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Kaizen: Workplace 02

Integrated Commercial Workplace Fitouts

Gadens Melbourne Tenancy Fitout
Image courtesy of Shape

Integrated Commercial Workplace Fitouts

Slattery's commercial workplace team addresses the array of conundrums associated with the ever popular 'integrated fitout'.

In Australia, both Sydney and Melbourne have considerable new office supply due for completion between 2020 and 2021, with more modest additions in other capital cities such as Brisbane and Perth.

Pre-committed tenants underpin the launch of the vast majority of these new developments, and are a necessity for landlords.

Many landlords of existing stock across the country are also repositioning their assets in a bid to retain current tenants, as well as attract new ones to backfill vacant space.

Developers and landlords alike offer tenants the ability to 'integrate' the fitout of their workplace with the base building construction works.

In this Kaizen, we explore the critical issues and risks that can arise for tenants in delivering an integrated fitout and the opportunities and mitigation measures available to manage these risks.

'Integration' Comes in Many Forms

For both new developments and existing asset repositioning projects, a tenant may choose to either 'fully' or 'partially' integrate with the base building construction works. This takes advantage of program benefits that hopefully coincide with the end of their current lease, avoiding or at least minimising the need to pay 'double rent'.

Full integration is where the main contractor undertakes the fitout in its entirety whilst simultaneously completing the base building works, whether those works are for a new development or on-floor works as part of an asset repositioning project. These fitout projects are typically delivered under a managing contractor procurement methodology, but fixed lump sum and design and construct are also possible depending on the tenants desire to control the design.

Partial integration is when the main contractor adjusts certain elements of the base building scope (i.e. access floors, finishes, in-ceiling services, etc.) with a fitout contractor finishing the workplace construction. Again, this is equally relevant to new developments and base building refurbishments.

Deciding whether to use an integrated or non-integrated fitout can be difficult for tenants due to the plethora of advantages and disadvantages that each option presents. The most appropriate course of action will be derived from the tenant's desire and ability to control what amounts to the two main influencers of any project, namely; time and cost.



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Integrated Fitouts: Challenges & Opportunities

In a perfect world, completing the construction of the base building and the fitout works simultaneously should reduce the time it takes for the project to be completed. On the surface, making use of a fully integrated fitout, as opposed to waiting for the base building to be completed before commencing the fitout, is the most effective way to maximise the benefits.

Using an integrated fitout can minimise wastage created in the developer or landlord's base building construction, and then the tenant's fitout when they occupy the building. Such wasted resources which result due to undertaking cumulative fitouts can include time and money, as well as material components such as sprinklers, lights, ducts, carpets and even partitioning. This also has sustainability benefits; many organisations, developers/landlords and tenants alike are now striving to achieve zero net carbon emissions.

However, tenants can be exposed to delays in the base building works, which could prolong the fitout period overall. Delays in resolution of the base building design also negatively impact the programme of the fitout because the tenant's design team will require them to proceed.

