

NRC Harbour Board Building Options: Peer Review.

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Executive Summary

This document reviews the two feasibility studies commissioned by WDC from Deloitte for the 2 main options for the redevelopment of the old Harbour Board building.

Of the two proposals, the Forward Whangarei proposal (“Harbourside”) is the least well developed and consequently carries greater uncertainties, particularly around operational expenditures.

The main uncertainties of both projects, however, are the operating revenues, derived from visitor forecasts and pricing strategies. Deloitte set out break even targets for both projects at 95,000 visitors (i.e. paying visits) but based on different price assumptions.

Our recommendation is that, whichever proposal is chosen by ratepayers, should move to the development of a marketing strategy (including a pricing strategy) before implementation. This, in our view, will be the best protection for ratepayers against unexpected operating losses.

This process will also allow for some fine tuning of the proposals to better meet the needs of the market.

Despite these uncertainties, the proposals are quite different in concepts and offer ratepayers a real choice of direction.

1 Our Brief:

To undertake Peer Review in tandem with Deloitte for the NRC Building options. Focus on visitor numbers and entry fee.

2 Background Documents:

Our focus is on the Feasibility studies for the 2015 HWMAC and Harbourside proposals and the summary comparison. The other documents provide background understanding of how these proposals came about.

Author	Title	Date Published	Date received at Nexus
Prosper Northland Trust	Revised proposal	undated	4/2/15
Crowe Horwarth	Peer Review of Deloitte 2011 Feasibility Study	9/10/14	4/2/15
Deloitte	Hundertwasser Feasibility Study	29/9/11	5/2/15
Future Whangarei	Revised Harbourside Proposal	19/12/14	5/2/15
Future Whangarei	Original Harbourside Proposal	October 2014	13/2/15
Hundertwasser Foundation	Agreement with WDC	20/12/12	13/2/15
WDC	Assessment of 2 proposals	undated	13/2/15
WDC	Assessment of shortlist	12/11/14	13/2/15
Visitor Solutions	Initial Market Appraisal and preliminary Economic Impact Assessment for Hundertwasser Art Centre	April 2011	19/2/15
Deloitte	1 st Draft 2015 HWMAC Feasibility Study	25/2/15	25/2/15
Deloitte	3 rd Draft 2015 HWMAC Feasibility Study	3/3/15	3/3/15
Deloitte	Draft Harbourside Feasibility Study		
Deloitte	Comparison Summary	20/3/15	20/3/15

3 Working Relationship with Deloitte

Nexus has worked closely with Deloitte on the Peer Review with Deloitte supplying the background documents and explaining the approach. Nexus has responded with several suggestions some of which are reflected in the final report.

4 Background

Proposals for the redevelopment of the old NRC/Harbour Board building have a fractious history. The latest chapter is set for a public binding referendum in May 2015 where the ratepayers of Whangarei District will be asked to vote for one of 3 options:

- The Hundertwasser Wairau Maori Arts Centre proposal, promoted by the Prosper Northland Trust (PNT)
- The Harbourside proposal, promoted by Future Whangarei (FW)
- An option to demolish the building and turn it into a park

Feasibility studies have been prepared for the first 2 proposals by Deloitte, as well as a comparison summary, and Nexus Planning and Research have been commissioned to conduct a peer review with a focus on the visitor numbers and pricing strategies.

Both projects are described as catalysts for future economic prosperity of the District derived from an expected increase in the number of visitors to Whangarei.

5 Acceptance of Information Provided

While this is a peer review of 2 feasibility studies there are many background documents that were used as sources of information for the analysis which have not been formally reviewed as to their veracity or authenticity. These include:

- Estimates of capital costs associated with the proposals
- Memorandums of understanding between parties referred to (e.g. between PNT and the Whangarei Arts Museum Trust (WAMT) regarding guarantees for operating losses and between PNT and the Hundertwasser Non Profit Foundation (HNPF) to supply exhibition items at no cost apart from shipping and insurance).
- Existing and likelihood of Building and Resource Consents being granted.
- Legalities around building ownership and future responsibilities.
- Criteria for obtaining large grants for the projects.
- Comparability of other local attractions for comparison with proposals (particularly with the Harbourside proposal).
- Accuracy of calculations in the Deloitte financial models

6 Feasibility study approach:

We have taken, as a starting point, the terms of reference (TOR) for the feasibility studies supplied by Deloitte.

