

DECISION

NSUARB-P-128.08
2008 NSUARB 165



NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE PUBLIC UTILITIES ACT

- and -

IN THE MATTER OF AN APPLICATION by **NOVA SCOTIA POWER INC.** for the approval of a work order to construct office space at the Water Street location

BEFORE: Peter W. Gurnham, Q.C., Panel Chair
Murray E. Doehler, CA, P.Eng., Member

REPRESENTATION: **NOVA SCOTIA POWER INC.**
René Gallant, LL.B.
Eric Ferguson
Bob Boutilier
Anne-Marie Curtis, P. Eng.

FORMAL PARTICIPANTS: **NEWPAGE PORT HAWKESBURY LIMITED** and **BOWATER MERSEY PAPER COMPANY LIMITED**
George T.H. Cooper, CM, Q.C.
David S. MacDougall, LL.B.
James MacDuff, LL.B.

AVON VALLEY *et al.*
Robert G. Grant, Q.C.
Nancy G. Rubin, LL.B.

CONSUMER ADVOCATE
John Merrick, Q.C.
William L. Mahody, LL.B.

OPPOSITION ENERGY CRITIC
Frank Corbett, MLA
David MacKenzie

**PROVINCE OF NOVA SCOTIA DEPARTMENT OF ENERGY
("NSDOE")**

Stephen T. McGrath, LL.B.
Scott McCoombs
Richard Penny

HALIFAX REGIONAL MUNICIPALITY

Martin Ward, Q.C.
Mary Ellen Donovan, LL.B.

BOARD

CONSULTANT:

**DTZ BARNICKE ATLANTIC REAL ESTATE BROKERAGE
LIMITED**

Tim Margolian

DECISION DATE:

December 22, 2008

DECISION:

Work order approved in part with conditions.

TABLE OF CONTENTS

I INTRODUCTION 4

II ISSUES 5

 2.1 Confidential Information 5

 2.2 Search for Office Space Alternatives 6

 2.3 Emera Association 7

 2.4 Class A Space Requirement 8

 2.5 Leadership in Energy and Environmental Design Requirements 9

 2.6 Negotiations with the Current Landlord 10

 2.7 Property Tax Exemption 12

 2.8 NSPI's Role as Developer and Landlord 13

 2.9 Board Consultant's Conclusion 16

III ANALYSIS AND FINDING 16

I INTRODUCTION

[1] On July 23, 2008, Nova Scotia Power Inc. ("NSPI") submitted an application to the Nova Scotia Utility and Review Board ("Board") for approval to construct office space on its property located on Water Street in Halifax, Nova Scotia.

[2] As stated in its Application:

In 2011, Nova Scotia Power Inc (NSPI) intends to move its corporate offices from the current leased facility to a renovated facility presently owned by the Company. NSPI is therefore requesting Utility and Review Board (UARB, the Board) approval of a Capital Work Order Application (CI 29131) to renovate the former Water Street Generating Station.

...

The lowest cost means of acquiring the required office space is to renovate the former Water Street Generating Station and relocate NSPI's head office groups to this site. The Company respectfully requests Nova Scotia Utility and Review Board approval to renovate this site at a cost of \$58.2 million.

[3] The Board established an application process to consider this request and allow input from the participants. The timeline for this Application was established as follows:

Information Request to NSPI	September 19, 2008
Response to Information Request by NSPI	October 3, 2008
Submission by Participants and Board Staff Consultant	October 17, 2008
Response by NSPI	October 31, 2008

[4] This timeline was altered when one of the participants, Avon Valley *et al.*, filed a confidential response to the submission of the Board's Consultant on November 4, 2008. NSPI responded to this late response on November 4, 2008.

[5] On November 20, 2008, Board staff requested NSPI to file responses by November 27, 2008 to four additional Information Requests:

1. A request to NSPI to "unlock" the Excel spreadsheets accompanying the WO submission

2. A recalculation of the NPV Excel spreadsheet based on revised parameters
3. A recalculation of the Capital Cost Excel spreadsheet, based on revised parameters
4. More information on two figures in the Capital Cost Excel spreadsheet

On November 27, 2008, NSPI provided the requested responses.

