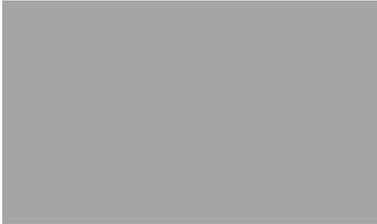


Reference: 20190721

14 November 2019



Thank you for your Official Information Act request, received on 2 October 2019, for *Treasury Report T2019/856: Bowen State Building Fit-out Costs*.

Attached is the requested document, which is being released subject to information being withheld under the following sections of the Official Information Act 1982 (OIA):

- sensitive information under section 6(a) – to protect the security or defence of New Zealand or the international relations of the Government of New Zealand and section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions, and
- contact details of officials and names of junior officials, under section 9(2)(a) – to protect the privacy of natural persons, including that of deceased natural persons; section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage; and section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions.

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 document may be published on the Treasury website.

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

Yours sincerely

Colin Hall
Manager, Justice, Security & Government Services

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Bowen State Building Fit-out Costs

Date:	25 July 2019	Report No:	T2019/856
		File Number:	SH-14-1-1-0

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note that the prime cause of the increase in fit-out costs for Bowen State Building has been the security arrangements put in place.	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Hamish Coghill	Analyst, Justice, Security & Government Services	s9(2)(k)	N/A (mob) ✓
Colin Hall	Manager, Justice, Security & Government Services	s9(2)(a)	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No.

IN-CONFIDENCE**Treasury Report: Bowen State Building Fit-out Costs****Executive Summary**

This report is for your information and provides an assessment of the causes of the cost increase associated with Bowen State Building fit-out.

The table below provides the history of the cost increases.

Date	Cost (\$m)	Comment
June 2015	30.0	The Ministry of Business, Innovation and Employment's (MBIE) initial assessment of costs for the ground floor to level 6, reconfirmed by MBIE in July 2017.
August 2017	50.0	MBIE's revised estimate of costs following decision for the New Zealand Defence Force (NZDF) to take over as lead agency. This included costs associated with taking over the full building (basement to level 10) and adding s6(a) for a Secure Compartmentalised Information Facility (SCIF).
November 2017	100.0	NZDF's assessment of costs following quantity surveyor advice based on draft plans that took into account sub-tenant requirements, including enhanced security arrangements.
October 2018	110.0	NZDF's assessment of costs following further quantity surveyor advice based on final design.

We consider that the high-level and rough-order nature of the MBIE 2017 costing for the change in use to a secure facility meant there was a high risk that the estimate would prove to be inadequate and that additional costs would flow from the detailed design.

While construction industry cost escalation, and some other factors such as stricter seismic requirements, have had some impact on costs, security arrangements being put in place in Bowen State Building has been the prime driver of the increase in costs:

- the development of the SCIF is expected to cost between s6(a) rather than the s6(a) allowed for in MBIE's cost estimate, and
- other security related costs, for example external security and communication systems, have also added significant costs.

Security requirements mandated by the Cabinet approved Protective Security Requirements (PSR) appear to have largely driven the security costs. We are not in a position to comment on whether all costs attributed to these factors are reasonable or whether NZDF, and security agencies, had options in how the PSR requirements were implemented. We are not aware of NZDF commissioning any independent assessment of its implementation of the PSR standards. Undertaking an assessment of the reasonableness of NZDF's application of the PSR requirements would require specialist advice.

It is likely that some of the cost increases are the result of choices NZDF has made about the design and construction, for example the amount of space assigned to the SCIF and other protected areas. We are unable to confirm that this is the case or determine any resulting impact.

The failure to secure additional funding for the fit-out costs in Budget 2018 has provided NZDF with incentives to rigorously control costs. While time pressures prohibited a fundamental rethink of the design, cost savings have been identified in some areas but these have been offset by other cost pressures. We have been informed by NZDF that although

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risks still exist, it continues to closely monitor progress and tightly managing scope to limit cost-creep, and the project continues to be within the \$110 million budget.

s9(2)(g)(i)

Recommended Action

We recommend you:

- a **note** that the increase in fit-out costs for Bowen State Building has primarily been driven by the security arrangements, consistent with the Cabinet approved Protective Security Requirements, and
- b **note** that it is likely that some of the cost increases result from choices made by NZDF but specialist advice would be necessary to undertake an assessment of the reasonableness of NZDF's application of the Protective Security Requirements.