These TOR outline what is required in the feasibility studies as:

- An analysis of risks around securing capital funding required for the 2 projects
- A review of financial forecasts and ongoing funding requirements for both projects, including the basis of forecast visitor numbers, ticket prices and assumptions regarding operating expenses
- A sensitivity analysis which addresses ticket price elasticity
- Review and document ownership and governance models, highlighting any risks to Whangarei District Council (WDC)
- Develop comparative information for the binding referendum in relation to:

- Capital expenditure
- Ongoing operating expenditure
- Revenue assumptions, pricing and visitor numbers

Implicit in these TOR is the required scope for the comparison as one that compares the ideas, governance arrangements and the financial costs of the two projects and any associated risks.

The studies adopt a break even analysis as the central framework which seems appropriate and highlights the uncertainties around the forecasts of visitor numbers and revenues.

Missing from the studies, however, is the integration of the break even analysis with the project design and business case, especially the marketing strategy. Ideally, the target set by the break-even analysis should feed into a marketing strategy which will deliver the desired revenue. If this is not achieved in the first iteration, then adjustments to strategy can lead to new financials and new targets. This can be repeated until the desired outcomes look feasible.

The Deloitte reports present a “best estimate” of likely outcomes based on what we know about the projects. The addition of a marketing strategy to deliver the desired (break- even) revenues would greatly assist the evaluation.

In the case of the HWMAC the plans are well developed and the supply side estimates quite assured. The revenue estimates are less certain and we will address these later. For the relatively new Harbourside proposal, the supply side estimates are less well developed and the risks are consequently higher. In the short space of time between the first submission in October 2014 and the revised proposal in December 2014 the plans were changed quite significantly and the FW team have chosen not to explain where they are heading with the proposals. As a consequence, the Deloitte team have done the best they can in the circumstances to anticipate what the new proposal looks like in order to draw comparisons.

7 The projects and project governance

7.1 Hundertwasser Wairau Maori Arts Centre (HWMAC)

7.1.1 The building

The feasibility study makes the point that this will be a unique building of wide appeal to international and NZ visitors who admire Hundertwasser’s work.

The building (of 2177m²) will be on 3 levels with the top (roof) level laid out as a grass park with sculptures and open to the public. The ground floor will house the Wairau Maori Art collection of fine art. The proposal makes it clear that this will be art of international quality and the only curated Maori Art gallery. Also on the ground floor will be an entrance, shop, space for education and administration. The first floor will house the display area for Hundertwasser art as well as a café.

It will be possible to access the outside, the grass roof and the café without paying an entrance fee. The FH and Maori exhibitions, however, will require an entrance fee.

7.1.2 Governance

The Governance structure for HWMAC is described in some detail and illustrated to show the connections between the organisations. The main points are:

- The centre will be operated by the well-established Whangarei Art Museum Trust (WAMT)
- The building will be owned by WDC but leased to WAMT for a peppercorn rental.

- Any operating losses incurred by the centre will be underwritten by the PNT who will also be responsible for the fundraising on behalf of the trust.
- The Hundertwasser Non-profit Foundation (HNPF) will supply FH artworks and authorise use of the drawings for the building design.
- The Wairau Maori Advisory Panel will supply the artworks for the Maori Fine Art collection.

Risks are addressed under the headings of operational and development risks (pp21-22) and all assessed as low likelihood which seems reasonable. The only risk greater than low is the “low-medium” chance that the PNT are unable to raise the funds required for development within the stipulated 2 year period.