[6] The parties that actively participated in the process were NewPage Port Hawkesbury Limited and Bowater Mersey Paper Company Limited (“NPB”), Avon Valley *et al.* (“Avon”), and the Consumer Advocate (“CA”).

[7] The Board engaged the services of Tim Margolian of DTZ Barnicke Atlantic Real Estate Brokerage Limited (“DTZ”) to assist in the analysis and synthesis of the information. Mr. Margolian filed a submission, dated October 17, 2008.

[8] Along with the formal participants, the Board received letters from the Halifax Downtown Halifax Business Commission, William J. Phillips, Personala Xavier, and Jim Kimbrell.

II ISSUES

2.1 Confidential Information

[9] The review undertaken by the Board in considering this matter was largely an analysis of financial information and projections. NSPI filed virtually all of this information in confidence. The Board and Board staff analyzed the information as did the participants. To respect confidentiality in this application, however, the analysis of the information which was provided to the Board and the Board's own analysis is not fully disclosed in a public decision to NSPI or interested parties. Clearly, this is problematic in

a circumstance like this but it does not appear to the Board there is any way around it. The Board does not believe that it should issue confidential and redacted versions of decisions. As has been the case in the past, all of the Board's decisions in their entirety should be available to the public. The Board is very concerned about the extent of confidentiality sought by NSPI in this proceeding, thereby impairing the Board's ability to issue fully transparent reasons.

[10] The Board's Rules permit filing of information confidentially and maintaining that information in confidence in circumstances where there are legitimate reasons to protect its disclosure. No party challenged the confidential filings in this case, likely for the reason that they were given access to all the information by virtue of agreeing to various confidentiality undertakings. The Board intends to review the issue in the new year to ensure the confidentiality rules appropriately protect the public interest and ensuring there is sufficient transparency when proposed expenditures to be recovered from ratepayers are decided by the Board.

2.2 Search for Office Space Alternatives

[11] Emera, NSPI's parent company, issued a Request for Expressions of Interest and Qualifications ("RFEIQ") on August 27, 2007, for Sustainable Corporate Office Facilities Development. Subsequently, it abandoned this process and did not issue a

Request for Proposal ("RFP"). This decision was criticized by the participants. NPB in its October 17, 2008, submission, page 2, said:

NSPI failed to conduct a formal Request for Proposal ("RFP") process for its requirements for head office facilities.

...

Notwithstanding the receipt of 17 responses to the RFEIQ, many from very reputable developers and contractors, NSPI did not carry out an RFP.

[12] However in its Response to NPB IR-9, NSPI replied:

The RFEIQ was initiated to identify a wide range of possible alternatives. After the evaluation of the alternatives it was determined that none of the scenarios presented would meet the timelines in downtown HRM. The RFEIQ was terminated.

[13] Avon, in its October 21, 2008, submission, page 4, stated:

Here, while the RFEIQ was widely disseminated and a reasonable number of responses submitted, the failure to follow up with an RFP process undermines the value of any purported cost-benefit analysis. As the submissions were only at the conceptual stage and lacked accurate costing, it is impossible for the Board to meaningfully rely on NSPI's cost analysis of the alternatives, as the alternatives have not been developed in a detailed and thorough manner.

[14] NSPI, in its rebuttal submission dated November 4, 2008, page 2, indicated that following the RFEIQ, its focus was drawn to evaluating the renovation of Water Street:

Following a standard and objective Request for Expressions of Interest and Qualifications (RFEIQ) process that was managed and reviewed by NSPI, it became apparent that renovating an existing NSPI owned asset would be the most economic and efficient means to meet the Company's requirements. The Company's provincial property tax treatment and "as of right" ability to renovate within an existing footprint drives significant cost savings for customers over the life of the project. ...

[15] The Board observes that NSPI has provided a rationale as to why Emera did not follow the project timeline in the RFEIQ. The process that was subsequently followed by NSPI has been sufficient to inform the Board on the application. The completion of an RFP stage for a major project with many variables is a usual course of action; however, the

fact this step was not taken for this work order is not fatal to the ability of the Board to arrive at a decision.

