

15 August 2008

Ms Elizabeth Williams
Principal Advisor
Gateway
Infrastructure Asset Management & Procurement Branch
NSW Treasury
Level 26, Governor Macquarie Tower
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SYDNEY NSW 2000

Dear Elizabeth

HMRI Building Business Case Gateway Review

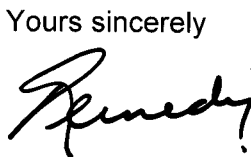
We are writing to you in your capacity as Review Manager for the HMRI Building Business Case Gateway Review, which will be conducted in August 2008.

As stakeholders in the HMRI Building Project, we present the attached document, Principles of HMRI Building Governance, dated 15 August 2008 for consideration by the Review Team. It will be referred to in the Business Case Review interview relating to Project Governance.

This document is a summary of the key principles and was developed to assist in the preparation of the Term Sheet for the Funding Agreement, the Funding Agreement, Land Lease, Building Lease and Sub-Leases and Building Licences.

It reflects the current position of the stakeholders in relation to the Governance of the HMRI Building and, subject to final legal advice, will form the basis of the project governance.

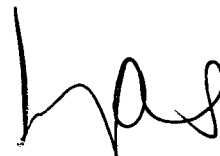
Yours sincerely



Mr Bob Kennedy
Chair
HMRI Board



Prof. Barney Glover
Acting Vice Chancellor and President
The University of Newcastle



Dr Nigel Lyons
Chief Executive
Hunter New England Health

In partnership with our community



THE UNIVERSITY OF
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Principles of HMRI Building Governance
Summary prepared for HMRI Building Business Case Gateway Review
15 August 2008

Background

An original Discussion Paper was prepared by HMRI, in consultation with UoN and HNEH, and subsequently reviewed by Sparke Helmore in February 2008. Further advice was sought from Sparke Helmore in July 2008.

Since then, the following meetings have been conducted to refine and develop the principles:

1. 9 April 2008 – Brad Webb and Barney Glover (UoN) to discuss Sparke Helmore advice;
2. 21 April 2008 – Brad Webb and Tracey McCosker (HNEH) to discuss Sparke Helmore advice;
3. 19 May 2008 – Brad Webb, Craig Wallis (UoN), Alex Richard (HMRI), Darren Turner (PwC) and Richard Anicich (Sparke Helmore) to consider accounting treatment and balance sheet recognition of capital expenditure;
4. 21 May 2008 – Brad Webb and Craig Wallis (UoN) to further consider accounting treatment of capital expenditure;
5. 28 May 2008 – Brad Webb, Craig Wallis (UoN) and Sue Beach (UoN) to discuss accounting and legal issues arising from Sparke Helmore advice;
6. 17 June 2008 – Brad Webb and Sue Beach (UoN) to discuss alternative governance models that would address risk exposures of each party to the project;
7. 15 July 2008 – Principles presented to HMRI Building Committee;
8. 24 July 2008 – Principles approved by HMRI Board;
9. 11 August 2008 – Brad Webb, Sue Beach (UoN) and Tracey McCosker (HNEH) with Tina van Epen and Angela Razborssek (Sparke Helmore) to discuss Sparke Helmore advice.

The Principles of HMRI Building Governance were developed to assist in the preparation of the Term Sheet for the Funding Agreement, the Funding Agreement, Land Lease, Building Lease and Sub-Leases and Building Licences. At the time of writing, Sparke Helmore was updating their advice to incorporate the outcomes from the meeting dated 11 August 2008. The stated Principles of HMRI Building Governance are outlined below and, subject to final legal advice, will form the basis of project governance:

Ref. Number	Principle	Actions and Agreements Required	Timing
1	Lease of Land and Buildings		
1.1	HMRI will lease a parcel of land from Hunter New England Health (Research Facility Site A). The site will include an expansion zone for future development. The boundary of the site is yet to be surveyed.	HNEH will liaise with Sparke Helmore to address all statutory requirements in relation to the leasing of HNEH lands. Land Lease will be drafted by Sparke Helmore.	August 2008 TBA
1.2	Market rental will be charged on the site. The Statement of Commitment, signed on 30 June 2008, notes that HMRI will receive a 'rental assistance grant' to offset this market rental.		
1.3	The land must be subdivided in order for the lease to be enacted.	Brad Webb and APP to liaise with HNEH Surveyor (Hutchisons) to commence the subdivision process.	August 2008
1.4	HMRI and the University of Newcastle (UoN) will make capital contributions towards the construction of a joint research facility. The final value of these respective capital contributions is yet to be determined.	Development Agreement is being drafted by Sparke Helmore. Funding Term Sheet and Agreement will be finalised	August 2008 TBA

