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2 February 2018

Mr John Wicks
Chief Operating Officer
Art Gallery of NSW
Art Gallery Road
Sydney NSW 2000

Dear Mr Wicks

RE: SYDNEY MODERN GALLERY ALTERNATIVE LOCATION

You have asked that I consider the business case implications of developing the new Sydney Modern Gallery at an alternate CBD or regional location. This alternate location would be in lieu of the site proposed in the Sydney Modern Project business case[1] ("SMP Business Case") which is to locate the Sydney Modern Gallery on Art Gallery Road adjacent to the existing Art Gallery of NSW ("AGNSW").

For the purposes of this advice I have assumed the alternate sites will be located in the Sydney CBD or at another location in the Sydney metro area. I have also assumed that capital costs and overall building operations are materially the same.

Overview

The development of the Sydney Modern Gallery at another site will have material SMP Business Case impacts and it is arguable that the change is so material that it is in fact a different business case. Key areas that will materially change are visitation, operating cost, private funding, art philanthropy and consumer surplus estimates for the residents of NSW.

The development of the AGNSW at two distinct locations will also:

1. create two galleries that fall well short of the regional and global trend to develop highly activated city art precincts, and
2. not resolve the limited operating spaces (display, exhibition, public and back of house) and sub-optimal art handling facilities that currently limit the scale and scope of the AGNSW.

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[1] As outlined in the Sydney Modern Project Final Business Case 18 November 2016 & Sydney Modern Project Final Business Case Addendum 6 March 2017.

The SMP Business Case complied with the methodology prescribed in the NSW Government's Guidelines for Economic Appraisal (TPP 07-5). A cost benefit ratio ("CBR") of 1.62 was calculated for the SMP Business Case. As this was above 1.0 there was a significant positive return on investment. Constructing the new Sydney Modern Gallery at an alternate location would result in a CBR of 0.74 based on the material changes noted above.

Key drivers behind the reduction in CBR are the withdrawal of private capital funding, reduced art philanthropy, reduced operating cashflow and a lower consumer surplus for the residents of NSW ("Consumer Surplus"). The reduction in Consumer Surplus is not easily quantified and would require additional consumer surveys to be carried out to confirm. The reason that the Consumer Surplus is likely to fall is simply that two standalone galleries do not overcome the constraints of gallery scale and scope. The reduction in consumer Surplus assumed was 50% and if excluded from the CBR calculation, the revised CBR would have been 1.05.

The balance of this advice details the specific areas subject to material change as a result of constructing the new Sydney Modern gallery at an alternate location.

Visitation

The visitor demand forecast for the SMP was based on detailed research and benchmarking of previous gallery upgrades, gallery trends and detailed benchmarking with other Major Australian Galleries[2]. In Australia, the AGNSW currently has one of the lowest visitor conversion rates of all major galleries and has absolute visitation materially below that of the National Gallery of Victoria ("NGV") and the Queensland Art Gallery ("QAG"). On a world scale, gallery developments have increased the number, scale and scope of world class galleries and art precincts. The AGNSW conversely has remained static.

The reasons for AGNSW low visitor conversion rates are complex but essentially boil down to the following key drivers:

1. AGNSW infrastructure is at capacity and currently does not have the scale or scope of other comparable major Australian galleries despite being located in a global city with potentially the largest Australian visitor population. Benchmarking with other comparable Australian galleries highlights significantly smaller operating spaces (display, exhibition, public and back of house) and sub-optimal art handling facilities.

2. A key reason why the AGNSW benchmarks poorly is that it has been overtaken as the pre-eminent Australian Art Gallery primarily due to significant upgrades at other major Australian galleries. This has allowed major galleries such as Melbourne, Brisbane and Canberra to provide deeper art experiences and increase the scope and scale of their

[2] Art Gallery League Tables & Art Gallery Upgrade Benchmarks and Sydney Modern Project Demand Forecast, both reports prepared by Sandwalk Partners late 2015.

exhibitions. It is notable that AGNSW visitor conversion rates ("VCR") for out of state visitors is significantly lower than comparable galleries such as the NGV, QAG and the National Gallery of Australia (Refer attachment A).

3. On a global level the AGNSW visitation ranking has fallen rapidly. This reflects ongoing gallery infrastructure development that is increasing the size and scope of regional art precincts. This is driving global competition for major exhibitions and cultural tourists (Refer Attachment B).

The SMP Business Case is a project that will transform the AGNSW into a highly activated city art precinct. While there would be two separate galleries, they operate in proximity as an integrated precinct and connected by a linked public space. This gallery configuration substantially addresses the identified weaknesses and creates an art gallery precinct that has the scale and scope to attract both domestic & international visitors, and major art exhibitions.