2.3 Emera Association

[16] Concern was expressed by various parties with respect to the manner in which the RFEIQ was conducted. The documents were first issued by Emera and then, as matters evolved, this became an NSPI project. Yet again, there appeared to be confusion/clouding of the role and interests of affiliates and the role and interests of NSPI, at least in the early stages of this process. The Board is concerned to see this. However, these matters will be resolved in the new Code of Conduct currently being reviewed by the Board. The Board sees no problem with Emera being a tenant in the facility, so long as the conditions of the Code of Conduct are satisfied.

2.4 Class A Space Requirement

[17] In response to Avon IR-3(c), NSPI stated that:

Class A space is defined as flexible space with access to communication hubs, close to hotels and emergency back-up power for outage service, and close proximity to employee amenities. A Class A building must also have air conditioning, ceilings that are greater than 9 feet, be energy efficient, have large contiguous floor plates and enough elevators for the number of building occupants.

[18] NPB questioned the NSPI requirement for Class A space for all or some of its current head office staff. In its submission at page 5, it said:

NSPI's Submission is based on the requirement for Class A space for all of the current NSPI employees at its Barrington Tower location. In response to NPB IR-5(c) and Avon IR-1(a), NSPI indicates that of the 395 current employees at Barrington Tower more than half (214)

are in the contact center and billing and customer service functions. No specific analysis appears to have been conducted as to whether these employees actually require Class A space, and/or whether they could be located at other than a corporate headquarters location.
...

[19] NSPI, in support of its position, stated in its response to NPB IR-6(b):

The decision to maintain corporate and shared services functions at the corporate facility is based on the desire to ensure effective coordination of corporate support functions and to facilitate transportation for NSPI employees. Considerations specific to the Contact Centre relate to emergency restoration activity where access to hotels, food services and power supply are of critical importance.

[20] The Board observes it is reasonable that, in planning for new Headquarters, for NSPI to endeavor to locate its entire associated staff in one facility. Most new office space commercially available is marketed as Class A and NSPI's requirement that its Head Office space meet this criterion is reasonable.

2.5 Leadership in Energy and Environmental Design Requirements

[21] Leadership in Energy and Environmental Design ("LEED") is a point-based rating system for designing, constructing, operating and certifying "green" buildings. The certification process is administered by the Canada Green Building Council. Buildings are assessed using a checklist of criteria, some mandatory and others optional, that indicate environmental sustainability. Points are granted for building attributes considered environmentally beneficial. The office LEED certification is issued by the Canada Green Building Council after the building is complete and assessed.

[22] To receive LEED certification, a building is assessed and must achieve points in five categories:

1. Sustainable sites

2. Water efficiency
3. Energy and atmosphere
4. Materials and resources
5. Indoor environmental policy

[23] There are four levels of achievement: Certified, Silver, Gold and Platinum.

[24] NSPI's stated intention, in its application, page 10, was to achieve the LEED Gold standard at a minimum.

- The proposal provides effective utilization of a utility "brownfield" site and mitigates risk of deterioration associated with this site. As well, the building design will improve the aesthetics of utility infrastructure located at this site.
- The higher level of energy efficiency is consistent with NSPI efforts regarding DSM and the Company's efforts to reduce its "environmental footprint".
- The building will be designed to LEED Gold standard with potential to meet the LEED Platinum standard. This level of energy efficiency will increase the value of this investment should energy prices increase beyond the current forecast.

[25] Intervenors did not focus, for the most part, on whether NSPI should aspire to a LEED standard, but on whether Barrington Tower could or should be renovated to a LEED standard.

[26] NSPI, in its rebuttal submission, Appendix A, page 7 of 11, states:

As with the requirement for Class A space, NSPI's desire for LEED Gold energy efficiency must be considered in context. As discussed in NSPI (NPB) IR-4 and NSPI (Avon) IR-4, current construction standards will provide a LEED Silver energy efficiency level at the Water Street site.

The construction cost premium associated with NSPI's desire to achieve the higher Gold Standard is estimated to equal \$2.1 million, approximately 4% of NSPI's application. This incremental cost will be recovered through lower operating costs enabled by increased energy efficiency.

Despite the arguments put forward by NPB, there is no cost premium for NSPI customers as a result of NSPI's pursuit of a LEED Gold energy efficient standard. NSPI expects the majority of NSPI customers would support this investment.

