

Proposed Sale of the Central Park Office Tower

by the Government Employees Superannuation Board



AUDITOR
GENERAL

Western Australia

performance
examination



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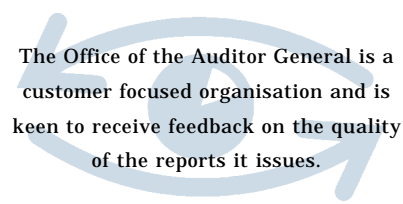
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Proposed Sale of the Central Park Office Tower

by the **Government Employees Superannuation Board**

Report No 2 – April 1999



A U D I T O R G E N E R A L

Western Australia



AUDITOR GENERAL

Western Australia

THE SPEAKER
LEGISLATIVE ASSEMBLY

THE PRESIDENT
LEGISLATIVE COUNCIL

PERFORMANCE EXAMINATION — Proposed Sale of the Central Park Office Tower by the Government Employees Superannuation Board

This Report has been prepared consequent to an examination conducted under section 80 of the *Financial Administration and Audit Act 1985* for submission to Parliament under the provisions of section 95 of the Act.

Performance examinations are an integral part of my overall Performance Auditing Program and seek to provide Parliament with assessments of the effectiveness and efficiency of public sector programs and activities, thereby identifying opportunities for improved performance.

The information provided through this approach will, I am sure, assist Parliament in better evaluating agency performance and enhance Parliamentary decision-making to the benefit of all Western Australians.

A handwritten signature in blue ink, appearing to read 'D D R Pearson'.

D D R PEARSON
AUDITOR GENERAL

April 21, 1999

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Proposed Sale of the Central Park Office Tower

Conclusions

- *The Board has long recognised the prudence of reducing the exposure of the Fund to property while at the same time diversifying its property holdings. The proposed sale arrangement would have enabled the Board to achieve this objective.*
- *The method of sale whilst practiced in the private sector is rarely used in the public sector.*
- *A more openly competitive sale process would have provided greater assurance regarding the adequacy of the price.*
- *The Board had not obtained the Treasurer's approval for that part of the proposed sale transaction involving investment in the Unit Trust.*
- *Transparency and public confidence would have been enhanced by:*
 - *appointment of a replacement independent expert to assist in the evaluation of proposals rather than relying solely on internal expertise.*
 - *clearly placing AMP at arms length from the GESB.*
 - *appointment of a probity auditor to oversee the process and provide assurance as to its integrity.*



Background

The Government Employees Superannuation Board (GESB) is the largest Western Australian superannuation fund, responsible for administering the superannuation entitlements of over 238 000 current and former public sector employees. The GESB manages an investment portfolio valued in excess of \$1.4 billion comprising substantial holdings in Australian and overseas equities, property, indexed bonds, cash and fixed interest securities.

The GESB was established under the Government Employees Superannuation Act 1987 (the Act) to manage the Government Employees Superannuation Fund (the Fund) for the purpose of maximising returns whilst having regard to exercising care and prudence to maintain the integrity of the Fund. The Act gives a seven member Board (the Board) overall responsibility for the administration and investment of the Fund and the management of the organisation. The Act, authorises the Treasurer to direct the Board on matters concerning investments and for the Minister to direct the Board in respect to any particular matter.

Property investments comprise approximately 22 per cent of the investments of the Fund. The Board has since the early 1990's made public its recognition of the need to diversify its property investments away from the current concentration of commercial properties in Western Australian. Fundamental to any diversification process is the sale of Central Park, a 65 000 square metre Office tower located in the central business district of Perth. Central Park's market value represents over 80 per cent of the property portfolio of the Fund.

In January 1998, the Board appointed AMP Property Management Ltd as property advisers for a two year period. Between April 1998 and June 1998, AMP provided the Board with a series of reports that advocated a shift in its property mix to a diversified portfolio of commercial, retail and industrial properties located across four States. The reports proposed both direct ownership and investment in an unlisted (pooled) unit trust whereby a number of owners would contribute properties in return for proportional unit holdings.

In mid August 1998, four property groups were invited to submit proposals for the part sale or exchange of assets for Central Park. This was in addition to the AMP which two days earlier had advised the GESB that it was preparing a proposal for consideration.

