

MAJOR PROJECT – Business Case

Project Name	Burns Beach Café / Restaurant and Coastal Node Redevelopment
Project Sponsor	CEO
Project Manager	Manager City Projects
Joondalup 2022 Key Theme	Economic Prosperity, Vibrancy & Growth
HP Records	INT21/14768

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1. INTRODUCTION AND BACKGROUND

1.1 Purpose of paper

This report is a business case and intended to provide sufficient justification for the City to proceed with:

- Burns Beach Coastal Node Redevelopment.
- Burns Beach Café / Restaurant.

This project has been active for several years, has continually evolved with ongoing internal reviews, consultancy, and frequent status reports to the Major Projects & Finance Committee. The last status report in September 2020 provided an outline of the latest design and scope and indicated that a business case would be prepared which this report addresses.

This report effectively consolidates all of the key aspects of all reports of the past few years into one report providing a definitive audit trail for the project.

1.2 Project Management Framework (PMF)

The City uses a standard project methodology for managing projects, the PMF. This business case, the financial evaluation and the project schedule align with the requirements of the PMF.

1.3 Out of scope

The following are out of scope for this report:

- Community consultation – this will be addressed in a separate report, being presented at the same time as the business case.
- Coastal Hazard Risk Management Action Plan (CHRMAP) – a separate analysis for the Burns Beach coastal node has been prepared and indicates no significant risk during the assumed term of the lease (42 years).

1.4 Coastal Node Redevelopment

There are several parts of the Burns Beach coastal node that would need to be addressed, such as parking, to fully support the Café / Restaurant. In other words there is no point in building a new facility without considering the overall surrounding area or implementing enhancements that are known to be required.

Therefore the project assumes that the Coastal Node redevelopment takes place at approximately the same time as the construction of the café / restaurant. The one-off costs for the redevelopment are included in this business case to give clear authority for those works and to also demonstrate that there is still a reasonable financial benefit to the City in carrying out those works at the same time as the café / restaurant is constructed.

2 OBJECTIVES

2.1 Project Philosophy and Parameters

The origins of the Café Kiosk Restaurant (CKR) project are from the Project Philosophy & Parameters that were adopted by Council on 22 June 2010 (*Item CJ103 – 06/10 refers*). The parameters have provided a framework for each of the CKR projects to work within and include a section on “Fiscal Responsibility and Commerciality” which includes the following:

“The principal objective is to develop high class, environmentally friendly facilities...This in turn will ensure the commercial viability of the business and a continuation of return on capital or land investment to the City.

It is anticipated that City will receive a commercial return on any capital investment made, or as a result of providing land as a development component.”

In addition, the parameters also refer to the social and economic benefits required from all CKR developments:

- advance the City's ability to attract visitors / tourists for entertainment and socialising
- provide more employment, increase business opportunities, a greater awareness of the City's natural assets and a greater social and economic contribution by tourists
- provide equitable community-based facilities that acknowledges and provides for the lifestyle and alfresco culture of Western Australia.

2.2 Quantified project objectives

It is now important to restate the project objectives and where possible to do so, to quantify them. By quantifying the project objectives will enable the options to be evaluated and will provide the success criteria by which the project should be measured in future stages and after completion.

The quantified project objectives have been considered against the standard project parameters of Cost Time Resource (CTR). The table below lists the five objectives, these encapsulate the requirements of the Project Philosophy and Parameters.

	Objective	Success Criteria	Measurement
1	<u>Time</u> Develop the area and build the Café / Restaurant within a reasonable timeframe.	Date of opening of Café Restaurant to the public.	This will be measured versus the Gantt Chart in the business case, estimated opening of August 2024.
2	<u>Financial Sustainability - City</u> A recurring financial benefit to the City which will pay back to the City the one-off investment costs in a reasonable timeframe.	i) Operating Surplus, after Depreciation - ii) Cashflow: The 42-year cashflow impacts are positive.	Business case will include financial evaluation based on all identifiable income and expenses. The objective will be evaluated after implementation using the City's financial systems.