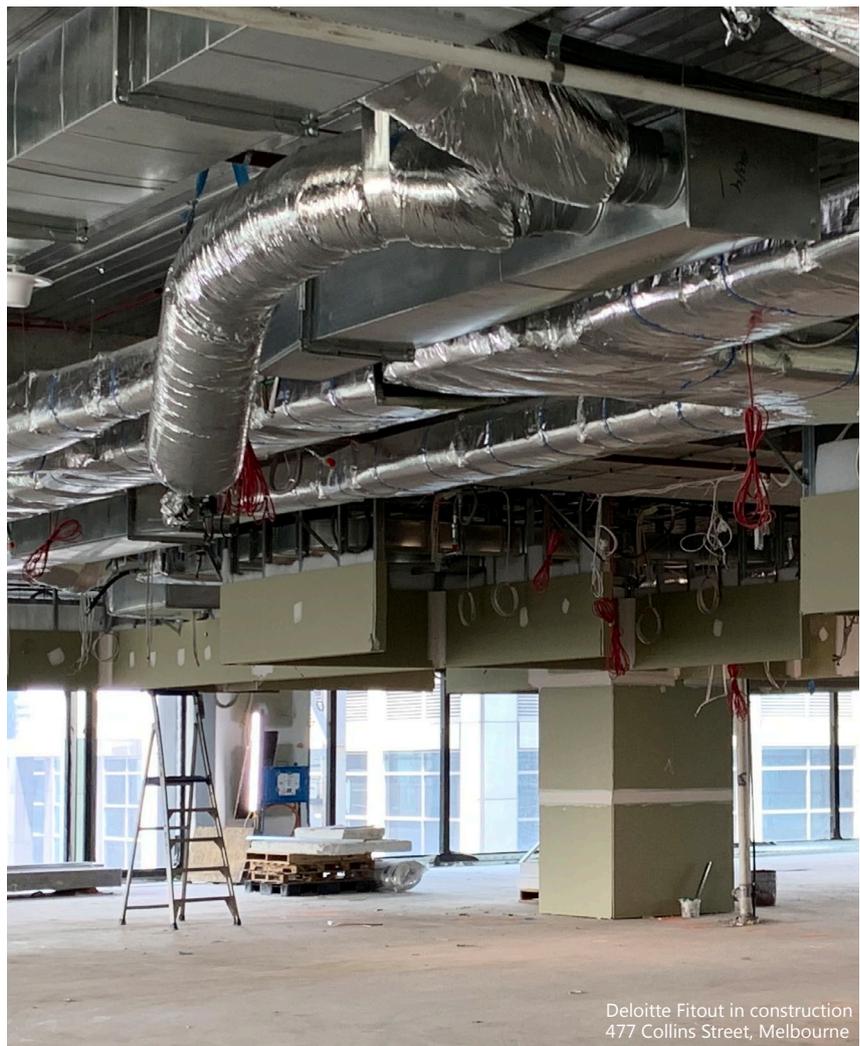
Base building works are often procured through a 'Design + Construct' methodology, meaning that tenant driven alterations to the base building, such as changes in finishes to amenities and lift lobbies, could lead to unknown costs and possible program implications depending on the timing of the requested change. Other changes can include the final layout of fire protection services (often self-certified by the sub-contractor) and the final layout of air conditioning services.

Fitout designs need to be completed well in advance to dovetail with the base building milestone dates usually stipulated in the Agreement for Lease (AFL). This can cause significant design development pressure for the tenant and their teams. Moreover, the tenancy fitout will often change, resulting in additional costs attributed to base building consultant reviews, updates to documentation and variation costs.

It is common for the main contractor to insist that the use of incumbent building services sub-contractors (fire, air conditioning, electrical etc.) be mandatory. This simplifies the main contractor's commissioning of the base building and reduces the number of sub-contractor organisations requiring supervision.

However, it can lead to cost premiums due to the non-competitive nature of the tender process. To mitigate a real or perceived lack of competitive tension, it is best practice for tenants to negotiate schedules of rates for common finishes (carpets, ceilings, etc) and services (ductwork, lighting) items so that any cost impacts are understood early, negotiated and budgeted for.

As the base building contractor hurtles towards practical completion, any changes could also be detrimental to the program. This means that once trade packages are let, any changes to the tenancy fitout will not only incur variation costs but additional base build consultant review costs, as well as potential delay costs.



Deloitte Fitout in construction
477 Collins Street, Melbourne

Agreement for Lease (Afl) Considerations

An Agreement for Lease (Afl) sets out the rights and obligations between the landlord and prospective tenant. Whilst these are typically lengthy documents which need to be relied on for the duration of the lease, they often don't consider or provide clarity on issues that arise in delivering the workplace fitout if an integrated delivery method is chosen. The following are just some of the considerations that tenants and landlords alike should be cognisant of:

Flexibility

A tenant's business needs (e.g. their way of working) may change throughout their term of tenancy. Having the flexibility to change the workspace to cater for these needs allows the tenant to make more dynamic business decisions.

In the 2019 'Future of Workplace' seminar facilitated by the Property Council of Australia and Arup, findings revealed that *'participants gravitated towards the idea of holding back 5-10% of a fitout budget to allow for flexibility and responsiveness'*.

Hand over conditions

This is particularly relevant for base building alterations and partial integration situations in which the main contractor alters certain aspects of the base building (perhaps even undertaking part of the fitout such as services or stairs), before a fitout contractor takes possession of the site to complete the works. Ensuring to clearly establish expectations surrounding the condition of the workspace at time of hand over will provide clarity to all parties, preventing double ups or gaps in scope.