7.2 Harbourside

7.2.1 The building

This proposal is for the upgrade and restoration of existing buildings on 2 levels to create 1688m2 of a variety of uses including:

- Local maritime history exhibits
- Maori contemporary art
- Northland Art
- Digital art collections
- Aquarium
- 4D theatre
- Education uses
- Café and souvenir shop

There is provision for display of digital art on a modern addition to the building on Dent Street.

Initially the proposal was also to house the Whangarei Art Museum collection and the CHART (Creative Northland) operations. Subsequent discussions resulted in these organisations being removed from the proposal. We understand that the floorspace available in the Harbourside Building would not be sufficient to accommodate the needs of these organisations, alongside the other planned uses.

7.2.2 Governance

FW plan to establish the Harbourside Community Trust, which would be responsible for fundraising and operating the project on behalf of the Council and ratepayers.

Deloitte’s risk analysis highlights that no firm arrangements are in place to supply the art works.

7.3 Commentary on proposals

Both proposals follow a similar layout with similar headings to make comparisons easy. It is apparent that the governance structures for Harbourside are less well developed and present greater risks. Partly this is due to the proposed Harbourside Trust not yet being set up and the finding by Deloitte that major grants will be less easily available to organisations with no audited accounts.

Neither proposal discusses the individuals involved. We would have expected to see some discussion the skill sets of the people who will be managing the money and the operations of the proposed centres.

8 Building Costs

8.1 HWMAC

The independent review of capital costs identifies likely building costs, including contingencies, of \$15 million. The Deloitte report shows the likely revenue sources to cover this expenditure as follows:

- \$2.8 million from WDC
- \$12.8 million from fundraising

The fundraising expectations are seen as realistic and the following potential sources are cited:

- WAMT reports that it has \$2 million in “pledges” (although we have not seen any verification of these).
- Lotteries have previously allocated \$2.5 million to a similar project and this is expected to become available again
- PNT expect the balance of \$8.3 million, as outlined in the Deloitte report, to come from “national Trusts and private donors who have indicated support for the project to PNT and WAMT if the HWMAC is approved”. There are no supporting documents that we have seen to verify this.
- PNT will have 2 years to complete the fundraising.
- The Klu’dupe Ltd. capital cost evaluation suggests that the building cost estimates are “low risk”.

8.2 Harbourside

In contrast to the HWMAC, the capital costs for construction of the Harbourside are less well developed. From initial estimates of \$5million these estimates are now up to \$10 million for what Klu’dup Ltd describe as a “basic developer quality” building with a “civic fit out”. This building cost is also described as “high risk” due to the potential unknowns of refurbishing an old building¹.

The latest cost estimate has only been available since February 27th 2015 and there has been no response from FW that we are aware of.

The Deloitte report outlines the following anticipated (by FW in their original proposal) sources of capital, although these were based on previous much lower cost estimates:

- \$2.5 million requested from WDC with the balance of \$7.8 million to be raised by the proposed Harbourside Charitable Trust.

Possible sources of funds are listed in the report (based on the original FW proposal) as:

- \$2.5 million from the Lotteries Environment and Heritage fund
- \$2.5 million from the Ministry of Culture and Heritage Regional Museum Fund
- \$0.5 million from Lotteries Significant Projects Fund
- \$0.5 million from the ASB Community trust

Deloitte point out, however, that no funding has yet been requested or committed. Deloitte then identify a number of risks associated with these fundraising plans including:

¹ The original Harbour Board building was built in 1922 and reportedly, has been vacant for over a decade.

- Trust has no audited accounts (it is not yet incorporated) which are apparently required for successful fundraising
- The Harbour Board building is not recognised as a heritage building and therefore will be unlikely to qualify for heritage grant considerations.
- The focus of Harbourside is “mainly regional” which may reduce its chances of successful grant applications.