	Objective	Success Criteria	Measurement
3	<u>Financial Sustainability - Operator</u> The operator's business model is viable and provides a reliable accessible service to the area.	Number of years that business continues to be viable.	This objective is simply measured by the continuity of business.
4	<u>Building and Coastal Node Development</u> The final design and construction of the area, and building, aligns with the design principles and goals as outlined in previous reports.	<ul style="list-style-type: none"> ○ North west orientation to protect patrons from sun and wind ○ Proximity to car parking ○ To not negatively impact the local residents, visually or acoustically ○ To take full advantage of the setting for the benefit of ratepayers. 	External architectural advisor to continue to assist with design review. Appointed builder and operator will evaluate the design and provide comment to the design principles.
5	<u>Social & Economic Return on Investment (SROI)</u> The provision of additional amenities will provide additional economic, tourist, visitation, social and community benefits.	The success criteria for SROI is the evaluation of the Benefits Cost Ratio (BCR). The BCR includes the core financial impacts of the project and an estimated monetary impact of social and economic benefits. The City has established a threshold of between 1.5 and 3.0 for the BCR, the higher the better. This project would be expected to be a high-scoring BCR and potentially more than 3.	The City can engage an external consultant to estimate the BCR for options within a project. Alternatively, the City can also evaluate options internally and provide comments on which option would provide a higher BCR than others.

3 OPTIONS AND SCOPE

3.1 Options

Throughout the last few years, there have been numerous options evaluated, the business case now summarises four options as follows:

- Do nothing – no coastal node redevelopment and no new Café / Restaurant
- Option 1 - Crown land leased, Operator builds Café / Restaurant
- Option 2 - Crown land purchased, City builds Café / Restaurant
- Option 3 - Crown land leased, City builds Café / Restaurant.

Note that for Option 2 the City has already attempted this, by submitting a business case to the Department of Lands but they have informed the City they are unwilling to sell the land and that the arrangement must be set up as a ground lease with them. Nevertheless, this business case has included Option 2 for comparison purposes.

3.2 Scope

The table below summarises the key features of each option, the key issues are:

- All options, except do nothing assume the coastal node is redeveloped which will result in additional operating expenses and depreciation/capital replacement.
- Option 1 and 3 assume the City arranges a ground lease with Crown, Option 2 assumes the City purchases the land from Crown.
- Café/Restaurant – option 1 assumes the operator builds, option 2 and 3 the city builds. All new options assume the operator fits out the café / restaurant to their desired specification.
- Option 1 would provide a much lower income stream to the City, a ground lease only, whereas option 2 and 3 would provide a higher income stream

Option Definition / Scope	Do Nothing	<u>Option 1</u> Crown land leased, Operator builds Café / Restaurant	<u>Option 2</u> Crown land purchased, City builds Café / Restaurant	<u>Option 3</u> Crown land leased, City builds Café / Restaurant
<u>Coastal Node</u>				
Redevelopment		✓	✓	✓
Existing expenses to maintain	✓	✓	✓	✓
Additional operating expenses		✓	✓	✓
<u>Crown land</u>				
Purchased by City			✓	
Ground lease paid by City		✓		✓
<u>Café / Restaurant</u>				
Built by operator		✓		
Built by City			✓	✓
Fit-out by operator		✓	✓	✓
Capital replacement: operator		✓		
Capital replacement: city			✓	✓
<u>Income</u>				
Market rent to City			✓	✓
Ground lease only paid to City		✓		
Rates: new income		✓	✓	✓

4 FINANCIAL EVALUATION

4.1 Financial evaluation background

The project has been subject to several financial evaluations during the past few years, with reports provided to Major Projects & Finance Committee throughout, this report will summarise the key inputs and outputs only.

4.2 Financial evaluation key parameters

Some of the key aspects of the financial evaluation are:

- Whole of life costings used, including one-off costs, recurring impacts, and depreciation.
- Escalation factors are included in the model, including an assumption that lease income increases by 1% more than CPI. This is considered a reasonable assumption because in reality the lease would be based on market reviews which could be expected to be above CPI. Additionally, the City's Strategic Financial Plan assumes that lease income to commercial operators will increase by 1% more than CPI.
- Model – the City has used its Project Financial Evaluation Model (Detailed), (01 July 2020) to summarise the cashflows.
- Phasing – capital costs are spread as per the project schedule as summarised at the end of the business case
- Term – a 42 year lease term is assumed and is included in the model. This is a standard term for leases of this nature. However, it should be noted that Crown have indicated that they will agree to a 21 year lease, with the potential to extend another 21 years, subject to an updated CHRMAP being prepared at that time. The financial impacts at both 21 years and 42 years will be subject to separate comment.

