area leased (m^2)	~~14,611~~15311	15,311	~~700.00~~ nil	~~4.8%~~nil
Total occupancy ($ million)	*			
Capital costs ($ million)	~~23.00~~24	5.74	(~~17~~18.26)	~~(75.0%)~~
Whole of life costs (real terms) ($ million)	*			
Net Present Value (NPV @6.5%) ($ million)				

30. The whole of life costs in real terms (being the total net cash payments over the 20 year appraisal period adjusted for inflation) have increased by * million compared to those ~~projected in the November 2012 business case~~approved in 2014 (equivalent to * or * million per annum). This increase is the result of moving from an ownership to lease model for the hard fit-out assets as described above.

31. The net present value (being the whole of life costs in real terms, discounted at a rate of 6.5% per annum), has decreased by * million compared to ~~the November 2012 business case~~February 2014. This decrease reflects the timing of cash payments over the 20 year appraisal period with * million of capital spending in the years 2015/16 and 2016/17 being avoided under the renegotiated solution.

Table 4: Other KPIs relating to the renegotiated solution

Other KPIs (20 year CBA period)	~~November 2012 preferred option~~February 2014 Preferred Solution	December 2015 renegotiation	Difference
Average total property costs ($ per FTE per annum)	*		
Average total property costs ($ per m^2 per annum)			
Total capital cost ($ per m^2)			

32. Average total property costs per FTE are projected to increase by ~~under~~ over * and average total property costs per m^2 is projected to ~~decrease, however, reflecting the increase in floor space of 700m² compared to the November 2012 business case~~increase by *

From: Davin Hall [TSY]
Sent: Friday, 24 June 2016 3:48 p.m.
To: 'Fergus_Welsh@moh.govt.nz'
Cc: Ben McBride [TSY]; Stephen_O'Keefe@moh.govt.nz; duncan.p.scott@nz.pwc.com
Subject: RE: 133 Molesworth Street paper

[IN-CONFIDENCE]

Hi Ferg. Thanks for the feedback. We were hoping to see more of the PWC review work outlined in the paper. There was never a formal report to Ministers on the outcome and it would be useful to close the loop.

Also, just FYI we've been OIA'd for anything related to the Property consolidation project since March. Will send over the documents for comment once I've had a chance to pull emails together.

Have a good weekend. Regards, Davin

From: Fergus_Welsh@moh.govt.nz [mailto:Fergus_Welsh@moh.govt.nz]
Sent: Friday, 24 June 2016 10:49 a.m.
To: Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>
Cc: Ben McBride [TSY] <ben.mcbride@treasury.govt.nz>; Stephen_O'Keefe@moh.govt.nz; duncan.p.scott@nz.pwc.com
Subject: 133 Molesworth Street paper

Hi Davin

Thanks for your comments. We are going through these and will amend the paper accordingly.

You made a comment about the last dot point prior to the recommendations regarding the nature of the transaction and the flows of capital and the need to increase the forecast Ministry of Health – Capital Expenditure PLA in 2016/17 only. This capital expenditure will be offset by the sale of the assets on completion and has no impact on the Crown's debt, however I had initially thought that the arrangement will require the Ministry to increase its capital PLA from 2016/17 (currently totals $15.010 million), given that while the net cash impact of the transaction for the Ministry expenditure will be zero, because capital expenditure will be incurred by the Ministry to develop the asset ahead of the sale (recorded as WIP), there would be cashflow changes to the accommodation funding arrangement, and I thought that this leg of the transaction would need to be appropriated.

However having looked over the advice and agreement to the MoH approach from Audit and Treasury and reflected in the letter from Sally Britnell, I understand this is not required given the nature of the transaction, so this should paragraph should have been removed. I removed it from the body of the report but failed to remove it from the front before I sent it out.

Regarding your comment on the key points - bullet point 3 and para 7 and 8 and how it is characterised. We will look at the wording and amend it as necessary. Are you expecting to have more of the context outlined in the PWC report in this report?

Thanks
Ferg

Fergus Welsh
Finance and Performance
Ministry of Health

Mobile: s9(2)(a)

Fax: 04 496 2344

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mailto:Fergus_Welsh@moh.govt.nz
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From: Davin Hall [TSY]
Sent: Friday, 8 July 2016 10:35 a.m.
To: 'Fergus_Welsh@moh.govt.nz'
Cc: Ben McBride [TSY]; Stephen_O'Keefe@moh.govt.nz
Subject: RE: Revised MoH_133 Molesworth_Joint Ministers paper_May16_draftv05

Hi Ferg,

We're happy with it being reflected in the report that we have been consulted, but as I mentioned earlier, we'll be looking to provide a corporate centre perspective on the proposal, leveraging PIMCOE's expertise in this area.