[27] The Board observes that it is reasonable to expect NSPI to aspire to a LEED standard in acquiring new space, whether leasing or owning. To do otherwise would be

to ignore the current environment in which NSPI finds itself. This materially impacts the economics of the Barrington Tower lease option.

2.6 Negotiations with the Current Landlord

[28] The current NSPI lease for Scotia Square has no fixed rate extension clause. Intervenors felt that the negotiations between NSPI and its current landlord were not rigorous enough.

[29] NPB stated in its submission, page 7:

The information in the Confidential Data Room filed in response to UARB IR-20 appears to show that there was no negotiation with NSPI's existing landlord upon receipt of its offer.

[30] NPB goes on to state at page 8:

There does not appear to have been any negotiation conducted following receipt of these initial offers. Considering the significance of the expenditure in question, and the major tenancy involved, NPB would have anticipated there being a significant series of negotiations and counter-offers between NSPI and its current landlord after receipt of the Crombie offers in order to determine the true cost of this option, before an application was brought to the Board for another alternative. Nor apparently was there any consideration given by NSPI to the cost of renewing its lease without requiring either the "major renovation" requested by NSPI or the achievement of LEED certification. Once again, NSPI's lease renewal file appears to indicate a rushed approach, rather than well-planned lead time to fully evaluate and negotiate competitive alternatives.

[31] NSPI disputes this position in its rebuttal submission, Appendix A, page 10 and 11:

As is evident from NSPI's Application and the comments provided in the attached, the choice between refurbishing the Water Street facility and renewing the Barrington Tower lease is straightforward:

...

Most significantly, the reduced figure would undeniably be below the downtown market value for class A or B space and well below the rent paid by NSPI under the current lease. It is highly unlikely Crombie would commit to this. Indeed there was no indication from Crombie at any time that such a scenario was even remotely realistic. Combined with Crombie's refusal to extend the existing lease for two years, this analysis lends credence to NSPI's

concern that a protracted negotiation with Crombie would have left NSPI with no alternative but to commit to a long-term lease renewal at a significantly increased cost. This is not in the interest of customers.

[32] Through the confidential filings, the Board was informed about some of the terms requested by NSPI during discussions with its present landlord. According to the Board's consultant in his submission on page 6:

For the Barrington Tower lease renewal option, the proposed leasehold allowance is well above market and adequate to eliminate the Relocation Costs, Additional Lease Costs, pay for the Leasehold Improvements, and Furniture & Fixtures and still have unallocated allowance. Sensitivity analysis would show that the impact of reducing the Tenant Improvement Allowance to that required to pay for these items without surplus allowance would result in lower rent, lower Annual Property/Realty Taxes thus making this a much more attractive option.

[33] In NSPI's rebuttal submission they suggested that this was not the case and that the lease option was still economically unattractive. It did not, however, provide a satisfactory explanation of the quantum of the proposed leasehold allowance, which served to inflate the cost of renewing the Barrington Tower lease. In spite of this, the Board was able to use NSPI's economic model of alternatives to test the sensitivity of these terms and was able to confirm the conclusions in NSPI's additional rebuttal submission.

2.7 Property Tax Exemption

[34] In accordance with the *Nova Scotia Power Privatization Act* ("NSPPA"), as amended by the *Financial Measures (2003) Act*, NSPI is exempt from taxation by any municipality, other than deed transfer taxes. Under the NSPPA, NSPI is required to make two payments to the Province each year which are then distributed among municipalities by the Province of Nova Scotia. Where NSPI leases premises from a third party, NSPI

indirectly pays the property tax by way of additional rent over and above its provincially mandated payments.

[35] Avon commented on this at page 10 of its submission:

While NSPI states it does not anticipate any change to the current tax treatment of the facility, we observe that NSPI's use of the Water Street Property for its corporate headquarters seems to be pushing the envelope of what the legislation was contemplated to cover. To the extent the Legislators respond to close the loop hole, it is NSPI's shareholders and not the ratepayers who should be at risk.

[36] The Board observes that even though there is some question as to whether or not this exemption will remain, there is no present proposal for changing the legislation. Therefore, it makes sense for NSPI to use this to the advantage of its ratepayers while it exists. This is a consideration that impacts on the finances of this project. Because of the current exemption that NSPI enjoys from property tax in Nova Scotia, the Water Street options are more attractive financially than they would otherwise be.