Schedules of rates

A schedule of rates addressing a number of the fitout components is essential in ensuring a fair and reasonable price for any additional works and credits. A schedule of rates is not always incorporated into the Afl. When it is, rates become contractually binding and provide certainty of outcome to all parties.

Make Good Obligations

Any make good obligations will come down to a commercial negotiation between the tenant and landlord and can vary whether the fitout is integrated or not. If the base building has been heavily altered to suit the tenant's requirements then the landlord may want some form of make good when the lease expires.

Preliminaries and margin on trade costs

Many Afl's which contemplate an integrated fitout have the main contractor's preliminaries and margin as a simple percentage; often about 12% of all trade costs. There is a case for advocating two separate percentages: a higher percentage for building trades such as partitions, joinery and finishes (which require greater site supervision) and usage of the main contractor's amenities. A lower percentage (4-6%) is attributed to workstations, loose furniture and audiovisual equipment. This difference is due to the latter trades typically placing less pressure on the main contractor's preliminaries and generally having much greater tenant involvement in their procurement than the former trades.

Milestone dates for design delivery

This is equally applicable for the tenant and landlord's respective design teams. Without the timely delivery of quality base building design information, the tenant's fitout team won't be able to advise of any base building alterations or provide the fitout design to the main contractor, who will be waiting to commence works. It is also incumbent for the fitout designers to provide quality designs in alignment with the program. Late delivery of such documentation will lead to main contractor delays, attracting costs that often aren't budgeted for.

If the documentation provided by either party is not of the necessary quality or properly coordinated, the main contractor is within their rights to reject said documentation. This will cause delays while designs are revised, or lead to variations during construction (when a lack of coordination becomes most evident).

Back to back with the main contractor

This is highly dependent on the timing of when the Afl and construction contracts are being executed. If it's possible to mirror the relevant parts of the Afl in the construction contract, then it gives clarity to all parties involved.

Base building modifications

Tenants who become part of the development process early enough, can alter the base building to suit their workplace fitout needs (subject to the landlord's approval). This may include several different aspects, such as changes to finishes within the tenancy and/or lift lobby or changing the layout of base building services to suit the intended fitout.

The base building modification which seems to cause the most uncertainty is stair voids. Tenants wanting to create vertical connectivity within their workplace will certainly need to install stairs, and whilst Afls set out the size of the stair void(s) and whether the tenant will pay rent on the area, they often don't address the impacts of the shape of the void, construction cost of program delays.

Preliminaries matrix

The main contractor's preliminaries and margin is a percentage applied to all trade costs, meaning definition must be placed on what is being provided for that percentage. This is best achieved through a demarcation matrix that allocates responsibility between the main contractor and the sub-contractors for preliminary items such as temporary services, materials handling, access, labour and supervision.

Key Considerations

There are a number of considerations associated with fully and partially integrated fitouts, all of which can be broadly categorised into the 'procurement' and 'base building' stages respectively. As such, tenants should be aware of the challenges and mitigation strategies to take in response, as well as how to capitalise on the opportunities that can arise.

Procurement

Integration Election

Although there will be programme benefits by proceeding with a fully integrated delivery, the decision not to do so is a common one. However, some components such as interconnecting stairs and building services are generally more effectively delivered as part of the base building works. As such, tenants often benefit by utilizing partial integration for these areas, but should be clear on the demarcation of the works and handover conditions of the tenancy before the fitout contractor commences their works.

Base Build Modifications

New buildings are usually constructed to a generic floor plan, with structural components such as the lift, core, floor slabs, façade, roof, ceiling grid and tiles, air conditioning equipment, lighting, smoke detectors etc, and the developer's choice of flooring. When the tenant comes in, they will need to modify these components to a greater or lesser extent to fit their workplace needs. The opportunity that arises from this is that the tenant may be able to influence stair void penetrations, wintergardens, etc. If these are instructed early enough in the process, the tenant can mitigate cost premiums and program delays.

Open Book Tendering

For both a fully integrated and partially integrated fitout, a transparent tender process with the Main Contractor is essential. Ideally, the fitout consultant team will have input into the pool of sub-contractors being asked to tender. It is imperative that the sub-contractors chosen are interested and appropriate in terms of track record and capacity, to avoid wasting tender spots and potentially minimising competitive tensions. The fitout team must also be involved in tender vetting, so that the team and Main Contractor can review the submissions received together, saving time in the assessment process.