4.3 Establishment cost

The estimated capital costs including design costs but excluding escalation, are:

- Coastal node redevelopment \$3.2 million
- Café / Restaurant construction \$3.9 million
- Land purchase from Crown \$1.0 million (Option 2 only)

The City's standard approach to financial evaluations is to assume that borrowings are required so that a cost of interest (or lost earnings on reserves) is factored into the model. The actual funding of the project will be subject to evaluation as part of the annual update of the Strategic Financial Plan (SFP) and annual budget, and it is likely that all the capital costs can be funded from the Strategic Asset Reserve.

4.4 Recurring impacts

The scope of the recurring income and expenses was listed in the previous section, some of the key values within the financial evaluation are:

- Existing costs of maintaining Burns Beach Park are approximately \$60k per year – this is factored into all options.
- Market lease income, excluding escalation, for a café / restaurant built by the City is assumed to be \$314k per year, this was based on previous consultancy advice from similar developments along the Perth metropolitan coastline. This is relevant for Option 2 and Option 3. The \$314k is only indicative at this stage, this will be subject to further market testing and evaluation as part of the process for appointing an operator.

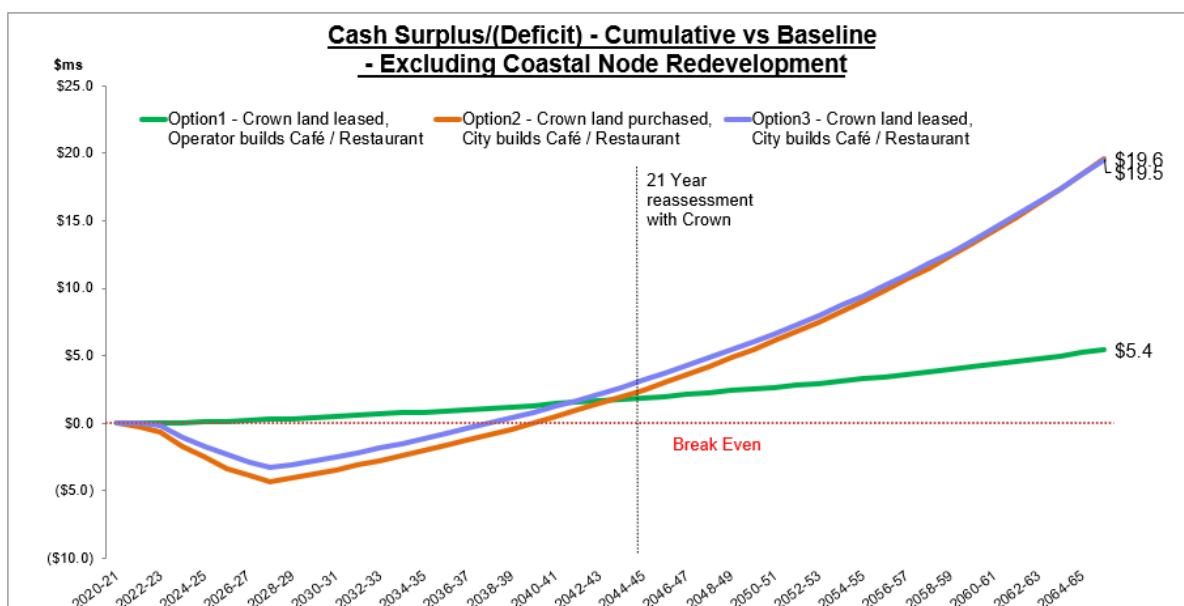
- Ground lease income payable to the City for a facility built by operator (Option 1 only) is assumed to be 25% of the market ground lease, this has been previously estimated by external consultant as \$45,000 per year.
- Ground lease of \$11,250 per year payable by the City to the Crown for Option 1 and 3. This is based on an assumption that the City pays the Crown 25% of the market ground lease (\$45,000), the 25% assumption is based on the agreement for the Café / Kiosk / Restaurant at Pinnaroo Point.
- Coastal node redevelopment is mostly upgrade/new infrastructure and will result in additional operating expenses and depreciation. An estimate of 2% of the capital cost for new operating expenses is assumed and 3% for new depreciation.
- Depreciation for the Coastal Node redevelopment is assumed to be 3% per year, this is a combined estimate which takes account of the higher depreciation rate for parks/public open spaces and a lower depreciation rate for civil infrastructure (paths, car parks, etc) as they have a longer life.
- Café / Restaurant owned by the City will result in depreciation/capital replacement of 2.4% per year, this is based on a 42 year life the same as the lease term.