2.8 NSPI's Role as Developer and Landlord

[37] NSPI appears to be poised to manage this development on its own. The Board's consultant in his submission expressed concerns in this area, both from an operating and a capital point of view. This submission states at page 5:

Our concerns with this recommendation fall into two categories, that of physical and financial.

1. Physical

Physically, the Water Street redevelopment calls for 129,000 sq. ft. of rentable area with 110,000 sq. ft. to be occupied by NSPI and affiliates and 19,000 sq. ft. to be rented to third parties. This 19,000 sq. ft. of third party office and retail space provides for potential expansion premises of 15% over the base NSPI and affiliate requirement. Notwithstanding NSPI's restructuring, which resulted in downsizing, growth of 1% to 2% annually is typical. The expansion potential for Water Street is limited and may be inadequate. It is noted that the new building option out of the downtown core does not provide for expansion premises.

2. Financial

Our financial concerns with the Water Street redevelopment are for both capital and operating revenue and expenses.

Regarding capital, both cost consultants to NSPI recommend a greater contingency allowance, ... [redacted] ... As well, even though the NSPI and affiliate leaseholds may be built along with the base building, the amount budgeted for leasehold improvements and other exclusions to the building contract may not be adequate.

Regarding operating revenue, the financial proforma assumes zero premises growth by NSPI and affiliates. To the extent that growth by NSPI and affiliates occurs, third party revenues will be reduced. Should even minimal growth by NSPI or affiliates occur, they will be forced to either expand to spaces adjacent to third parties, thereby introducing security issues; or, expand off site. Furthermore, expansion by NSPI and affiliates will necessitate reducing or discontinuing third party leased premises and result in the loss of associated revenue. Sensitivity analysis, eliminating third party revenue after 20 years, may result in a reduction in value such that this option would be more costly than a new building outside of the downtown. Should NSPI want to retain third party revenues and also provide for future expansion, they will need to undertake construction of the additional 40,000 sq. ft. of undeveloped space. For the third party premises, the operating revenue provides for 100% occupancy and therefore 100% recovery of the proportionate share of operating expenses over the analysis period. By industry standards, this is an aggressive assumption.

[38] The consultant's concerns are in areas where experienced property developers have expertise. In the application, NSPI proposes to manage these concerns internally. The Board observes that this is not a core competency of NSPI. The financial risk to ratepayers of NSPI developing an office complex is greater than if NSPI contracted with an experienced property developer.

[39] Some participants were also concerned about the aspect of NSPI becoming a landlord and its ability to fill the third party space.

[40] The building on Water Street will be competing with other locations in the central business district for tenants. There are three concerns about the attractiveness of this building and the ability to lease to third parties. They are: location of the site; the absorption and vacancy rate for commercial space; and the competition with other new construction.

[41] The south end of Lower Water Street, which may be considered to be downtown by some, is not considered to be in the central business district by most industry professionals. This location, therefore, will be a negative factor in attracting third party rentals.

[42] NSPI's response to (UARB) IR-35, Attachment 1, page 4 of 5, shows that year to date quarter 3, 2008 absorption for downtown was 14,265 sq. ft. (162,696 sq.ft. less 148,280 sq.ft.). The chart on page 3 of 5 of this attachment shows that, using a base of 1.4 million sq.ft., the absorption for quarter 3, 2008 was a negative 12,696 sq. ft. The Board is concerned that these factors, along with the weak economy, may add significant risk to leasing to third parties.

[43] There are numerous new buildings proposed for downtown. All very centrally located, these buildings will be either under construction or in a pre-leasing stage during the relevant time frame, effectively increasing the vacancy rate. This may further reduce the ability of NSPI to achieve its third party rental projection.

[44] On the other hand, the Board observes that using NSPI's plant to generate additional income is not a new concept. For example the Company currently rents pole space to third parties for attachments. In NSPI's submission, the inclusion of rental revenues from Emera and other third parties for the Water Street renovation makes this option the most economically attractive. However, the Board's consultant was concerned that this cost advantage could be eroded if there was a significant lease up period, soft

rental market with high vacancy and low rental rates, or if NSPI chose to forego the third party space for uses of its own.