Main Contractor Preliminaries

In an integrated fitout, it is assumed that the Agreement for Lease will have an agreed preliminaries and margin percentage for the Main Contractor. This will then be applied to the trade packages as they are let. It is advantageous from a cost perspective if there are two percentages; one for the fitout works, which is typically higher at 12%, and one for loose furniture, workstations, Audio Visual etc, typically a lower percentage at 4-6%. This can be administered through a robust preliminaries responsibility matrix which clearly defines what preliminaries are to be undertaken by the main contractor and those to be carried out by the various trade sub-contractors.



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Base Building

Floor Finishes

It is typical that the 'Warm Shell' handover condition for the majority of new and existing spaces is a base building carpet tile. In an integrated fitout, this will often be changed to a different finish such as vinyl, stone, tiling, timber etc. Depending on the wording of the AfL, the tenant can claim a credit from the developer to put towards the alternative finish. Tenants receive an advantage in this instance by negotiating credits from the Main Contractor and putting these towards their desired finish, without paying for demolition or creating waste.

Stair Void

The tenants desired stair design may affect the base building structure, incurring additional costs through the forming of voids, additional reinforcement, concrete and formwork to deal with any additional loads and structural steel to 'trim' the void and connect with, what is typically, a steel structure for the stair itself.

Many AfL's between landlords and tenants will contemplate a stair void and its size, but rarely do they mention the shape of the void. A circular void is more expensive and time consuming to form than a square or rectangular void. There is then a disconnect between the AfL and the main contractors 'D & C' contract as the two contracts may not be 'back to back', leading to unnecessary angst between the parties which could be easily avoided if considered earlier in the process.



333 George Street, Sydney
Image courtesy Watpac

Stair Structure

Tenants will encounter lifting and access requirements associated with installing the stair structure if undertaking a partially integrated fitout. To ease pressure and reduce costs, tenants should consider having the stair structure delivered by the Main Contractor who can fabricate and install the stair one flight at a time using the tower crane. If the stair is undertaken by the fitout contractor, the structure will need to be taken up in pieces in the goods list and 'stick' built, which can be costly and time consuming.

Building Services

Ceilings often need to be altered in certain zones, departing from a grid system. Base build lighting may need to be replaced with a different type of lighting solution, in which case tenants can obtain credits for deleted lighting to offset the cost of the alternative lighting solution. The same process is equally applicable to other services such as air conditioning and sprinklers.

Ceiling Finishes

Similar to floor finishes, it is assumed that the 'Warm Shell' handover condition for majority of spaces is a ceiling grid with acoustic tile and plasterboard margin. In an integrated fitout, it is common that these will then be changed or omitted for other finishes such as feature ceilings, alternative ceiling tiles, or set or perforated plasterboard ceilings. Depending on the AfL, the tenant can claim credits from the developer to put towards alternative finishes. Tenants should query with the Main Contractor whether, as a part of the AfL, they will provide an acoustic treatment to the slab soffit and rigid ductwork, which is a more aesthetic finish than an off-form concrete soffit with flex ductworks. Depending on the answer, there could be significant costs which should be captured early in the design stages. Or, if unaffordable against the budget, a more cost-effective design can be planned.

Cost Model & Analysis

The table below analyses a predominantly open plan workplace fitout of 10,000m² in an 'A' Grade office building in a CBD location. The analysis models the potential cost outcome of a tenant choosing to deliver either a fully integrated, partially integrated, or standalone fitout from base building construction.