I'd appreciate a copy of the final report when it is sent.

Regards,
Davin

From: Fergus_Welsh@moh.govt.nz [mailto:Fergus_Welsh@moh.govt.nz]
Sent: Thursday, 7 July 2016 9:59 a.m.
To: Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>
Cc: Ben McBride [TSY] <ben.mcbride@treasury.govt.nz>; Stephen_O'Keefe@moh.govt.nz
Subject: RE: Revised MoH_133 Molesworth_Joint Ministers paper_May16_draftv05

Hi Davin

Chai will sign this out in the next 24 hours. However he did want to add one sentence and wanted me to get Treasury's okay with it.

While we have a paragraph on the Auditors' review of the funding and accounting approaches, Chai has asked for one addition to be made to the paper making reference to consultation with the Treasury, given it is now not a joint MoH/Treasury paper as initially intended, and you will be putting up separate advice to the MoF.

I think just an additional sentence is required, but are you comfortable with something like:

Auditors' and Treasury review of the funding and accounting approaches (March 2016)

MoH's external auditors (Audit New Zealand) have reviewed the renegotiated development agreement and the proposed funding and accounting approaches that underpin the preferred funding mechanism. Audit New Zealand have written to MoH to confirm that they are satisfied that the preferred funding mechanism is consistent with the Public Finance Act and with the relevant accounting standards.

We have discussed this paper and recommendations on the preferred funding mechanism and accounting treatment with the Treasury and they agree with the proposed approach.

Could you please confirm you are comfortable with this addition, or provide some alternative wording?

Thanks
Ferg

Fergus Welsh
Finance and Performance
Ministry of Health

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From: "Davin Hall [TSY]" <Davin.Hall@treasury.govt.nz>
To: "Fergus_Welsh@moh.govt.nz" <Fergus_Welsh@moh.govt.nz>,
Cc: "Stephen_O'Keefe@moh.govt.nz" <Stephen_O'Keefe@moh.govt.nz>, "Ben McBride [TSY]" <ben.mcbride@treasury.govt.nz>
Date: 01/07/2016 09:23 a.m.
Subject: RE: Revised MoH_133 Molesworth_Joint Ministers paper_May16_draftv05

[IN-CONFIDENCE]

Hi Ferg,

Thanks for the feedback and for sharing the lease documents. Can you please let us know when the report is submitted to Ministers.

Thanks,
Davin

From: Fergus_Welsh@moh.govt.nz [mailto:Fergus_Welsh@moh.govt.nz]
Sent: Friday, 1 July 2016 9:06 a.m.
To: Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>
Cc: Stephen_O'Keefe@moh.govt.nz; Ben McBride [TSY] <ben.mcbride@treasury.govt.nz>
Subject: Revised MoH_133 Molesworth_Joint Ministers paper_May16_draftv05

Hi Davin

Thank you for your feedback on the earlier draft.

We have made a number of changes and additions to address your comments and observations. In addition, we have slightly revised the December 2015 numbers as we have firmer data on some aspects, and thought it makse sesnesre to get the most up to date numbers reflected in the paper.

Changes made to address the points raised by you (in blue) are as follows:

- "We disagree with this characterization of event and would suggest that this opportunity be used to outline to Ministers the failings that occurred within the Ministry in relation to this bid – i.e., the money was spent despite being committed."

I have amended the wording in the key points section and under paragraphs 7 - 9 - it is consistent with the observations from the PWC report (which is public) as to the reasons for the situation.

- "We were hoping to see more of the PWC review work outlined in the paper. There was never a formal report to Ministers on the outcome and it would be useful to close the loop."

Refer a new section under paragraphs 10 - 14. We have tried to summarise succinctly as possible the actions taken.

- The comparison should be to the final commercial terms in the 2014 report that Ministers signed off on rather than the business case. The reference back to the business case ignore the revisions in 2014 and does not provide a clear comparison to what Ministers previously agreed.
-

We have updated the tables to take the 2014 decisions, and also at the same time ensured that the 2015 numbers reflect the most up to date numbers.