Ref. Number	Principle	Actions and Agreements Required	Timing
		when final value of capital contributions is known.	
1.5	This joint research facility will be known as the HMRI Building, or some other name as agreed by the HMRI Board.		
2	Space Allocations in the Building		
2.1	<p>The primary purpose of the facility is medical research. For the purpose of definition, reference is made to the NHMRC definition of medical research:</p> <p>‘Medical research includes the laboratory based or clinical study, or group or community based study of the causes, treatment and prevention of human diseases and also includes dental research.’</p> <p>The space will be allocated to activities that are related to health and medical research activities at HMRI, UoN and Hunter New England Health (HNEH).</p>		
2.2	<p>Other restrictions on the use of space that will need to be considered in the allocation of space include:</p> <ul style="list-style-type: none"> - Restrictions imposed by individual funding agreements between funding bodies and HMRI / UoN - Local government zoning restrictions (current land zoned 5A) - NSW Health, HNEH and UoN Policies, which may preclude certain activities 		
2.3	Space will be allocated to distinct groups of activities, for example, HMRI Administration, Priority Research Centres, HMRI Programs or distinct teams within these groups. Continued occupancy of the space allocated to a group will be subject to annual review of need, demand and the delivery of performance targets.		
2.4	A Building Management Committee will be formed to provide advice to HMRI #2. This Committee will have representatives from HMRI, UoN, HNEH and the researchers occupying the building.	Building Management Committee to be formed when new company is incorporated.	TBA
2.5	Space allocations will be determined jointly by the Building Management Committee, with reference to the ‘Master Plan’ for research accommodation. This includes the introduction of commercial tenants.		
2.6	The Building Management Committee will determine the method by which car parking will be allocated. In principle, all car parking will be allocated on a user-pays basis, with priority given to senior staff in the building. In addition, a number of bays will be reserved for visitors to the Institute and will be managed by HMRI on a day to day basis. Charges for car parking will be in line with other car parking on the campus.		
3	Proposed Governance Structure (refer to Appendix 2)		

Ref. Number	Principle	Actions and Agreements Required	Timing
3.1	HMRI will form a new company limited by guarantee (HMRI #2) to operate and maintain the HMRI Building. The entity will adopt an identical structure to HMRI, thereby maintaining the independence of the organisation.	New company to be incorporated.	TBA
3.2	As noted, HMRI will lease a parcel of land from HNEH.		
3.3	HMRI will be responsible for the design and construction of the HMRI Building on the leased parcel of land.		
3.4	HMRI will lease an identified area in the HMRI Building to the University of Newcastle (UoN). UoN will sub-lease this area to HMRI #2. This provides both UoN and HMRI with security of tenancy, mitigating future risk to both organisations.	Building Lease will be drafted by Sparke Helmore.	TBA
3.5	HMRI will lease the remaining area in the HMRI Building to HMRI #2.	Building Lease will be drafted by Sparke Helmore.	TBA
3.6	HMRI #2 will be responsible for the operation and maintenance of the HMRI Building. It will licence the space to UoN, HNEH and HMRI, providing flexibility in the way in which research and administration team occupancy is managed. It will also have the power to sub-lease space to commercial tenants.	Building Licences will be drafted by Sparke Helmore. Building Sub-lease will be drafted by Sparke Helmore.	TBA TBA
3.6	<p>HMRI #2 will incur costs related to operating the facility to the standard required of the licence-holders. These costs typically include:</p> <ul style="list-style-type: none"> • Cleaning • Computer expenses • Fees and Permits • Health and Safety • Insurance – Building and Contents • Insurance – Public Liability • Property Management Fees • Rates and Taxes • Repairs and Maintenance • Salaries and Wages – Facility Manager, Building Management Staff • Security • Staff Amenities (including carparking) • Tenancy and Property Supplies and Services • Utilities (Electricity, Gas, Water) <p>Additional costs specific to the HMRI Building will include:</p> <ul style="list-style-type: none"> • Animal Facilities • Shared Equipment and Research Infrastructure • Shared Facilities and Common Areas 		
3.7	Related licence-holders (UoN, HNEH and HMRI) will pay a licence fee calculated with reference to the recovery of the actual operating costs.		