8.3 Commentary

The comparison of the 2 projects is on similar criteria and the Harbourside is described as the riskier venture, with less accurate cost estimates and less chance of success for fundraising. Given the importance of the qualification criteria for grants we would have liked to see more analysis of the various funding agencies requirements. The greater risks associated with Harbourside may be a result of the stage of planning which is described in the report as “concept stage”.

9 Operating Expenses

9.1 Commentary

We have reviewed the operating expenses and have no real concerns except that, again, the lack of detail from Harbourside makes comparisons difficult. Deloitte have attempted to estimate costs from earlier documents and from information received. We note the following:

- The revenues from Souvenirs and café rentals are substantially higher in the HWMAC proposal, presumably because of the expected higher number of visitors.
- Security costs are higher in the HWMAC.
- Staff costs of approximately \$400k in Harbourside compare with \$500k in HWMAC
- The advertising budget of \$120,000 at HWMAC is much higher than the \$30,000 at Harbourside.

We are pleased to see an allocation for “advertising” which we believe will be essential to maximise the number of visitors. We would suggest that this be seen as a marketing budget so that a marketing plan can be prepared in the first instance.

10 Break Even Analysis

The break even analysis (BE) has been calculated in terms of visitor numbers at different price points. It addresses the question “**how many visitors do we need, at different price points, to achieve a financial break-even (i.e. no losses and no profits)?** “. The following summarises the alternative targets for both options:

10.1 HWMAC

The table shows that BE is highly sensitive to visitor number estimates and price points.

Scenario	Adult Price	Child Pricing	BE visitor numbers ² required
A	\$9.50	\$3.75	144,000
B	\$15	\$7.50	95,000
C	\$20	\$10	73,000
D	\$25	\$12.50	60,000

10.2 Harbourside

This table shows similarly sensitive results.

Scenario	Adult Price	Child Price	Seniors	BE visitor numbers
A	\$10	\$3	\$8	95,000
B	\$15	\$5	\$10	67,500

10.3 Commentary

What should follow from these results, in our view, is a market analysis to see how these may be achieved and whether changes are needed to the proposals to better meet the market needs. There will still be risks but set in the context of a marketing strategy they would be part of the business plan going forward. For example, should the exhibitions be designed to attract repeat visits by rotation of exhibits? This will affect the percentage of visitors who come to Whangarei that we need to attract. Two visits from one person may be just as valuable as one visit from two people but, in some situations, easier to achieve.

How should the targets be divided between international, domestic and local visitors? Do the requirements differ?

How much are the different segments prepared to pay and how can these pricing strategies be managed?

Deloitte have approached this differently, choosing instead to compare these target BE numbers with other attractions and with previously completed visitor forecasts (e.g. the 2011 Deloitte feasibility study).

11 Pricing

Both proposals suggest charging for entry to the museums. Most museums and galleries in New Zealand offer some level of free access so this is a departure. It may be that the buildings themselves offer a level of public art that is in place of free entry, although this is not addressed in the reports. This may be an important mitigating factor in gaining public acceptance for charges at the levels proposed.

Potential visitors to museums and arts –based attractions can be divided into 3 groups:

² In these tables, visitor numbers refer to paid visits which may include allowances for multiple visits by some people.

1. Those who are interested in the exhibits and are not concerned about price
2. Those who are interested but need to work within budget constraints
3. Those who have no interest in the exhibits

Price levels will not affect groups 1 and 3 but will have a big impact on group 2.

There does not appear to have been any investigation onto the size of these segments and how they may differ in proportions according to types of visitors (international, domestic and locals).

Price elasticity for museum entry will also differ across different types of attraction and different visitor types. For international visitors and long distance domestic travellers, the entry cost will be minimal compared with the travel and accommodation costs incurred and price sensitivity will be relatively low.

The character of the attraction will also affect the demand elasticity of ticket prices. A recreation style museum, such as the Harbourside proposal, will be competing for other local recreation opportunities which will tend to lead to a greater price sensitivity. The HWMAC however, will be one of a kind and likely to have lower price sensitivity. The division between the 3 groups above will still be important to know.