-
- Rec d and table 4 - According to table 3, the total occupancy cost has increased by s9(2)(i) with a corresponding increase in cost per FTE when compared to the capital funded scenario agreed by Ministers in 2014. Ministers need to be clear that this is a more costly solution, but that it mitigates the need for additional crown capital.
-

The revised numbers you recommend we use for the KPI metrics and therefore the changes you wanted made in the rec does not compare like with like. The CBA number you recommend we use for the 2014 comparison excludes depreciation (as a non-cash item), but table 4, which the recs is sourced from, should reflect the total property costs for each item, which thereof should include depreciation for the 2014 number. The total property costs have only increased over the 20 year period by s9(2)(i) compared to the 2014 option, not s as you noted in your prosed change. If MOH had gone with the 2014 option it would have incurred depreciation as part of the total property cost. For the 2014 report it had excluded depreciation for both the 2012 and 2014 options which won't have had an impact as both were looking at capital options so excluding non-cash items such as depreciation wouldn't have a significant impact in the comparison, but to do so with this option isn't comparing like with like.

- There is nothing in the paper to say how these additional costs will be absorbed by the Ministry

We have added some additional wording in paragraph 31.

I am happy to discuss the changes or any additional wording you might suggest with you further.

Thanks
Ferg

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IN-CONFIDENCE

THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference: T2016/1450 DH-1

Date: 8 August 2016

To: Minister of Finance (Hon Bill English)

Deadline: None
(if any)

Aide Memoire: Ministry of Health Head Office Accommodation Renegotiated Commercial Terms

The Ministry of Health (the "Ministry") has recently sent through a report (Aide Memoire: Ministry of Health – Head Office Accommodation Renegotiated Commercial Terms ref: 20161057) seeking Joint Ministers agreement to delegate to the Director General of Health the authority to execute the final commercial terms of the development agreement for the Ministry's head office accommodation. This aide memoire reflects a Treasury perspective on the arrangements, with input from the Government Property Group (GPG).

At the core of the renegotiated terms is provision for the hard fit out elements of the premises ($12.4M) to be leased from the landlord, rather than the initially anticipated ownership of the fit out by the Ministry. The requirement for the Ministry to consider different approaches arises from the discovery during Budget 15 that insufficient cash reserves were retained by the Ministry to fund the fit out after the original business case was approved (T2015/416 refers). The outcome of the investigation into this financial management failure is outlined in the report (see below).

The fit out leasing arrangement eliminates the need for additional Crown funding to be provided via a capital injection, but results in a s9(2)(i) higher whole of life cost s9(2)(i) in real terms) over a 20 year period. The Ministry will not accrue the associated depreciation funding for the fit out to manage potential future liabilities, but in practical terms this outcome is not a change from the current situation. Increased costs of s9(2)(i) per year over current accommodation related expenditure will need to be absorbed by the Ministry in its departmental baseline.

Audit New Zealand have reviewed the renegotiated proposal and have confirmed that they are satisfied the funding mechanism is consistent with the Public Finance Act and relevant accounting standards.

Government Property Group (GPG)

From the perspective of the GPG, the Ministry have found themselves in a less than ideal situation in that the options available were somewhat limited by the fact that the original development agreement had already been executed. GPG recognises that no transaction is the same and each proposal from a commercial perspective should be considered on its own merits, however its generally accepted that a leasing model has a higher cost profile than that associated with ownership, and thus in the first instance GPG's preference is for the Crown to self-fund (subject to funding availability).

GPG acknowledge the efforts that have been undertaken by all associated parties to resolve this fit out funding issue, and have incorporated the lessons learnt from this particular transaction into its wider project funding framework model.

Given the circumstances, the Treasury and GPG consider the renegotiated agreement to have achieved an acceptable result.

Ministry of Health Financial Management Review

The PriceWaterhouseCoopers Review of the Ministry's capital management, which arose from the 2015 Budget bid for a capital injection to fund the fit out, has triggered changes to the capital management processes at the Ministry and more fundamental changes to the Ministry's finance operating model, including an elevated role for the Chief Financial Officer within the organization.

The Treasury strongly supports the changes to clarify the CFO's responsibility for strategic financial management across Vote Health and we are working closely with the new Ministry CFO and his team as they navigate a significant change process.

Davin Hall, Senior Analyst, Health, 04 917 6195
Ben McBride, Manager, Health, Health, 04 917 6184