

PART B

THE IMPACTS OF HERITAGE REQUIREMENTS ON THE FINANCIAL VIABILITY OF INDIVIDUAL DEVELOPMENT PROPOSALS

Prepared by

THE NEW SOUTH WALES DIVISION OF THE
AUSTRALIAN PROPERTY INSTITUTE

For

The NSW HERITAGE OFFICE

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EXECUTIVE SUMMARY

This Consultancy Report has been prepared in respect to a research project which has been undertaken by the New South Wales Division of the Australian Property Institute in accordance with instructions received from the New South Wales Heritage Office. The NSW Heritage Office was commissioned by the NSW Heritage Council's Economics of Heritage Listing Working Party to manage this research project on a day-to-day basis. The NSW Heritage Council is acting on behalf of the national Heritage Chairs and Officials.

The project was created under the working title of the Economics of Heritage Listing Consultancy, where the stated objective was to produce guidelines to enable the preparation and assessment of economic and financial information submitted in development applications involving heritage items and heritage conservation areas. The project was divided into two parts, Part A (a 'macro' study of Social and Community Economic Costs and Benefits arising from heritage listings) and Part B (a 'micro' study of the Impacts of Heritage Requirements on the Financial Viability of Individual Development Proposals).

The NSW Division of the Australian Property Institute was charged with the task of addressing Part B of the project, which accordingly is the subject of this Report. Approval was also received from the client to investigate the economic impacts in respect to heritage listings in existing-use passive investment properties, in addition to adaptive re-use redevelopment scenarios. In accordance with the Consultancy Brief, our study is confined to a focus on commercial investment properties (as opposed to residential properties) in the urban environment.

Our research methodology was based on the Case Study approach. Seven case studies were selected for this Part B component of the consultancy. Of these, five heritage-listed commercial property examples were selected from the central Sydney Commercial Business District. A further case was selected from the Parramatta CBD, which comprises a major commercial and heritage precinct in its own right, located some 20 kilometres west of the Sydney CBD. A final case at Maitland, some 170 kilometres to the north of Sydney, was selected as an example of a country-regional adaptively re-used and commercially redeveloped property.

The Sydney CBD cases are geographically dispersed throughout the central city precinct and comprise a variety of characteristics in terms of property size, age, condition and the nature of commercial use. Similarly, there is a considerable variety in the character of the properties in heritage significance terms.

Our case studies confirm the highly individual nature of heritage items, which is already a well-documented aspect of the heritage system. The highly individual nature of commercial property assets, per se, in their own property sub-markets, has also always been an acknowledged consideration in professional property practice. This historical rule of the market place is also confirmed in our case study series. No two commercial properties are ever *exactly* identical, no matter how many elements of outward or more inward similarity they may possess.

We are mindful that this Report is intended for distribution to and readership by a variety of interested parties throughout Australia. To this end, we have selected a series of Case Studies which we trust will be sufficiently cross-sectional and representative in their nature so as to be readily usable for comparison purposes in various other heritage and market environments throughout Australia.

In each of our case studies we have examined, in some depth, the nature and degree of heritage significance of each property example. We have also explored the fundamental property characteristics of each case in their respective sub-market. Four of the cases comprise redevelopment examples, while three cases comprise examples of passive investment assets, thereby making up our total of seven cases.

Accordingly, this Report has divided the findings and conclusions into two categories - those from the adaptive re-use / redevelopment standpoint, and those from the existing use / passive investment standpoint.

In the heritage redevelopment context, we have found that the basic orthodox market-related principles which govern ordinary *non-heritage* property development activity - that is, the desirability of pre-emptive market research, the identification and satisfaction of unmet market demand, the presence of suitable sub-market and property cycle conditions which are conducive to development taking place, and risk acceptance relative to estimated financial return - have also been first and foremost the fundamental factors influencing the decision of developers to commit to *heritage-listed* projects.

We have found that heritage considerations do not pre-empt the fundamental market-related factors in property development, but rather are simply part of the 'next step' which comprise property availability and development approval considerations in the normal routine of the property development process.

We have found that all four of the redevelopment case studies have comprised successful projects, both from the heritage preservation and financial viability perspectives.

In the three remaining case studies, which are passive investment examples (as opposed to redevelopment cases), we have concentrated upon the asset management perspective. We have found that all three heritage-listed passive investment property examples are currently performing satisfactorily for their owners in a commercial investment context - particularly in light of the recent purchase prices which the current owners paid for the subject properties in the market place.

In respect to the same three passive investment cases, we found that the subject heritage listings have an impact upon yearly operating costs which varies in scale from a moderate degree to only a very minor degree - this depends on a number of heritage-listing features, the individual nature of which varies in each case. In two instances, we also discovered several heritage-related factors which have an economic impact on property performance from a longer-term life-cycle costing and value maintenance / enhancement perspective. These factors are commented upon in some detail within our Part 4 Case Study Findings and Part 5 Conclusion within this Report.