Ref. Number	Principle	Actions and Agreements Required	Timing
3.8	HMRI's NSW Government Infrastructure Funding will be used, in part, to offset the operating costs of the facility. The level of funding contribution from NSW Government Infrastructure Funding will be determined by the HMRI Board.		
3.9	Third party lessees (commercial tenants) will pay a lease fee calculated with reference to commercial rates where appropriate.		
3.10	It is recognised that an important role of the HMRI Building is to act as an incubator for related spin-off companies. This may require the provision of a guaranteed space allocation for a particular period of time. In these situations the licence fee, while referenced to commercial rates, may be reduced to reflect the incubator role.		
3.11	Any profit arising from commercial tenants will be used to offset the licence fees of HMRI, UoN and HNEH. The profit will be calculated annually and distributed in proportion to the licence fee of each related party for that period		
4	Calculating the Licence Fee (Related Parties)		
4.1	Within each area arising from the space allocation there will be employees from one or all of the three related parties (HMRI, UoN and HNEH).		
4.2	The combination of employees within each area is expected to change regularly.		
4.3	Floor space per person is calculated as floor area / head count. The floor space per person for each group in the building may vary depending on how the group uses the area allocated to them.		
4.4	It is acknowledged that laboratory space is more expensive to operate than office space. While distinguishing costs between the two types of space is not feasible, it is feasible to determine a cost-loading for laboratory costs and incorporate this into the licence fees. The cost-loading is still to be defined based on estimates derived from benchmarked buildings.		
4.5	The licence fee will be calculated on the basis of floor space per person.		
4.6	The sub-licence fee will be calculated in the following manner: 1. Determine head count for each area 2. For each allocation, calculate floor space per person (split between lab and office) 3. Split head count between parties 4. Calculate floor space per party per area (split between lab and office) 5. Calculate total floor space per party (split between lab and office) 6. Calculate percentage of floor space (split between lab and office),		

Ref. Number	Principle	Actions and Agreements Required	Timing
	which will be used to determine quantum of licence fee See Appendix 1 – Example Calculation of Licence Fee		
4.7	In order to equitably share the operating costs of the facility, HMRI #2 will calculate and invoice the licence fee annually.		
4.8	The Licence fee will be calculated in advance. In the event of unexpected costs that were not included in the estimate, HMRI #2 reserves the right to levy an additional licence fee in consultation with the related licence-holders.		
4.9	HMRI #2 will maintain up to date accounting records and bank accounts in respect of all income and operating expenses relating to the HMRI Building.		
5	Building Management		
5.1	HMRI #2 will be responsible for managing the HMRI Building.		
5.2	A Building Management Committee will be formed to provide advice to HMRI #2. This Committee will have representatives from HMRI, UoN, HNEH and the researchers occupying the building.		
5.3	As part of the management of the HMRI Building, HMRI #2 will enter into Service Level Agreements with other organisations to deliver specific elements of the operations of the facility, for example security, carparking, maintenance, cleaning, OHS. These may be provided by related parties or third-parties.		
5.4	Each of these elements will be formalised in a Service Level Agreement, with obligations of both HMRI #2 and the service-provider clearly specified.		
5.5	HMRI #2 will manage the facility to the requirements of the OHS standards of all relevant Acts and Regulations, UoN and HNEH. If there is a discrepancy between the respective standards the highest standard will be adopted.		
5.6	HMRI #2 will ensure that the facility is protected with adequate insurance and public liability protection.		
5.7	Prior to practical completion of the HMRI Building, processes will be conducted to agree, establish and document uniformly applied codes of conduct, general policies and procedures to ensure proper OHS.		
6	Building Life-cycle Maintenance		
6.1	The Building Management Committee will prepare a life-cycle maintenance plan for the building, which will be managed by HMRI #2. This plan will estimate life-cycle maintenance costs (painting, carpets, roofing, air-conditioning plant, major refurbishments) for the building and determine the timetable for major refurbishments.		
6.2	Generally speaking, repairs and maintenance will form part of the		