	Standalone fitout			Partially integrated			Fully integrated		
	%	\$ /sqm		%	\$ /sqm		%	\$ /sqm	
		Low	High		Low	High		Low	High
Program from Base Building finish to fitout completion		+ 5 to 6 months			+ 3 to 4 months			+ 1 to 2 months	
Main Contractor trade cost premium / risk / market volatility		n/a			5%	10%		5%	10%
Fitout Contractor trade cost risk / market volatility		0%	5%		2%	5%		n/a	
Base Building credits (finishes, services, etc)	0%	n/a		0 to -2%	-\$40/sqm	\$0/sqm	-2% to -5%	-\$100/sqm	-\$40/sqm
Base Building / Main Contractor – Preliminaries and margin	0%	n/a		12%	\$70/sqm	\$20/sqm	12%	\$220/sqm	\$230/sqm
Base Building Trade Component (%)	0%	n/a		10 to 30%	\$560/sqm	\$200/sqm	100%	\$1,860/sqm	\$1,950/sqm
Fitout Contractor – Preliminaries and margin	7-9%	\$130/sqm	\$170/sqm	7 to 9%	\$90/sqm	\$150/sqm	0%	n/a	
Fitout trade Trade Component (%)	100%	\$1,790/sqm	\$1,880/sqm	70 to 90%	\$1,270/sqm	\$1,680/sqm	0%	n/a	
Construction Cost (\$ /sqm)		\$1,920/sqm	\$2,050/sqm		\$1,950/sqm	\$2,050/sqm		\$1,980/sqm	\$2,140/sqm
Difference to Lowest		0%	7%		2%	7%		3%	11%
Potential Rent overlap (months)		4 months	5 months		2 months	3 months		0 months	1 month
Potential Rent Overlap (\$750/m ² p.a. A Grade, Melbourne CBD Location)		\$250/sqm	\$315/sqm		\$125/sqm	\$190/sqm		\$0/sqm	\$65/sqm
Construction Cost + Potential Rent Overlap (Melbourne)		\$2,170/sqm	\$2,365/sqm		\$2,075/sqm	\$2,240/sqm		\$1,980/sqm	\$2,205/sqm
Potential Rent Overlap (\$1,200/m ² p.a. A Grade, Sydney CBD Location)		\$400/sqm	\$500/sqm		\$200/sqm	\$300/sqm		\$0/sqm	\$100/sqm
Construction Cost + Potential Rent Overlap (Sydney)		\$2,320/sqm	\$2,550/sqm		\$2,150/sqm	\$2,350/sqm		\$1,980/sqm	\$2,240/sqm
Potential Rent Overlap (\$650/m ² p.a. A Grade, Brisbane CBD Location)		\$220/sqm	\$270/sqm		\$110/sqm	\$165/sqm		\$0/sqm	\$55/sqm
Construction Cost + Potential Rent Overlap (Brisbane)		\$2,140/sqm	\$2,320/sqm		\$2,060/sqm	\$2,215/sqm		\$1,980/sqm	\$2,195/sqm

A fully integrated solution will deliver the fitout the quickest with minimal time lag from completion of the base building. A standalone fitout for a tenancy of this size could have a gap of 5 to 6 months.

As the main contractor will invariably seek to use incumbent sub-contractors, particularly for partitions, finishes and services, there is a premium due to lack of market competitiveness and a general risk associated with short term market volatility of between 5% and 10%. This reduces to between 0% and 5% for fitout contractors as they are competitively tendering all trades and potentially to a lower 'tier' of sub-contractor. Fitout contractors may also have better relationships with specialist joinery sub-contractors, workstation and loose furniture providers which enables to gain competitive pricing with a lower risk profile.

Depending on whether the tenant chooses partial or full integration, research shows that base building credits of up to 5% of the trade cost could be owed to the tenant to offset other fitout costs. Timing is also critical in this regard to maximise real savings.

The main contractor's preliminaries and margin on a workplace of this type and size is typically around the 12% (on trade cost) mark, whereas a fitout contractor will be between 7% and 9%. The fitout contractors are a lower percentage because their access (cranes, etc.), level of site supervision and overheads are lower than base building contractors.

The amount of trades being used by the main contractor will vary depending on whether the fitout is being partially or fully integrated. In a fully integrated scenario, the main contractor is providing 100% of the sub-contractors.