To complete this Report, we have also provided what we believe are relevant suggestions for future avenues of meaningful and fruitful research in the broad *Economic Impact of Heritage Listings* theme of study. These suggestions are briefly presented at the very end of Part 5 of this Report.

In summary, the chief objectives of this research consultancy are linked to the development economics of heritage-listed commercial property assets. Accordingly, our main findings from this Consultancy Report are as follows :

- In property development terms, economic viability is dependent upon pre-emptive market-related factors which are not generally related to heritage considerations.
- The individual nature of the heritage listing in each redevelopment case study was such that it did not deter project commitment by the developer. Nor did the heritage listing in any of the four redevelopment cases negatively affect the direct financial feasibility of the project - in particular, *future* economic performance expectations were seen to most favourable in each of our four examples.
- The overall Project Costs in our heritage-listed redevelopment case studies were increased to a mild degree as a result of the heritage listing in each example. However, such costs were inevitably recovered, and in fact were counterbalanced and far exceeded by, the commensurate increases in Project Value which flowed into each of the three Sydney CBD schemes via the

development incentives provided. In particular, substantial Floor Space Bonuses provided a key financial and economic incentive in each of the three Sydney CBD redevelopment cases. Rating and taxing subsidies, to various degrees, further contributed to a positive economic impact in overall terms, linked directly to the heritage listing.

PART 1

Introduction

1.1 The 'Economics of Heritage Listing' Consultancy. Background / Preamble.

This Consultancy Report has been prepared by the New South Wales Division of the Australian Property Institute (the consultant), in response to an Instructional Brief received from the New South Wales Heritage Office (the client).

The Brief was first forwarded to the consultant in Draft form early in 2000, and the consultancy agreement between the parties was legally formalized on 6 June 2000.

The proposal for this Consultancy Project first arose in 1997 as a consequence of an earlier *Economic Effects of Heritage Listing Study* completed in July 1995 which was funded by the national Heritage Chairs / Officials. The NSW Heritage Council, being a member of the national heritage group, resolved to establish an Economics Of Heritage Listing Working Party to further explore the issues raised by the 1995 national study.

These efforts culminated in the creation of the current 2000 Economics of Heritage Listing Consultancy Project. It was agreed that the project be steered by the NSW Heritage Council's Working Party, and that it be managed on a day-to-day basis by the NSW Heritage Office.

This immediate Consultancy undertaking and report assembly, conducted by the NSW Division of the Australian Property Institute, could not have become a practical reality without the considerable preparatory work conducted by Mr Ian Kelly, Principal Heritage Officer, NSW Heritage Office, and Mr Michael Collins, Deputy Chair of the NSW Heritage Council. Mr Collins had been appointed to the Heritage Working Party in 1997, and in his additional capacity as New South Wales Divisional President of the Australian Property Institute, played the key role in arranging for the involvement of the API as one of two chief consultants.

1.2 Objectives of the Consultancy and Client Instructions.

In its original format, the Brief focused upon a central stated objective, which was as follows :

The objective of this consultancy is to produce guidelines to enable the preparation and assessment of economic and financial information submitted as part of development applications involving heritage items and heritage conservation areas (HCA's) in a standardized, comparable and easily understandable manner. To maintain a manageable scope of work, the study will focus on commercial (non-residential) properties in an urban environment.

The Working Party divided the project into two sections - firstly, a Part A 'macro' cost / benefit study from a wider community-value perspective, and secondly a Part B 'micro' cost / benefit study from an individual development project / developer's perspective.

Professor Peter Abelson of Macquarie University was appointed as the chief consultant for the Part A study. The NSW Division of the Australian Property Institute was appointed as chief consultant for the Part B Study.

The API in turn appointed Mr Colin Dominy of the University of Western Sydney as its representative in the consultancy task, to undertake the relevant field-based investigations and to prepare the Part B Final Report.

This Report therefore addresses the requirements of the Part B Study, as per the Instructions contained in the Brief.

At a meeting held at the Australian Property Institute's Sydney offices on 21 February 2000, the Institute was provided with additional, more finely-tuned verbal instructions in respect to the Part B Study. The additional instructions provided for the preparation of field studies, focusing specifically upon the financial viability and economic performance of heritage-listed commercial investment properties of various grades and types, with a particular emphasis placed upon properties which had been the subject of major recent development schemes.

The thrust of the verbal instructions revolved around the stated intention to distribute the Part B Study outcomes on a nation-wide basis. Additional to the

Report being distributed to Heritage Authorities throughout Australia, it was anticipated that commercial property developers and investors might also benefit from the contents and outcomes of the Study.