Background

In October 1998 after evaluating the submitted bids, the Board agreed in principle to the AMP proposal. This involved:

- Selling Central Park to AMP for an agreed price based on two independent market valuations.
- Creation of an unlisted property Unit Trust by AMP.
- Investment of part of the sale proceeds into the Trust. The Trust assets would comprise 30 per cent of Central Park¹ along with part ownership of like quality office towers owned by AMP in Sydney and Melbourne, the price of which would also be based on independent market valuations.
- The GESB acquiring about 48 per cent ownership of the Trust with the balance of the Units held by AMP and an Eastern State's public sector superannuation fund.

Between November 1998 and early March 1999, various due diligence procedures were undertaken including independent legal analysis of the suitability of the contract documentation and a review by the Valuer General of the valuation of Central Park and of the methodology used by the independent valuers in valuing the other properties.

In mid March 1999, the Board decided to not proceed with the sale because of:

- Implications for the unit trust arrangement from proposed changes to Commonwealth business tax laws.
- Valuation issues.

As at the end of March, the Board was reviewing its options for the sale of Central Park.

¹ The other 70 per cent of Central Park would be held separately by interests associated with AMP.



Examination Objective and Approach

Evaluate the proposed sale of Central Park against current best practice, including corporate governance, propriety and compliance with government guidelines.

The methodology involved:

- Documentation review.
- Discussions with relevant stakeholders.
- Enquires of other public sectors regarding property disposal practices.
- Employment of a consultant to advise on related corporate governance and probity best practice.

Findings

▲ Need to diversify

The examination found that the Board had prudently decided to diversify and reduce the property portfolio of the Fund by selling Central Park. Since the late 1980's, the Fund's property portfolio has comprised an over concentration of commercial investment properties in Perth (see Table 1).

Current properties	Commercial	Retail	Industrial/ other
Central Park	82%		
10 Kings Park Rd	3%		
Bullcreek Shopping Centre		14%	
Karri Valley			1%
Total	85%	14%	1%

Table 1 - the GESB's current mix of properties

All the Fund's current properties are located in Western Australia.

The Board has been aware for many years of the need to diversify its property portfolio and reduce exposure to market volatility. The need to diversify was noted by the Burt Commission in 1989, the Auditor General in 1990 and by consultants in the mid 1990s². The Board was also aware through approaches from various major institutional investors² of market interest

² Including AMP

Findings

in Central Park. However, in order to optimise returns the Board had chosen to not sell Central Park until it had progressed from the development stage to a near fully leased and operational building. That stage was reached in March 1997.

In January 1998, the GESB appointed AMP Property Management Ltd as property advisers for a two year period. This appointment was conducted through a tender process involving the Department of Contract and Management Services.

Between April and June 1998, AMP put to the Board three reports that advocated a major structural diversification of the property portfolio. Broadly, AMP suggested a property portfolio comprising a mix of property types across Australia with a target of 65 per cent direct ownership and 35 per cent in unlisted pooled unit trusts (Table 2) ³. The target mix of property by type and location was similar to that reported by the Property Council of Australia through its composite index of the actual spread of institutional assets in Australia. Crucial to the strategy was to sell all or part of Central Park by September 1999 so as to avoid anticipated market volatility in Perth.

On June 25, 1998 the Board approved the strategy 'in principle'. To meet the sale timetable of September 1999, the sale process was scheduled to begin by October 1998. The Board noted the lengthy period involved with due diligence and negotiation and decided that the process for reviewing alternate methods of disposal needed to be addressed quickly.

State	Commercial	Retail	Industrial/ other
NSW	30%	15%	3%
VIC	15%	12.5%	2%
QLD	5%	7.5%	
WA	5%	5%	
Total	55%	40%	5%

Table 2 - The target mix of properties as suggested by AMP

The target mix was based on enhancing returns and reducing exposure to single market volatility.



Key Finding: *The Board prudently decided to sell Central Park in order to diversify and reduce its exposure to property.*

³ The Board had been considering use of pooled property vehicles since at least 1996



Findings

▲ Sale process

Guidelines

Government guidelines on property disposal practices are not clearly applicable to Central Park. The Treasury Department has issued guidelines for managing real estate including property disposal though it is apparent that these guidelines are aimed at the disposal of surplus government assets rather than investment property of the nature of Central Park.

It is however, common practice for government assets to be sold by an open selling approach whereby all interested parties have equal opportunity to purchase. The underlying principals of this approach are to foster open competition and importantly provide assurance as to the adequacy of the price received.