Colin Hall
Manager, Justice, Security & Government Services

Hon Grant Robertson
Minister of Finance

IN-CONFIDENCE**Treasury Report: Bowen State Building Fit-out Costs**

Purpose of Report

1. This report responds to your request for an assessment of the cost increases associated with Bowen State Building fit-out.

Background

2. The Wellington Accommodation Project Tranche 2 (WAP2) was originally formulated to implement a single procurement process to secure office accommodation for approximately 24 government agencies that had leases due to expire between 2017 and 2019.
3. A renovated Bowen State Building was identified as the future permanent home of a number of agencies, with the Ministry of Business, Innovation and Employment (MBIE) to be the head lessee with responsibility for construction of the fit-out, negotiation of the head lease, and arranging sub-tenants.
4. The Kaikōura earthquake had a significant impact on commercial office space in Wellington, with approximately 7 percent of available space lost due to buildings being severely damaged or closed for assessment. Many government agencies had their accommodation circumstances affected.
5. The New Zealand Defence Force (NZDF) occupied three buildings in Wellington that were impacted by the earthquake, including Defence House which was subsequently demolished. The Ministry of Defence (MoD) was also located in Defence House and both agencies temporarily relocated to the Freyberg Building.
6. As part of a WAP2 program reconfiguration in August 2017 Cabinet agreed to create a security and intelligence sector cluster at Bowen State Building on the basis there were benefits from grouping together agencies with similar security risk profiles and to “leverage the significant investment required to develop replacement Secure Compartmentalised Information Facilities (SCIF) for NZDF and MoD” [EGI-17-MIN-0218 refers]. NZDF was made head tenant, responsible for the negotiation of the development agreement and lease, including the split in responsibilities and costs between NZDF and the landlord, and construction of the fit-out.
7. To join NZDF as part of the security and intelligence sector cluster were:
 - the Ministry of Defence (MoD)
 - staff from Defence’s Security and Intelligence Sector Partners:
 - Government Communications Security Bureau (GCSB)
 - New Zealand Security Intelligence Sector (NZSIS)
 - Department of Prime Minister and Cabinet (DPMC)
 - the Inspector-General of Intelligence and Security (IGIS), and
 - staff overflow from Ministry for Primary Industries (MPI) unable to be accommodated in Charles Fergusson Tower next door.

IN-CONFIDENCE**Fit-out costs**

8. The capital costs of the construction of the fit-out have increased from the initial estimate of \$30 million in 2015 to the current budget of \$110 million based on NZDF's quantity surveyor estimate in October 2018. Annex A provides a breakdown of how costs have increased over time for each main category of expense.
9. MBIE's original estimate of the fit-out costs was based on a standard corporate-style fit-out for the ground to 6th floor, which was MBIE's expected footprint. On the basis of this estimate, \$30 million was put aside in a tagged capital contingency for WAP2-related costs. MBIE reassessed the costs in July 2017 and confirmed the 2015 estimate.
10. In August 2017 MBIE revised its estimate of costs to include all floors in the building (basement to level 10) and to include extra security-related costs, including a SCIF. This increased MBIE's high-level estimate of the costs from \$30 million to \$50 million.
11. Following its appointment as head tenant NZDF undertook a process to redesign the fit-out to meet its and sub-tenants' requirements. We understand GCSB, on behalf of Defence's Security and Intelligence Sector Partners, provided NZDF with the particular high security requirements of those agencies.
12. In November 2017 NZDF received a quantity surveyor estimate of the fit-out costs based on the initial consideration of the requirements of NZDF and its sub-tenant agencies. The design work had not been completed at this point so some cost estimates were only indicative. That estimate of \$100 million was double MBIE's costing. At this point the quantity surveyor estimate excluded a number of costs, for example raised floors for some parts of the building, ^{s6(a)} [REDACTED], and provision of 24/7 plant and equipment.
13. In October 2018 NZDF received a further quantity surveyor estimate based on the final construction design. That estimate identified a further \$10 million cost increase, taking the total estimated cost of constructing the fit-out to \$110 million.