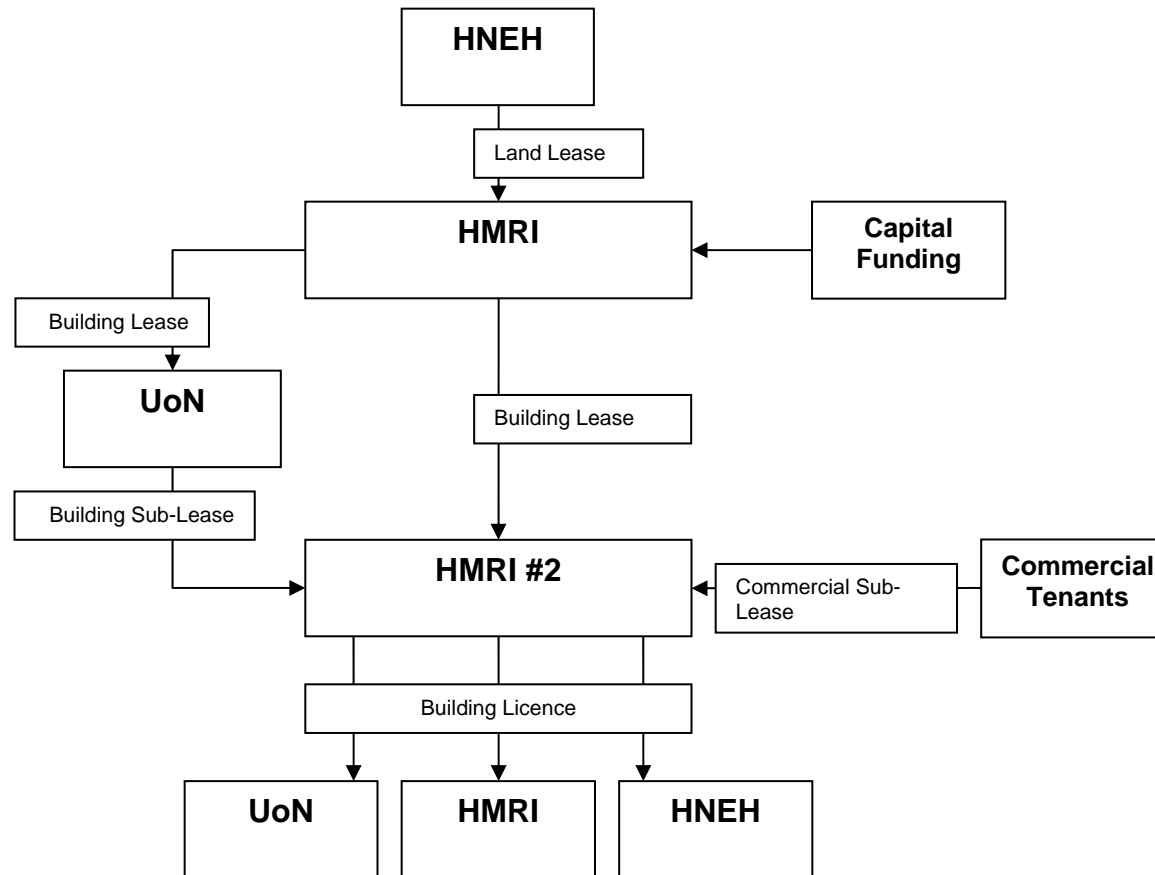
Ref. Number	Principle	Actions and Agreements Required	Timing
	annual operating costs of the HMRI Building and will be passed on through the licence fee.		
6.3	Building life-cycle maintenance does not include refurbishment for altered function, which is to be borne by the party making the alteration. In addition, major alterations may be required to be rectified when that party ceases to occupy the space. This will be explicitly addressed in the sub-licence agreements.		
6.4	Certain maintenance will be the responsibility of the lessor (HNEH). This will include maintenance of services up to the boundary of the subdivision including electrical, plumbing, computer cabling and telephony.		
6.5	These maintenance responsibilities will need to be defined and incorporated into the lease between HMRI and HAC. It is noted that the degree to which HAC will assume responsibility for maintenance may have a relationships to the level of any lease subsidy.		
6.6	HMRI, UoN and HNEH commit to meeting the obligations of the building life-cycle maintenance plan through contributions via the annual licence fee. The respective contributions required from each party will be determined with reference to their average annual occupancy percentage. A separate account for building life-cycle maintenance will be established and maintained.		
6.7	HMRI's NSW Government Infrastructure Funding will be used, in part, to offset the capital obligations of the life-cycle maintenance place.		
7	Dispute Resolution		
7.1	Any additional issues arising from the management of the HMRI Building will be considered by the Building Management Committee.		
7.2	In the event that the Building Management Committee is unable to resolve the issue, it will be escalated to the HMRI Chair, HNEH CE and UoN VC for resolution.		
7.3	Dispute resolution will be handled internally. Recourse for external mediation will be included in the Constitution of HMRI #2.		
8	Future Expansion		
8.1	The proposed site (Research Facility Site A) will include an expansion zone for future development. Any development must be conducted with reference to the Research Accommodate Master Plan and the degree to which it serves the interests of HMRI researchers from UoN and HNEH. HMRI will enter into an 'Agreement to Agree' in respect of the expansion zone, resulting in any proposed development requiring the approval of HNEH. The Principles of HMRI Building Governance contained herein do not apply to future development of the expansion zone.	'Agreement to Agree' will be drafted by Sparke Helmore in conjunction with the drafting of the Land Lease.	TBA