The table below summarises the recurring financial impacts, excluding interest and excluding escalation. The key line is the bottom line which compares the recurring impacts versus the existing costs of \$60,000 per year, this indicates that Option 1 would worsen the recurring costs but Option 2 and 3 would provide a benefit. Option 2 has a higher benefit than option 3 because there is no ground lease payable to Crown in Option 2.

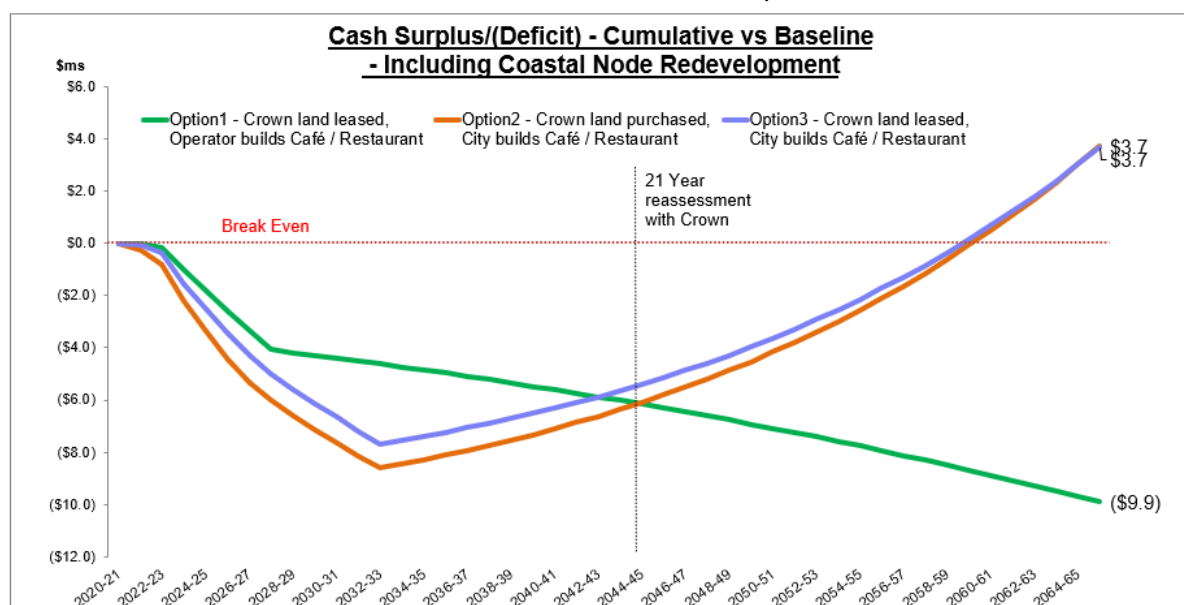
Operating Impacts excluding inflation and excluding interest		Base Do Nothing	Option1 Crown land leased, Operator builds Café / Restaurant	Option2 Crown land purchased, City builds Café / Restaurant	Option3 Crown land leased, City builds Café / Restaurant
Operating Income	\$000s		\$75	\$344	\$344
Operating Expenses, incl. Depn					
Operating Cash Expenses	\$000s	(\$60)	(\$135)	(\$134)	(\$145)
Depreciation	\$000s		(\$96)	(\$190)	(\$190)
Operating Expenses, incl. Depn Total	\$000s	(\$60)	(\$231)	(\$324)	(\$335)
Operating Surplus / (Deficit)	\$000s	(\$60)	(\$156)	\$20	\$9
Operating Surplus / (Deficit) vs Baseline	\$000s		(\$96)	\$80	\$69

4.5 Cumulative cashflow

The other key financial measure to evaluate the project is the overall cumulative cashflow, including the one-off costs and escalation. The first graph below shows the benefits of each option versus the baseline EXCLUDING the coastal node development i.e. just the cashflows for the café / restaurant itself. All three options provide a financial benefit when the coastal node is excluded prior to the expiry of the first 21-year lease term.