Sale method

Two methods of sale were considered by the Board. These were; broad public tender and, negotiation with selected parties with a view to exchanging Central Park for cash and other property via a pooled unit trust arrangement.

Points considered by the Board in relation to public tender included:

- *“.... a fully visible process is undertaken to discover the true worth of Central Park”.*
- *would likely “...result in a cash sale. This does not directly meet the Board’s needs as it would then be required to enter the market to purchase suitable investment properties.*
- *A public tender would have the drawback that the Board “....would have less flexibility to develop favourable structures if an exchange is proposed. Bids would essentially be presented in a completed format with less opportunity to negotiate”.*
- *That “...it is AMP’s view that a significant premium over valuation would be unlikely due to a reasonably consistent review process adopted by most significant purchasers”.*

In relation to negotiation with selected parties, the Board considered the following:

- *An exchange of property for other assets “...allows the GESB to tie acquisition with disposal. It can potentially negotiate a more favourable outcome in terms of transition to a diversified portfolio”.*

Findings

- *“...a visible market price is not obtained, although this can be mitigated by a suitable valuation process for the exchange”.*
- *“...does not rule out a public sale process if a satisfactory arrangement can not be found”.*

Notwithstanding the advice from AMP, other advice received during this examination indicates that sale by public tender of quality property in particular can on occasions bring a ‘significant premium over valuation’. Other advice also indicates that a public tender could have been structured in such a manner as to avoid a sole cash sale whilst still providing flexibility for negotiation.

The method of sale as chosen by the Board is used in the private sector market. However, canvassing of other Australian public sectors found only two examples in the last ten years of significant property disposals that were based on assessed market value.



Key Finding: The method of sale selected by the Board:

- ***does not give a high level of assurance as to the adequacy of the price.***
- ***is practiced in the private sector though is rarely used in the public sector.***



Legal Compliance

The Treasurer has issued the Board with investment guidelines in accordance with Section 13 (3) of the Act, authorising:

- investment in equities including units in a listed or unlisted trust.
- the purchase or lease of land and property in Australia or a purchase of an interest in land and lease of property in Australia.

The guidelines also permit the Board to invest in ‘other asset classes’ provided *“...the investment is approved by the Treasurer on the basis of suitability in an overall portfolio context”.*

The proposed sale arrangement included investment by the Fund in a property unit trust. Such an investment would be an investment in ‘other asset classes’ and would therefore have required the approval of the Treasurer. The need to obtain the approval of the Treasurer was brought to light by the audit examination.



Findings

Subsequent to this advice, the Board was advised that the unit trust arrangement would not be viable under proposed reforms to Commonwealth business tax laws⁴. This advice was a major factor in the Board's decision to not proceed with the sale.



Key Finding: The Board had not obtained the Treasurer's approval for that part of the proposed sale transaction involving investment in the Unit Trust.



Management of the Transaction

In July 1998 the Board established a management framework for implementing its diversification strategy including sale of Central Park. This involved:

- The Board being responsible for high level policy decisions such as approving sale plans and purchase decisions.
- The Investment Division of the GESB being responsible for achieving the Board's goals including coordination of external consultants and advisers.
- Establishment of an advisory committee to the Investment Division, the members of which included two AMP representatives. The role of the AMP representatives included advice on implementation, ownership structures and negotiations.⁵

Significantly, the management framework did not include a probity auditor. Good practice suggests that for large, complex or controversial contracts, consideration should be given to the appointment of a probity auditor to provide external scrutiny and ensure integrity of the process, in particular of equity, value for money and best practice.

Over August 12 and 13, 1998, the Investment Division of the Board invited four property groups to submit proposals by the end of August. These groups were:

Lend Lease	A major property owner and adviser to several Funds
Macquarie Bank	A merchant bank with extensive contacts in the property market

⁴ the 'Ralph Report'.

⁵ AMP advice in respect to the sale of Central Park did not extend to advice on the evaluation of proposals.

Findings

Colonial Mutual	A major property owner that had previously presented proposals to the GESB
National Asset Management	A major property owner that had previously presented proposals to the GESB

These four groups were in addition to the AMP who advised the GESB at an advisory committee meeting on August 10, 1998 that they were preparing a product for consideration. However, the GESB had previously recognised the AMP's interest in developing a proposal in a letter to the AMP on July 2, 1998.