The SMP business case forecast higher visitation based on the achievement of higher VCR which are summarised in the following table:

Visitor Segment VCR	**AGNSW Base Case**	**SMP Business Case**
Out of state - International	2.7%	10.0%
Out of state - Interstate	4.2%	12.5%
Intrastate - Sydney Metro	15.5%	18.3%
Intrastate - Regional	5.2%	5.3%

The higher VCR rates were based on the SMP gallery and precinct configuration noted in the above table, detailed VCR benchmarking and operational benchmarking with comparable Australian galleries. The uplift in total visitation projected for the SMP Business Case when benchmarked was not unreasonable. (Refer Attachment C).

In contrast, the separation of the SMP into two galleries operating at separate and unlinked locations is a very different art gallery configuration. There would be two galleries neither of which has the scale or scope to be a major art precinct destination. In Australia there is no working example of a world class art gallery providing an integrated art experience across two remotely located galleries.

Locating the new Sydney Modern at an alternate location in the Sydney CBD will facilitate out of state visitation but it will be incidental rather than driven by a highly activated art precinct. The absence of a highly activated art precinct would also limit any the increase in intrastate visitation and potentially lead to rebalancing of visitor numbers between galleries.

An alternate gallery located outside the Sydney CBD would on the other hand facilitate intrastate visitation but again it would be incidental visitation due to two locations rather than the attraction of a highly activated art precinct. Out of state visitation is unlikely to be drawn given distance from Sydney CBD and the lack of a highly activated art precinct.

Given these location considerations, we have assumed the major impact of moving the new Sydney Modern Gallery to an alternate location will be to reduce the uplift in out of state visitation. This is reflected in the following table that details VCRs used to forecast visitation should the new Sydney Modern Gallery be constructed at an alternate location.

Visitor Segment VCR	AGNSW Base Case	SMP Business Case	SMP Alternate Location
Out of state - International	2.7%	10.0%	6.0%
Out of state - Interstate	4.2%	12.5%	8.5%
Intrastate - Sydney Metro	15.5%	18.3%	18.3%
Intrastate - Regional	5.2%	5.3%	5.3%

Based on financial modelling using the above VCRs, there will be a reduction in visitation compared to the SMP business case of 371k per annum and a consequential net loss of self-generated income after minor cost savings of $2.0m per annum.

For the purposes of calculating a revised CBR, recurrent funding from government is assumed to increase by NPV $23.2m (i.e. loss of net self-generated income after minor cost savings expressed as an NPV).

Private Funding

The SMP Business Case includes $100m in nominal private funding committed to cover the SMP capital construction cost. For the SMP CBR calculation, private capital funding was treated as a NPV $71.8m benefit. This funding is conditional on the SMP being undertaken adjacent to the current AGNSW site. As a consequence, it cannot be assumed that private capital funding will be contributed if the new Sydney Modern Gallery is constructed at an alternate location. The implication of this is twofold:

1. the shortfall in private capital funding would need to be made up by the NSW government or the project scaled back from $340m to $240m. For the purposes of calculating a revised CBR, it is assumed the shortfall in private capital funding is covered by increased funding from the NSW government.

2. Benefits of NPV $71,8m attributable to private capital funding can no longer be treated as a benefit and will need to be excluded from the CBR calculation.

Art Acquisition

The SMP Business Case anticipates a doubling of art acquisitions both in cash and In-kind. Increased art acquisitions were included as a NPV $114.9m benefit in the SMP Business Case.

The doubling of art acquisitions was based on the actual experiences of the Queensland Art Gallery and the National Gallery of Victoria when they undertook major gallery upgrades. Both these galleries had situations where either the main gallery was enhanced and/or a new gallery established in a linked precinct. These upgrades provided an opportunity to leverage the philanthropic donor base to drive a step change in art philanthropy.

The same level of support or leverage will not be present if the new Sydney Modern Gallery is relocated to an alternate location. The implication of this is that NPV $114.9m benefits attributable to art acquisition will need to be excluded or at least significantly scaled back.

For the purposes of calculating a revised CBR, the benefit attributable to art acquisition is assumed to be NPV $28.7m (i.e. 25% of the SMP business case NPV $114.9m art acquisition benefit).

Consumer Surplus

The SMP Business Case includes an estimate of the consumer surplus enjoyed by the residents of NSW. For the SMP CBR calculation, a consumer surplus benefit of NPV $249.1m was included.