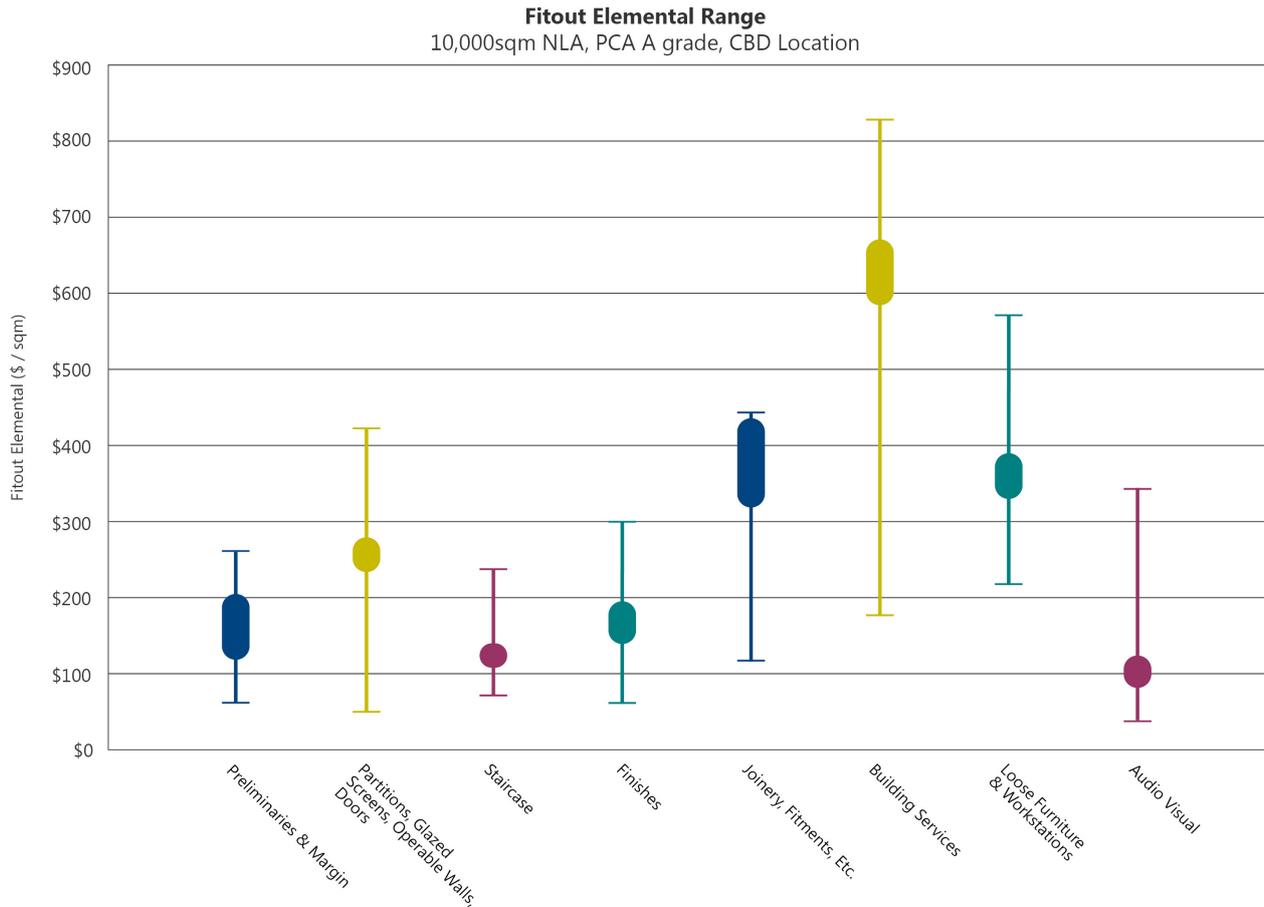
Meanwhile, this figure reduces to between 10% and 30% in partial integration, with the fitout contractor employing the balance of the required trades. In a standalone fitout, the main contractor has no involvement, with all of the trades managed by the fitout contractor.

The \$/m² provided for trade cost is taken from benchmarked projects, similar in type, area and procurement path. The table above shows the elemental \$/m² across the major elements and the range that is possible for projects of this kind.

So, whilst the model shows that a standalone fitout is typically less expensive than either of the two integration delivery methods from a construction cost perspective, it doesn't factor in any implications due to a lag in the program, particularly the potential for tenants to have to pay double rent. Based on this, a standalone fitout could end up being more expensive, rendering the partial and/or fully integrated fitout models more attractive.