Why the costs have increased

14. MBIE's \$50 million costing was a high-level, rough-order, estimate of the costs of developing a suitable secure facility. As a result there was a high risk that additional costs would flow from the detailed design.
15. Security requirements mandated by the Protective Security Requirements (PSR) approved by Cabinet in December 2014 [CAB Min (14) 39/38 refers] appear to have been the prime driver of the increase in costs. The whole of the building is designed to operate at a minimum of Restricted security level, compared to most government office accommodation that operates at the In-confidence level. Significant parts of the building have been designed with additional security requirements to provide for Secret and Top Secret classified material.
16. A tight construction market, caused by increased demand as a result of the earthquake and reduced supply in the industry, is likely to have contributed to some of the increase in costs. We have not been able to accurately determine the extent of this impact, although the "other non-residential buildings" component of the Capital Goods Price Index increased by 17.7% between June 2015 and March 2019.

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17. Other contributing factors to the increase in costs include:
- additional seismic requirements to meet consenting conditions subsequent to the Kaikōura earthquake
 - the change in use resulted in sunk costs for MBIE of around \$2.5 million and NZDF compensated MBIE for these costs, and
 - exchange rate impacts.
18. Space allocation within the building is within the Cabinet endorsed GPG guideline for office space density of between 12 - 16 square metres (m²) per person. The building has an average density of 14.3 m² per person, including common areas. If the common areas are excluded, NZDF occupy around 75% of the space at 11.8 m² per person, the Ministry of Defence occupy around 10% of the space at 11.5 m² per person, and Security and Intelligence Partners occupy around 15% of the space at s6(a)

Cost of constructing the SCIF

19. The PSR require that SCIFs are used to handle certain sensitive information. MBIE's allowance of s6(a) for the construction of a SCIF was based on s6(a)

20. s6(a)

21. We are not able to comment on whether the size of the SCIF and the s6(a) are reasonable and represent value for money.

22. NZDF has yet to conduct an analysis of the SCIF costs based on the 2018 quantity surveyor estimate, though it does not expect the final cost to exceed s6(a). It previously calculated the cost to be approximately s6(a) based on the 2017 quantity surveyor's report.

Other security-related costs

23. The design also includes one floor and small areas of some other floors that enable agencies to handle information that is highly classified s6(a). NZDF have not conducted an analysis of the quantity surveyor reports to determine which costs are directly attributable to constructing these secret areas.
24. Additional costs¹ have also resulted from other security "requirements". In some cases this has caused responsibility for the relevant costs to transfer from the landlord, who is responsible for the "base build", to NZDF.

¹ Any costs referenced in this paragraph are whole of building costs, so a portion of the costs are counted within s6(a) SCIF costs.

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- PSR-mandated design standards for physical security result in additional costs to control access to the building through doors, grates, windows and ventilation systems, and the use of external bollards, speed gates, special and accredited locks, and guard postings.
- In order to address fire egress issues through secure areas, special fire egress passages outside of secure areas have been built on most floors.
- Given the use of the building, the fire suppression systems are required to be of a higher specification and we understand this is estimated to have added around \$7.5 million to the costs.
- Higher specification air conditioning and temperature control systems have added costs of around \$1.7 million.
- Ensuring systems can continue to operate in the event of a power outage has added \$6.4 million - \$2.8 million for a diesel generator and \$3.6 million to install a generator in the basement, including excavation and structural strengthening works.

• s6(a)

•

25. NZDF explain that further factors in the cost increase are:

- meeting country of origin requirements for key materials and equipment, and
- additional seismic costs to meet Wellington City Council consenting conditions, particularly for mechanical, electrical and fire hardware specific to security features.