It was confirmed at the February 2000 meeting that the concept of statutory heritage protection tends to be somewhat negatively regarded by some sections of the commercial property development and investment industry. The parties to the meeting discussed the proposition that much of this generalized negative perception has arisen, possibly as a result of past information entanglements, inaccurate commentary and reporting, hearsay and the like, the nature of which has constituted a combination of part fact and part fiction. It was thus agreed at the February meeting that one of the key strategic objectives of this Consultancy was to '*sort out the facts from the myths*' surrounding the true economic effects of heritage listings on commercial properties, as they exist in real-world situations.

On a tactical level, the following areas of study were consequently identified as a means of addressing the overall strategic objectives :

- an examination of the direct impacts of heritage listing requirements on properties which were the subject of major development schemes.
- an examination of the restrictions and mitigating factors on development, arising out of heritage controls on individual commercial properties.
- an examination of the countermanding and offsetting heritage-related inducements, management policies, and financial incentives conferred upon commercial development proposals by the relevant heritage authorities in the same development scenarios, the anticipated nature of which would likely contribute significantly to development viability.
- a cost / benefit analysis of the financial feasibility of individual development schemes in light of the above three avenues of investigation - subject to available information from property industry sources.
- an examination of the impact of heritage controls upon the ongoing economic and financial performance of so-called passive (or 'standing') commercial investment properties, particularly from a property asset management and life-cycle costing perspective.

The methodology and scope of study in this Consultancy was consequently formulated in light of the above strategic and tactical implications, and also the budget and resources available for the work to be conducted.

1.3 Research Methodology - Case Study Approach.

It was agreed between the parties that the central thrust of the Consultancy should be conducted via a series of Case Studies. The selected Case Studies were chosen with the intention of providing a representative cross-section of different commercial property scenarios, including examples which had been the subject of recent major redevelopment schemes, as well as examples of passive (or 'standing') investments.

Consequently, the chosen Case Studies involve a variety of different types of commercial property assets, and a range of various commercial pre-existing uses and adaptive re-uses. Each property in the study series contains characteristics such as size, age, location, and volume / magnitude of development, which varies considerably across the spectrum of properties so selected.

A total of seven (7) cross-sectional Commercial Case Studies was thus decided upon. It was anticipated that the selected examples would, by their nature, be sufficiently similar and comparable in thematic terms so as to possess readily usable applications for heritage managers, property developers, and property investors who operate in Australian urban heritage and economic environments outside the limiting boundaries of New South Wales.

Much of the deliberate differentiation in the case studies is expressed through the relevant project cost and sales-pricing levels which apply to the properties chosen for study. For example, in the four cases out of seven which constitute major redevelopment projects, the range of Total Project Cost varies from as little as \$680,000 extending to over \$600 Million at the top end of the series spectrum.

In respect to the remaining three cases which constitute passive investment assets, recent market acquisitions by new owners were recorded at price levels of \$6.5 Million (Case No. 7), \$7.5 Million (Case No. 2), and \$66.5 Million (Case No. 3).

Thus it can be seen that in our selected study series, scenarios are invariably encountered where the economic stakes are very high indeed.

Similarly, it was anticipated that the particular nature and degree of heritage significance attaching to each Case Study property would vary considerably. Although the specific heritage characteristics of each Case Study property were unknown at the outset of study, it was anticipated that by exploring the heritage merits of each case in detail, the highly individual nature of heritage significance and affectation which attaches to different properties in the real world would be clearly demonstrated.

It was agreed due to the thematic objectives and also budgetary and resource constraints that the focus of study should be centred on commercial examples located within the Sydney Central Business District - as opposed to a broader study encompassing heritage cases in the various built environments of other capital cities and regions around Australia. Consequently, the majority of the Case Studies conducted for this Consultancy are situated within the confines of the local government area administered by the Council of the City of Sydney.

However as part of a wider strategic and thematic objective, two properties located outside of the Sydney CBD were chosen for inclusion in the study series. These properties comprised a Sydney Suburban Regional CBD example (at Parramatta) and a Regional Country-based example (at Maitland, on the central eastern seaboard of New South Wales).

1.4 The Seven Chosen Case Studies.

In summary form, the seven Case Studies selected for the purposes of the Part B Consultancy task are as follows :

Case No. 1 The Sydney GPO Redevelopment Project

This case constitutes a redevelopment project of quite massive proportions, involving the preservation and adaptive re-use of the 1887 Sydney GPO building. The adaptive re-use scheme provided for the addition of major non-heritage commercial buildings and uses on land immediately behind the heritage building. The completed project constitutes an integrated mixed-use development scheme comprised of a 5-star international hotel, plus up-market retail, food-court, recreational and contemporary office-building elements.