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Final Insights & Advice

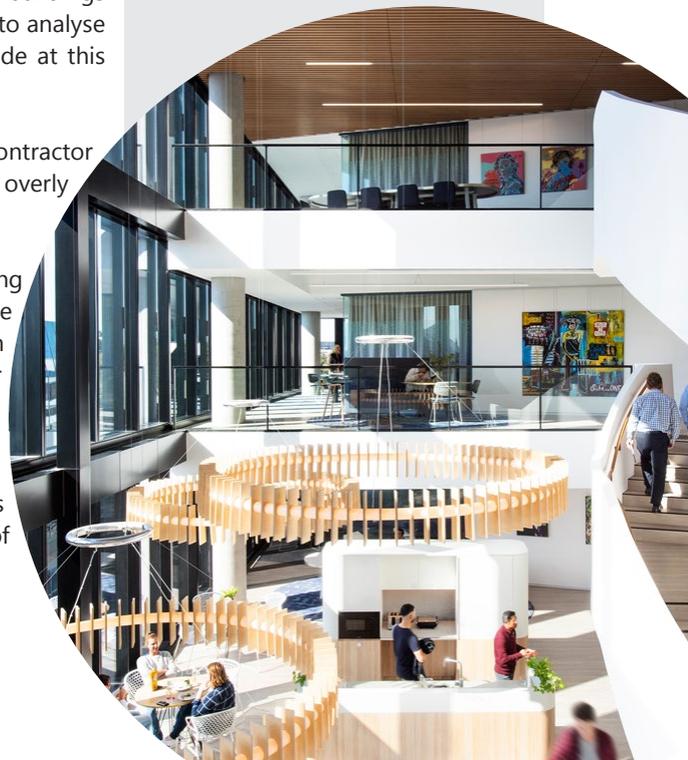
The decision-making process for tenants in choosing a new building, contemplating the right workplace design and deciding on the right delivery method is highly nuanced, with multiple permutations. The following are some overarching points to consider:

- Tenants must be rigorous with their due diligence during the site selection process. This will entail going to the extent of detailed briefing for their workplace needs and converting that to test fits for the various buildings being considered. Employing a consultant team at this early stage to analyse and assist in understanding the implications of any decisions made at this early stage can help save both time and money in the long run.
- There is no discernible difference in the quality produced by a main contractor or fitout contractor. As such, this is not an issue for tenants to be overly concerned about.
- Landlords/Developers can assist prospective tenants by workshopping some of the key considerations mentioned here and reflect the mitigation measures in the Afl documentation. Having some form of 'back to back' contractual mechanism with the main contractor is also beneficial. It sets the expectations and gives clarity to all parties.
- Tenants should ask themselves what their most important drivers are - cost or program? If the answer is program, utilizing a form of integration can be beneficial.

Please note the graph above excludes:

- Base building modifications
- Consultant fees
- Contingencies
- Escalation
- Statutory fees & charges
- Removalists
- Tenant business costs (IT, stationery, etc.)

105 Phillip Street Parramatta
Image courtesy of Bates Smart





About Slattery & Kaizen

Slattery is a property and construction advisory firm specialising in quantity surveying, cost management and early phase project advisory, with an outstanding history spanning more than 40 years.

We work hand-in-hand with governments, institutions and organisations as well as planners, developers, architects and design teams on a broad range of property and construction projects.

A commitment to excellence and innovation, and an ability to become an integral part of the project team has earned Slattery the trust and respect of clients and project teams alike. Slattery adds value by taking control and ownership of the cost management process from the outset. We understand the importance to drive innovation and productivity.

Slattery's Kaizen Papers focus on sharing knowledge, ideas and pertinent cost information related to our industry. Kaizen is the Japanese word for improvement, and a business philosophy that strives for continuous improvement in process. We produce papers across the sectors we work with, which are shared with our clients and made available on our website for all to view.

We invite you to explore these further at www.slattery.com.au/thought-leadership

Redefining workplaces

Slattery brings a comprehensive understanding of commercial developments and workplace projects, including the cost management of standalone, partial and fully integrated workplace fitouts. With our breadth of experience, we understand the impact of key project drivers specific to developers, landlords and tenants alike.

Using our knowledge of design, procurement and construction challenges and opportunities, we can assist our clients and industry colleagues to achieve successful outcomes.

For more information about our commercial office and workplace capabilities, please contact our National Sector Lead Barry Laycock at barry.laycock@slattery.com.au.