The Board's objectives for selling Central Park and acquiring other assets served as the criteria for evaluating the proposals. These were:

- Access the desired mix of assets by type and location.
- Optimise investment returns over the transaction period. ie: get the highest price for Central Park and the lowest price for the new assets whilst minimising transaction costs.
- Minimise ongoing management costs. ie: fees paid to the manager of the ownership structure.
- Maintain a degree of control over investment outcomes.
- Maintain liquidity levels.

On September 14, 1998 the Board considered an evaluation of the four submitted proposals and a recommendation by the GESB's Investment Division that negotiations continue with AMP and Macquarie. This was approved by the Board. No external independent experts were used in the evaluation to replace the AMP, who were precluded from assisting because of their conflict of interest.

On October 29, 1998 the Board endorsed a recommendation from the Investment Division to accept the AMP proposal. The Board noted improvements in AMP's proposal and accepted advice that the Macquarie proposal was still lacking in definition and firm commitment. The Board made an 'in principle' decision to accept the AMP proposal subject to a number of conditions including:

- Satisfactory valuations being determined for the exchange of assets.
- Satisfactory due diligence.
- Satisfactory documentation.



Findings

Elements of the tender process were found to fall short of good practice. For instance:

- The invitation to tender was by a phone call followed by a one-page facsimile. The facsimile did not specify the criteria by which the proposals would be evaluated.
- No documentation to show that the Board approved the criteria in advance of their use in evaluation of the proposals.
- No minutes of meetings between representatives of the GESB and the tenderers were on file.

On February 1, 1999 the GESB formally requested the Valuer General of Western Australia to give an opinion on the independent valuations of Central Park and the methodology used in the assessment of the other properties to be included in the unit trust.

On February 8, 1999 the two independent valuations of Central Park were consolidated to give an average price of \$265 million. Under the agreed process, \$265 million became the sale price subject to due diligence procedures and Board ratification. This was about \$14 million above the June 30, 1998 annual financial statements valuation.

On March 4, 1999, the Valuer General's Office reported to the Board that the likely valuation range of Central Park was \$266 million to \$272 million, but that it should be valued "*...at the higher end of the range*". The Valuer General also reported that the methodology used by the independent valuer employed by the Board to value the Sydney and Melbourne properties to be included in the Unit Trust, was appropriate. However, the Valuer General reported that the valuer for the AMP had not provided the valuations and reports relating to these Eastern States properties.

On March 19, 1999 the Board decided to not proceed with the sale arrangement, citing concerns about proposed changes to Commonwealth business tax laws and the valuation of Central Park in light of the Valuer General's findings. However, the Board has stated that it "*...remains firmly committed to its diversification strategy and is currently considering a number of options in regard to the sale of Central Park*".

Findings



Key Findings: *The sale process was not managed with a view to ensuring transparency and a high level of public confidence. In particular:*

- *The Board did not engage a replacement independent expert to assist in evaluating the proposals once the AMP elected to put forward a proposal, instead relying solely on internal expertise.*
- *The Board did not clearly put the AMP at ‘arms length’ throughout the transaction. AMP’s role on the advisory committee which included some matters associated with the sale put at risk public confidence in the openness of the process.*
- *The Board did not appoint a probity auditor to oversee the process and provide assurance as to its integrity.*

However, by inviting the Valuer General to assist in the due diligence process, the Board moved to enhance public confidence.

Recommendation

- *For future significant investment transactions, the Board as a matter of course should:*
 - *use a public and transparent process.*
 - *ensure evaluation of proposals is demonstrably independent.*



Appendix 1: Sequence of Events

1993 to 1997	→	The Board obtains diversification advice from various sources and is approached by a number of property groups expressing an interest in Central Park.
July 1997	→	The GESB advertises for property advisers.
January 1998	→	AMP selected from seven proponents and are appointed for two year term.
April to June 1998	→	AMP submit three property diversification and strategy reports which the Board accepts in principle.
August 12 to 13, 1998	→	Four groups invited to tender on Central Park. AMP had earlier advised that they were preparing a proposal.
September 14, 1998	→	Board shortlists AMP and Macquarie.
October 29, 1998	→	Board accepts 'in principle' the AMP proposal.
Nov 1998 to Mar 1999	→	Due diligence procedures undertaken including legal advice and review by the Valuer General.
March 19, 1999	→	The Board decides to not proceed with the sale.