It appears to us that the Harbourside development is intended to attract a more local audience for repeat visits but that prices will need to take account of other competing attractions. HWMAC however, appears to be a fixed exhibition (with possible exception of the Maori Art) making higher prices more feasible but repeat visits more difficult. The challenge for both will be sustainability beyond the initial visits from interested people.

Without any information about the different segments and their willingness to pay, commentary on the pricing assumptions can only be based on comparisons with similar attractions.

Deloitte provide a broad range of attractions and the proposed price ranges appear to cover this spectrum. There is very little discussion in the feasibility reports about which prices are appropriate and why.

12 Visitor Numbers

Visitor number estimates appear in the feasibility studies as a check against the break even requirements. It seems reasonable to ask what assumptions would be required for the 2 projects to break even.

12.1 HWMAC

The visitor estimates used are based on the 2011 Deloitte report. We have spent some time examining the underlying data sources and assumptions (see Appendix 1) made and conclude that the visitor estimates used are not sound. We suggest that no emphasis be placed on these forecasts for the purpose of evaluating the proposals.

The alternative approach taken is to study attendances at other attractions around the country and make some judgement about which are comparable.

Although Deloitte have assembled a substantial amount of data, there is no discussion about which are the most appropriate comparisons.

In our view, there is more work to be undertaken on this topic before we can comment on the likely visitor numbers.

12.2 Harbourside

Deloitte do not attempt to use the same statistical forecasting approach for the Harbourside proposal preferring to use comparisons with local attractions. A range from 20-50,000 visitors is suggested by Deloitte with a midpoint of 35,000. We note that the initial proposal felt that double what WAM currently attracts would be feasible, or around 20,000.

Whether it is 20 or 35,000 visitors doesn't really matter. The break even analysis shows targets of 95,000 will be required to break even.

12.3 Commentary

Given the absence of reliable visitor forecasts, the financial feasibility of both projects is uncertain. There is a need for more work in this area before we can say what the likely outcomes will be. We suggest that this should be approached as a marketing strategy which can inform and influence the design of the proposals in such a way that financial risks are minimised.

13 Conclusions and Recommendations

The feasibility studies are to be supplied to WDC and ratepayers to assist with the choice of HWMAC or Harbourside or a third alternative of demolition and grassing over.

In our view, the information currently available is not sufficient to comment on the relative financial viability of the 2 main options because we do not accept that the available revenue forecasts are soundly based.

Despite this shortcoming, the proposals are sufficiently different to offer ratepayers a choice. WDC may reasonably decide that the winner will be assisted with the next stage of planning rather than any expectation that we move on to implementation.

We strongly suggest that more work is needed on issues of market segmentation and price sensitivity for the 2 proposals as a step towards more reliable revenue estimates.

Some of the questions to be addressed in such a study include:

- Should the exhibitions be designed to attract repeat visitors by rotation of exhibits?
- How should the visitor targets be divided between international, domestic and local visitors? Do the requirements of these groups differ?
- How much are the different segments prepared to pay and how can these pricing strategies be managed?

Appendix 1.

Review of Deloitte Visitor Forecast Methodology

Deloitte have used visitor estimates consistent with previous feasibility reports that estimate visitor numbers of approximately 160,000 pa. These estimates are broken down into International, Domestic (from outside Whangarei District) and local.

The Deloitte 2011 report outlines how these figures were derived as follows:

International visitors

- Estimated international visitors to Northland (adjusted for travel type) = 943,000
- Multiplied by the proportion of likely museum and art gallery visitors (11%)
- Multiplied by a “capture rate” representing the proportion of such visitors who could be attracted to the HWMAC (75%)
- Total = 78,000

Domestic Visitors

- Estimated domestic visitors to Northland (adjusted for travel type) = 3.6 million
- Multiplied by the proportion likely visit Museums and Art Galleries (2%) = 72,000
- Multiplied by an estimated “capture rate” (75%)
- Total = 54,000

Local Visitors

These estimates were taken from a report by Visitor Solutions.