The Consumer Surplus was estimated by eliciting NSW residents' willingness to pay for the SMP and subsequently valuing this benefit over time. The Institute for Choice, University of South Australia (the Institute) was engaged by the Investment Appraisal Unit, NSW Department of Industry to estimate the willingness to pay through a stated preference choice experiment. The estimates of value for the consumer surplus were detailed in a Cost Benefit Analysis prepared by the Investment Appraisal Unit, NSW Department of Industry in November 2016 and included as an NPV benefit in the SMP Business Case.

The willingness to pay experiment was designed to capture use and non-use benefits for NSW residents. The use value represents those benefits accruing from the actual use of the new gallery facilities. This included for example, attendance at art exhibitions, use of new facilities (restaurant or conference) or spending time and engaging with the art precinct. Non-use benefits were where NSW residents valued the SMP contribution to Sydney's reputation, altruistically valued the provision of the asset for use by others, or the option of having access to the redeveloped Gallery in the future.

The Consumer Surplus modelling was based on the Sydney Modern gallery operating as an integrated arts precinct in proximity to the current AGNSW. As a result, it assumed a significant increase in gallery scope and scale that would drive a highly activated art precinct and enhance Sydney's cultural reputation. Construction of the new Sydney Modern Gallery at another location would not result in either gallery having significant scope or scale or a comparable arts precinct to that of the SMP Business Case. This would significantly reduce "willingness to pay" preferences and the Consumer Surplus value estimate. The extent of the reduction in Consumer Surplus cannot be easily validated without another consumer choice survey being undertaken.

For the purposes of calculating a revised CBR, the Consumer Surplus estimate is a conservative NPV $125m (i.e. 50% of the SMP business case consumer surplus estimate of NPV $249.1m).

Operating Costs

The SMP Business Case assumed the new Sydney Modern gallery would operate as an integrated arts precinct. As a result, staff were assumed to be shared across both galleries. Construction of the new Sydney Modern Gallery at an alternate location would reduce the ability to share staff services. Other costs are not expected to materially change given that two gallery buildings will be in use regardless.

High level estimates of the staffing increase due to an alternate are as follows:

Work Area	**FTE Increase**	**Driver**
Loading dock & security	4	Full security and loading dock facilities operating at both sites
Exhibitions & Design	2	Exhibition setup and design personnel required contemporaneously at two sites
Collections	2	Collection management will require more oversight, travel and co-ordination
Public programs	2	Staff need to operate contemporaneously and travel between 2 sites
Philanthropy	1	Fundraising programs will need to operate contemporaneously over two sites
Front of house	3	Full customer service facilities operating at both sites
ICT	1	Service support across 2 sites, particularly where supporting art installations
Total	15	

Additional staff of 15 FTE would increase annual operating costs by approximately $1.7m. For the purposes of calculating a revised CBR, the recurrent funding required from government is assumed to increase by NPV $19.9m (i.e. increased salary cost expressed as an NPV).

Cost Benefit Ratio("CBR")

SMP Business Case complied with the methodology prescribed in the NSW Government's Guidelines for Economic Appraisal (TPP 07-5). Project benefits or costs were estimated as a net present value (NPV) and the return on investment expressed as a CBR. A CBR greater than 1 is a positive return on investment and a CBR below 1 is a negative return on investment.

The NPV benefits and costs along with the calculated CBR are summarised in the table below for both SMP Business Case and the option of constructing the Sydney Modern Gallery at an alternate location.

Economic Appraisal Results (NPV $2016/17)

	SMP Business Case*	Alternate Location No Reduction in Consumer Surplus	Alternate Location With A Reduced Consumer Surplus
Capital expenditure	249,087	249,087	249,087
Recurrent operations funding	108,040	151,179	151,179
Recurrent capital funding	37,803	37,803	37,803
Terminal value	-33,311	-33,311	-33,311
Total project costs	**361,620**	**404,758**	**404,758**
Returns to NSW labour	56,016	56,016	56,016
Returns to NSW-owned businesses	85,821	85,821	85,821
Returns to NSW residents	254,305	254,305	127,153
Philanthropic surplus – capital	71,816	0	0
Philanthropic surplus – recurring	114,948	28,737	28,737
Payroll tax surplus	2,140	2,140	2,140
Total project benefits	**585,046**	**427,019**	**299,867**
Project net benefit	**223,426**	**22,261**	**(104,892)**
Benefit/Cost Ratio	**1.62**	**1.05**	**0.74**

*Source: Sydney Modern Project Final Business Case, 6 March 2017 Attachment C, Economic Appraisal Addendum

The SMP business case has a CBR of 1.62. Constructing the new Sydney Modern at an alternate location would have a CBR of 1.05 excluding any change to the Consumer Surplus. The CBR to construct the new Sydney Modern Gallery at an alternate location would be 0.74 including the 50% reduction in the Consumer Surplus noted in the earlier section on consumer surplus.