[45] The Board concludes, therefore, that the risk for third party rentals (not including Emera) should not be borne by the ratepayers. The use of NSPI's plant, which is core to its service needs (i.e. poles), to obtain additional rental revenue is different from obtaining rental income from an ancillary asset (head office building). An ancillary building is not core, but is needed to meet ratepayers' service requirements. The function of landlord is not specifically in NSPI's core competencies.

2.9 Board Consultant's Conclusion

[46] Mr. Margolian, in the Executive Summary on page 3 of his submission stated:

On balance, notwithstanding the concerns expressed herein which would reduce the financial benefit to the Water Street option, we believe that this option is the best alternative of the options submitted.

III ANALYSIS AND FINDING

[47] Based on the submissions of NSPI, interested parties and Board's consultant, the options available and which were considered by the Board are the following:

- Option 1 - Lease Extension at Barrington Tower
- Option 2 - Renovate Water Street for NSPI Only (86,000 square feet)
- Option 2(a) - Renovate Water Street with Emera as a tenant (110,000 square feet)
- Option 3 - Renovate Water Street with Emera as a tenant and with third party space (129,000 square feet)

Option 4 - New Facility in HRM outside the Downtown Core with Emera as a Tenant (110,000 square feet)

Based on the Board's analysis, Option 1 which includes the LEED requirement, is the highest cost option on a net present value (NPV) basis. Option 2 has a higher cost than Option 2(a).

[48] In analyzing Option 2(a), the Board included an assumption that the rent received from Emera would be a guaranteed lease payment which recovers the full proportionate cost of the facility plus a rate of return based on NSPI's allowed rate of return. For purposes of Board staff analysis, that lease payment was net \$40.00 per square foot. Based on the submissions of NSPI, the Board's consultant and staff have estimated the total capital cost for option 2(a) to be \$53,395,000.

[49] The Board is concerned about the risks associated with the rental assumptions in Option 3. For the reasons outlined earlier in this decision, the Board is not persuaded the assumptions for third party office and retail space rental are sound. Because of the uncertainties associated with this revenue, construction of the space should not be included in the amount funded by ratepayers. Whether it can be funded outside of rate base is an option for Emera and NSPI to consider.

[50] Based on the analysis of staff, and the Board, Option 4, a new facility in HRM outside the downtown core with Emera as a tenant and Option 2(a), renovate Water Street with Emera as a tenant (assuming rent based on the total cost plus NSPI's allowed rate of return) were the lowest cost options and are roughly equivalent on an NPV basis. Given the long time periods involved, and the assumptions that must go into these calculations,

the Board is prepared to consider them as equivalent although the analysis performed by Board staff suggests a new facility in HRM outside the downtown core with Emera as a tenant would be the lowest NPV cost alternative. It is noted, however, that minor changes in reasonable assumptions may vary this result.

[51] Accordingly, based on the economic analysis, the renovation of Water Street with Emera as a tenant (110,000 square feet) is considered a reasonable but not compelling alternative for a new NSPI headquarters. This is the option NSPI clearly wants to pursue.

[52] The Board is concerned, however, that the risks associated with developing the building at Water Street (parts of which are more than 50 years old) are greater than simply occupying 4 or 5 stories in an office building as a tenant with no responsibility for construction. Having regard to that concern, the Board advises NSPI that, while it is prepared to approve this work order, it also wishes to make it very clear to NSPI that it will be expected to manage the project within the \$53.4 million envelope approved before taking into account the allowance for funds used during construction ("AFUDC").

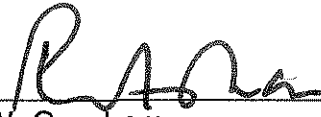
[53] Accordingly, the Board approves a work order for the renovation/construction of Water Street for 110,000 square feet subject to the following conditions:

1. The total cost, before AFUDC, is \$53,395,000.
2. NSPI is to manage the project within the envelope of money approved (\$53.4 million before AFUDC).

3. Emera is to lease 24,000 square feet for a forty year term at a rent which reflects the total proportionate cost plus NSPI's allowed rate of return.
4. The project as approved is to go into rate base, but does not include space to be rented to third parties other than Emera.

[54] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 22nd day of December, 2008.



Peter W. Gurnham



Murray E. Doehler