26. We have not been able to ascertain whether NZDF had options in how the PSR requirements were implemented. NZDF considers it has met rather than exceeded the relevant standards and it has taken a risk based approach to areas of non-compliance. However there may have been opportunities to s6(a)

Given the complexity of the security requirements, specialist advice would be needed to determine whether lower cost options were available while retaining consistency with the PSR standards.

27. The role of MBIE's Government Property Group (GPG) appears to have been limited once lead agency responsibility transferred to NZDF in 2017. We understand NZDF considered GPG engagement to be of limited value because it lacked experience in building the kinds of secure facilities required.

28. s9(2)(g)(i)

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29. The failure to secure additional funding for the fit-out costs in Budget 2018 has provided NZDF with incentives to rigorously control costs. As the lease on the Freyberg Building has a finite termination date of 31 October 2019, time constraints prohibited a fundamental rethink of the design. While cost savings have been identified in some areas these have been offset by cost pressures in other areas.

Current situation

30. NZDF has confirmed that the works are currently close to 80% complete and remain within the \$110 million budget. It commented that while it continues to closely monitor progress and tightly manage scope to limit cost-creep, it cannot yet have confidence that the works will be completed within budget. We understand the contingency included in the budget has already been exhausted.
31. Construction prices for approved tranches of works have been agreed with the main contractor, which has reduced the risk profile considerably. NZDF has identified the key risks to remaining within budget as:
- unexpected issues that may be identified during implementation of design (either construction or IT)^{s6(a)}
 - fluctuations in exchange rates^{s6(a)}, and
 - unexpected issues raised by the landlord or Wellington City Council as part of the building compliance approvals process.
32. The works are currently timed for completion at the end of September. As the project moves closer to completion these risks are reducing.

Other relevant information

33. Following an unsuccessful Budget 2018 bid for an additional \$35.0 million to help fund the increase in fit-out costs, the costs of the fit-out are being funded from a combination of:
- \$30.0 million from the WAP2 tagged capital contingency
 - \$36.7 million from insurance pay out of material damage policy for fit-out of Defence House, and
 - the balance of \$43.3 million from within NZDF's baselines.
34. The increased capital costs of the fit-out have flowed through to increased operating costs for sub-tenant agencies in the form of higher depreciation and capital charge costs. Most sub-tenant agencies sought, and were provided with, funding to meet these cost pressures in Budget 2019.
35. We understand that the higher costs resulted in the Ministry of Primary Industries seeking alternative accommodation. Despite high demand for office space in the Wellington CBD, NZDF (with MBIE's assistance) has not been able to secure another sub-tenant. As head tenant, NZDF is responsible for meeting the costs of any vacant space and we understand that NZDF has decided to reallocate its Wellington office space to utilise the space.

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Annex A: Breakdown of costs of the fit-out of Bowen State Building (\$ million)

	MBIE 2017 Estimate Ground - L6	MBIE 2017 Estimate Basement - L10	NZDF 2017 QS Estimate Basement - L10	NZDF 2018 QS Estimate Basement - L10
Variances requested to the base build	6.294	8.500	s6(a)	
Design fees	1.094	1.470	\$2.500	2.685
Hard fit-out	6.475	8.700	s6(a)	
s6(a)		s6(a)		
Professional and legal fees	2.990	4.100	4.600	6.480
Soft fit-out (furniture, furnishings, etc.)	4.460	6.000	8.000	6.500
Audio-visual	0.135	0.190	s6(a)	
Cabling, communications and data	0.548	0.740		
Network, switches and on-desk install	0.880	0.880		
NZDF specific on-desk computers				
Security	0.690	0.930		
Wellington electricity costs			4.500	0.200
Consent fees & levies	0.150	0.210	0.250	0.365
Insurance			0.670	0.670
Additional MBIE/NZDF resources	3.120	4.200	5.000	5.050
MBIE sunk costs covered by NZDF				2.500
Escalation	0.423	0.570	1.120	0.250
Construction contingency	1.502	2.100	3.890	4.254
Programme contingency	1.238	1.554	6.573	
Total	30.000	50.144	100.000	110.000

s6(a)