The second graph below then includes all of the one-off costs and recurring impacts of the coastal node redevelopment together with the café / restaurant. This shows that Option 1 does not provide a financial benefit because the lease paid to the City is low and does not allow the city to pay back for the investment in the coastal node. Meanwhile both option 2 and option 3 still provide a reasonable surplus after 42 years when the coastal node infrastructure is included. Both option 2 and option 3 do not provide a payback within the first 21 years when the coastal node redevelopment is included. There is very little difference between option 2 (purchase and own the land outright) versus option 3 (ground lease), although the cashflows exclude the terminal value that would exist in the land for option 2.



4.6 Sensitivity Analysis

The table below evaluates the financial benefit on Option 3 of two key assumptions, the Capital costs, and the Lease income. The starting point in the table is the value highlighted in the middle of the table which is the \$3.7 million benefit for option 3 versus the baseline as per the graph above.

The values to the left and moving to the top then show the worsening based on a combination of higher capital costs and lower lease income. Meanwhile the impacts towards the right and moving towards the bottom indicate how the impacts may be better if there was more income and/or lower capital costs. This table demonstrates that there would have to be an extreme set of circumstances to result in a negative financial impact e.g. 15% higher capital costs, 5% less income.

		Capital Costs higher or lower than estimated								
		20.0%	15.0%	10.0%	5.0%	0.0%	-2.5%	-5.0%	-7.5%	-10.0%
Lease income to city lower or higher than estimated	-20%	(\$5.5)	(\$4.7)	(\$4.0)	(\$3.2)	(\$2.4)	(\$2.1)	(\$1.7)	(\$1.3)	(\$0.4)
	-15%	(\$4.0)	(\$3.2)	(\$2.5)	(\$1.7)	(\$0.9)	(\$0.5)	(\$0.1)	\$0.2	\$1.1
	-10%	(\$2.5)	(\$1.7)	(\$0.9)	(\$0.2)	\$0.6	\$1.0	\$1.4	\$1.8	\$2.6
	-5%	(\$0.9)	(\$0.2)	\$0.6	\$1.4	\$2.1	\$2.5	\$2.9	\$3.3	\$4.1
	0%	\$0.6	\$1.4	\$2.1	\$2.9	\$3.7	\$4.0	\$4.4	\$4.8	\$5.7
	5%	\$2.1	\$2.9	\$3.7	\$4.4	\$5.2	\$5.6	\$6.0	\$6.3	\$7.2
	10%	\$3.6	\$4.4	\$5.2	\$5.9	\$6.7	\$7.1	\$7.5	\$7.9	\$8.7
	15%	\$5.2	\$5.9	\$6.7	\$7.5	\$8.2	\$8.6	\$9.0	\$9.4	\$10.3
	20%	\$6.7	\$7.5	\$8.2	\$9.0	\$9.8	\$10.1	\$10.5	\$10.9	\$11.8

4.7 SFP and Capital Works Program

























The draft SFP 2021 and adopted Capital Works Program (2021/22 to 2025/26) has included the capital costs for both the Coastal Node Redevelopment and the Café / Restaurant.

5 OPTION EVALUATION & RECOMMENDATION

5.1 Option evaluation

A project needs to be evaluated against all of the project objectives (CTR), not just the financials. The table below is a RAG (Red Amber Green) analysis for each option against the five objectives listed earlier. The differences between the scores are as follows:

- Time – Option 1 and Option 3 have a project schedule that can be mostly led by the City (although there are potential risks to the timescales) and therefore scored green. Option 2 though, would have no end date because Crown have already stipulated to the City that they will not agree to selling the land, so if any attempt was made to reopen this issue it could lead to protracted discussion and inevitable delays, so option 2 is scored red.
- Financial sustainability (City) – Option 2 and 3 provide a clear financial benefit, including the coastal node redevelopment and scored green but option 1 is scored amber as it would not provide a return after all costs are included so amber.
- Financial sustainability (Operator) – Options 1, 2 and 3 would provide a positive outcome and all scored green.
- Building and coastal node redevelopment – one of the key considerations for the City to build/construct the café/restaurant by itself is so that it can control the design of the building as well as all other construction aspects – this is a key learning point from the development at Pinnaroo Point. Option 1 has a risk that if the operator builds it to their design it does not meet all of the required parameters so is scored amber.
- Social & Economic benefits – option 2 is again given a lower score than option 1 and option 3 due to the potential delay in opening the facility if another attempt is made to purchase.