Should you have any further questions in regard to this advice please do not hesitate to contact the undersigned.

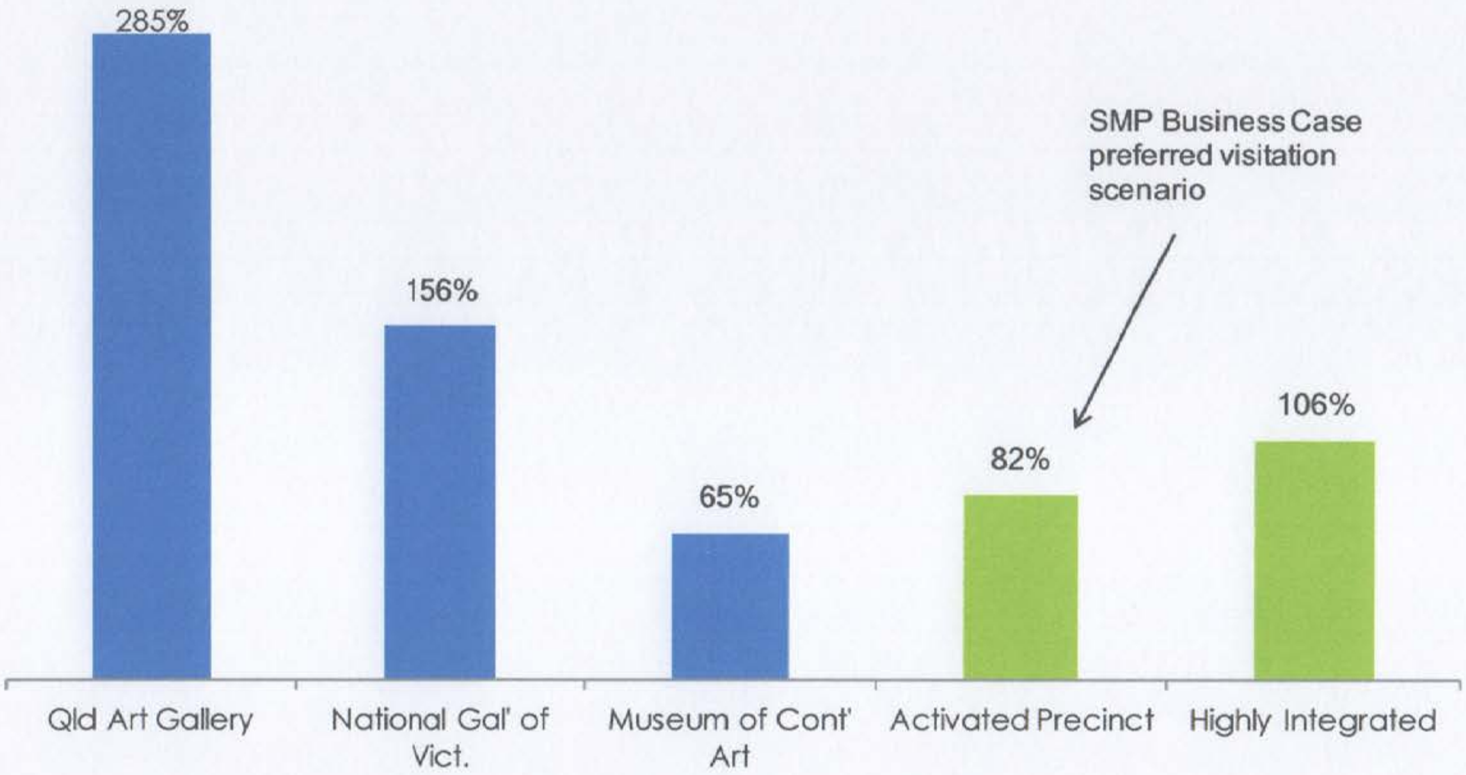
Yours sincerely

David Antaw.