Case No. 2 60 Macquarie Street, Parramatta

This case comprises an 1842 colonial residence located in the heart of a major suburban regional heritage precinct of Sydney, where the heritage building has been adaptively re-used as two-storey commercial offices since 1979. Further, a seven-storey non-heritage commercial office building was erected on side and rear land immediately adjoining the heritage building in 1979, and since that time both buildings have been operated as a combined commercial investment asset. This case is principally examined in its capacity as a passive ('standing') investment, as opposed to a development scenario.

Case No. 3 The Strand Arcade, George and Pitt Streets, Sydney

This case constitutes the only mainstream retail investment property in our study series. The building has been in existence since 1892, and is an acknowledged heritage landmark within the Sydney CBD precinct. The property was almost destroyed by fire in 1976 and many of the conserved current-day heritage characteristics of the building were, by necessity, reconstructed in their original forms. This case is principally examined in its context as a passive commercial investment asset.

**Case No. 4 The Medina Apartments Redevelopment Project,
Railway Square, Sydney.**

This case comprises a recently completed sizeable redevelopment project, well located amidst a major public transport hub and public infrastructure precinct on the southern extremity of the Sydney CBD. The 1913 six-storey heritage stone and brick building was custom-built as a government-owned Parcels Post Office, which by the 1990's had physically deteriorated due to technological change and disuse. The recent subject property redevelopment and heritage conservation proposals were included as part of a wider State Government pre-Olympic infrastructure renewal scheme at Railway Square. The property was redeveloped in 1999-2000 on the basis of an adaptive re-use scheme as serviced apartments. Included in the statutory approval was a provision for a roof-top floor-space addition which permitted the inclusion of some 20 extra apartments, or approximately 20% over and above the usable pre-existing floor-area volume.

Case No. 5 The Radisson Plaza Hotel, Pitt, Hunter & O'Connell Streets, Sydney.

This case constitutes a substantial commercial redevelopment scheme, based upon a comprehensive adaptive re-use of a 1928 former ten-storey office building known in the past as Wales House. The building enjoys notable prominence as a major Sydney CBD heritage asset, and considerable efforts were expended in the preservation of the heritage-significant external form and fabric of the building. The property has been adaptively re-used and completely redeveloped internally as a 5-star international hotel. A three-storey roof-top extension to the pre-existing building, representing a 14% increase in the effective Floor Space Index, was conferred upon the development scheme under the provisions of the Pre-Olympic statutory approval process for hotel uses.

Case No. 6 High Street, Maitland - Redevelopment Project - Adaptive Re-Use of Former Banking Chambers.

This case comprises our only country-based example in the study series. The subject property, which is in the final stages of redevelopment, comprises a fine three-storey 1888 former banking chambers. The internal and external form and fabric of the former banking chambers have been well preserved over time, however the property in an overall sense experienced an 8-year period of uneconomic disuse, neglect and asset-wastage prior to the recent acquisition and redevelopment by its new owners. The premises have been adaptively re-used as a ground-floor function / conference center, plus an upstairs bed-and-breakfast guesthouse. A notable feature in this case is the very positive attitude to the heritage aspects of the property which has been displayed by the new owners, a husband-and-wife local small-business enterprise.

Case No. 7 Moran House, Bridge Street, Sydney.

This case consists of a small, purpose-built six-storey office building, formerly known as Liner House, erected in 1961. As such, the property comprises the only example in our study series whereby a subject heritage-listed *office building* is currently devoted entirely to the type of use - in this case, owner-occupied commercial offices - for which it was first designed. This case also constitutes a somewhat unusual example of a *recently erected* heritage-listed building (in time-relativity terms). This example is principally analysed in

economic terms from the asset management perspective, where the focus is on the impact of the statutory heritage listing upon the annual operating costs and future life-cycle costing aspects of the building's financial performance.

1.5 Report Format and Other Content.

This Report has been assembled as a collection of 5 sequential parts.

The Case Study series which constitutes the core focus of this Consultancy is situated within the central, middle body of this Report, and is positioned as Part 3. This section occupies the greatest volume of the report work submitted.

The preceding section in this Report, Part 2 entitled *Developers and The Property Development Process*, is positioned so as to deal with a description and explanation of preparatory data from both the heritage and property development perspectives, prior to a reading of the case study analyses.

Part 4 of this Report consists of a summary analysis of Case Study Findings, evaluated under a number of centrally recurring heritage and economic themes which emerge from the Case Study series.

Part 5 of this Report contains an End Conclusion and Evaluation of this body of work in its entirety. A brief schedule of Suggested Themes for future heritage-related research is also provided, in an attempt to provide assistance for potential future directions of investigation by heritage authorities, property developers and commercial property investors alike.

It is with much pleasure and privilege that the following Report is presented.