Objective			Do Nothing	Option 1 Crown land leased, Operator builds Café / Restaurant	Option 2 Crown land purchased, City builds Café / Restaurant	Option 3 Crown land leased, City builds Café / Restaurant
1	Time	Develop the area and build the Café / Restaurant within a reasonable timeframe				
2	Financial Sustainability - City	A recurring financial benefit to the City which will pay back to the City the one-off investment costs in a reasonable timeframe				
3	Financial Sustainability - Operator	The operator's business model is viable and provides a reliable accessible service to the area.				
4	Building and Coastal Node Redevelopment	The final design and construction of the area, and building, aligns with the design principles and goals as outlined in previous reports.				
5	Social & Economic Benefits	The provision of additional amenities will provide additional economic, tourist, visitation, social and community benefits.				
SUMMARY						

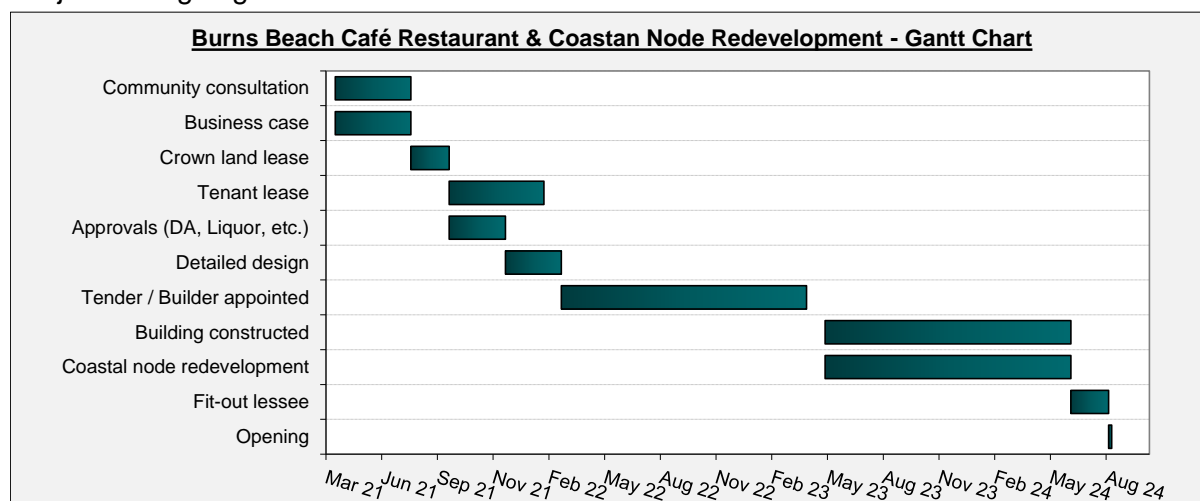
5.2 Recommendation

Based on the project objectives and the evaluation above, Option 3 provides the better overall outcome for the city and ratepayers.

6 NEXT STAGES

6.1 Key milestones

An indicative project schedule has been prepared for the project which includes both the coastal node redevelopment and the café / restaurant. The chart below summarises the key milestones for the project and indicates a target for opening of August 2024. This will be subject to ongoing review.



6.2 Disclaimer

This report does not contend that the financial projections will come to pass exactly as stated but are intended to give sufficient justification for the project to proceed. The projections are best estimates at this point in time but there is a level of risk and uncertainty in all the projections. The actual costs and income will vary, due to the following:

- Detailed design and specification.
- Crown lease negotiation.
- Operator lease negotiation
- Capital replacement estimates.
- Costs of power consumption

The financial projections will be updated at each stage of the project so that the confidence of the assumptions improves. At this early stage in the project, the financial estimates have a great deal of uncertainty.