- Estimated population of Whangarei City aged 15+ = 40,000
- Proportion likely to visit a museum or art gallery at least once in any 12 month period = 50% (20,000 visitors)
- Estimated population outside Whangarei City but inside Whangarei District aged 15+ = 21,700
- Estimated proportion of this group likely to visit a museum or art gallery at least once in any one year = 43% (9,500)
- Total = 29,500

Total Visitor Estimates

Segment	Number of visitors (Year 1)
International	78,000
Domestic	54,000
Local	29,500
Total	161,500

Comments on methodology

The following comments are offered:

- I. The 75% capture rate seems high given that Whangarei represents 50% of the Northland population and just 28% of existing international tourism expenditure in Northland.
- II. Estimates of international visitors also seems high when compared with total numbers of international visitors to NZ in any one year (2.7 million in 2014). It seems unlikely that 35% of all international visitors will visit Northland.

- III. The 11% (estimated proportion of international visitors who visit museums or art galleries) was based on a Ministry of Tourism “Sector Report” about “Museum Tourism” dated September 2009. This shows reported behaviour from the International Visitor Survey and the Domestic Travel survey. The 11% estimate for Northland compared with a national average of 27% which reflects the uneven distribution of museum visitors across the country. Wellington museums and galleries attracted the highest proportion of international visitors to that region (40%). The 11% was based on the museum offers at the time (2007/8) but may increase with an improved offering. The 11% represented 34,300 international museum visitors, spread across Northland (as reported in the Sector Report). This works out to be 311,000 international visitors to Northland which is just one third of the Deloitte estimate.
- IV. Checking with the published visitor statistics from the IVS data, the figure of 300,000 international visitors to Northland seems to be correct. It is likely that the Deloitte estimate was based on “visits” rather than visitors and the each visitor made approximately 3 “visits” while in Northland. A visit may be an overnight destination or a day trip. If this is correct then it is not appropriate to place the same likelihood of visiting HWMAC on each of the 3 trips in Northland.
- V. The estimated number of Domestic Visitors (3.6 million) cannot refer to comparable data. It seems that the Museum Sector Report itself was misleading, claiming there were close to 1 million Domestic Museum Tourists who represented 2% of all Domestic Tourists. The implied 50 million domestic tourists can only represent “visits” where each New Zealander makes approximately 15 qualifying trips each year³. We are not sure that we can use either the number of visits (3.6 million) or the 2% estimate with any confidence.
- VI. The capture rate of 75% applied to domestic Museum visitors also seems ambitious. Estimated domestic tourism expenditure in Whangarei is 35% of all such expenditure in Northland.
- VII. Visitor Solutions estimates for local visits to museums and art galleries is based on a 2003 survey by Statistics NZ and the Ministry of Culture and Heritage which found that 48% of NZers aged 15+ had visited a museum or art gallery at least once in the last 12 months. This was converted into an estimate of 19,500 visitors from Whangarei District. However, the report did not make any allowance for entrance fees and the likelihood that this might reduce the number of visits. We think some allowance needs to be made for this effect and reduce the 29,500 estimate accordingly.
- VIII. There are other approaches to visitor forecasts that could be used, from publicly available statistics but, in general, the quality of some statistics is poor and open to misinterpretation. There is no guarantee that an alternative approach would deliver satisfactory result.
- IX. Our recommendation is therefore to put the options to the ratepayers with appropriate caveats around the revenue forecasts, and make the development of a marketing strategy a key first step for the successful project team.

³ Based on an estimated 3.3 million New Zealanders aged 15+ who qualify as domestic ‘tourists’ in any one year. Given that the definition of a qualifying trip (back in 2007) included any travel more than 40 kms from the home address, this seems quite feasible.