ATTACHMENT C

COMPARISON OF POST UPGRADE VISITATION INCREASES

Percentage increase



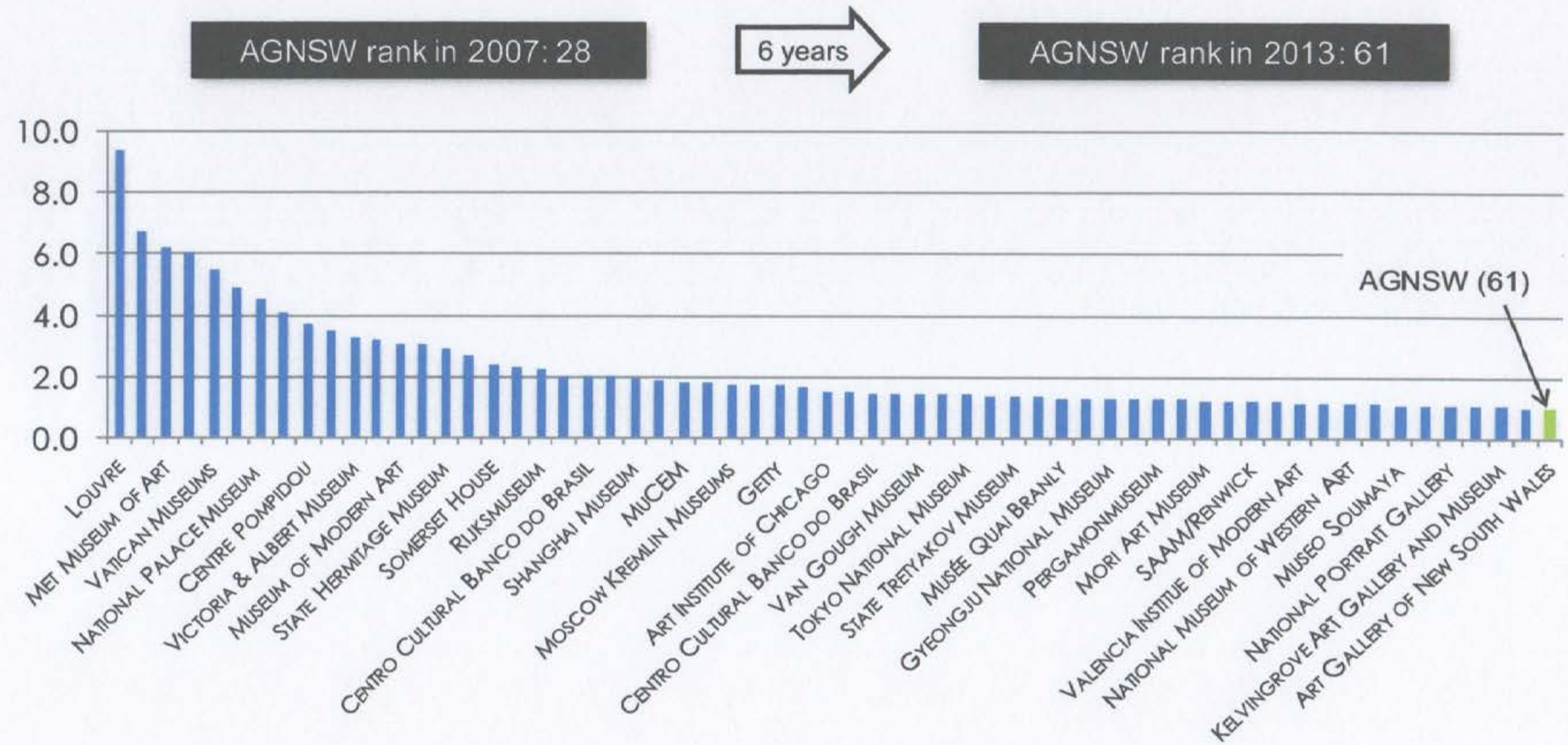
Source: SWP analysis October 2015. Refer Art Gallery League Tables & Art Gallery Upgrade Benchmarks Fact Pack dated 15 January 2015 prepared by Sandwalk Partners for more detailed benchmarking of major Australian gallery upgrades. MCA data for calendar year 2013 and may not reflect full impact of upgrade

ATTACHMENT B

There has been a significant increase in the number of major world galleries since 2007.

TOP 65 WORLD ART GALLERIES BY VISITATION 2013

Number of visitors (millions)



Source: The Art Newspaper "Total Art Museum Numbers 2013. Gallery names are as cited in the The Art Newspaper. Numbers for Australian Galleries have been taken from annual reports. Refer Art Gallery League Tables & Art Gallery Upgrade Benchmarks Fact Pack dated 15 January 2014 prepared by Sandwalk Partners for detailed analysis of gallery leagues tables.

ATTACHMENT A

ESTIMATED VISITOR CONVERSION RATES FY2014

Visitor Segment By Source	National Gallery of Vic.	Queensland Art Gallery	National Gallery of Australia	AGNSW
International Visitors	14.3%	19.6%	9.0%	2.0%
Interstate Visitors	17.3%	31.3%	21.1%	3.5%
Intrastate Visitors (metro & regional)	15.9%	9.2%	93.9%	10.1%

Source: SWP analysis February 2015.