Appendix 1
Example Calculation of Sub-licence Fee

This calculation is indicative to demonstrate the principles of calculating the licence fee. It will not necessarily reflect the occupancy of the HMRI Building.

	Space Allocation			Floor Space per Person		HMRI			UoN			HNEH		
Group	Lab (m ²)	Office (m ²)	Total Head Count	Lab (m ²)	Office (m ²)	Head Count	Total Floor Area (Lab)	Total Floor Area (Office)	Head Count	Total Floor Area (Lab)	Total Floor Area (Office)	Head Count	Total Floor Area (Lab)	Total Floor Area (Office)
Pregnancy and Reproduction	1500	650	95	15.8	6.8				65	1026	442	30	474	204
HMRI		350	30		11.7	30		350						
VIVA	1700	800	115	14.8	7				65	960	450	50	740	350
Information Based Medicine	1000	500	70	14.3	7.1				65	929	463	5	71	37
Total	6500 m ²		310					350		2915	1355		1285	591
% of Costs for Licence Fee								5%		45%	21%		20%	9%

Appendix 2
Proposed Governance Structure



1. Land Lease
HMRI will lease a parcel of land from the Health Administration Corporation (HAC).
The term of the lease is proposed to be 40x40 years.
Market rental will be charged on this lease.
The market rental will be offset by a 'subsidy' from HAC.
2. Capital Funding
HMRI and the University of Newcastle (UoN) will make capital contributions towards the construction of the HMRI Building.
The final value of these respective capital contributions is yet to be determined. They are contingent on the final source of funding.
3. Building Lease
HMRI will lease an area to the University of Newcastle.
The lease will be an identified area of laboratory and office accommodation.
The allocation of space under the lease is not intended to bear any relationship to the capital contributions made by UoN.
HMRI will retain the common areas and an identified area of laboratory and office accommodation.
The term of the lease is proposed to be 20x20 years.
The value of the lease will be 'pepper-corn'.
4. HMRI #2
An entity will be incorporated to operate and maintain the HMRI Building (HMRI#2).
HMRI #2 will maintain a structure that duplicates the independence of HMRI.
The Constitution of HMRI #2 will specify the objects of the company, which will be restricted to the operation of research facilities.
HMRI #2 will provide generic laboratory facilities. Licensees will be responsible for specialised fit-out and restoration of the generic facilities.
The Directors of the HMRI #2 will appoint a Building Management Committee to provide advice to the entity.
5. Building Licence
UoN and HMRI will lease their respective holdings in the HMRI Building to HMRI #2.
The term of the lease is proposed to be 20x20 years, consistent with the term of the lease.
The lease will impose conditions in relation to the operation of the HMRI Building.
The value of the lease fees will be 'pepper-corn'.
6. Building Licences
HMRI #2 will licence space to UoN, HMRI and HNEH (the related parties).
The term of the licences are proposed to be 20x20 years, consistent with the term of the land lease.
The inherent nature of the licences aims to provide flexibility in the allocation of space and determination of licence fees.
The value of the licence fees will be referenced to the operating and life-cycle maintenance costs of the facility.
7. Commercial Leases
HMRI #2 may enter into commercial leases with non-related parties and start-up biotech companies associated with the related parties.
The terms of these commercial leases will be determined on a case by case basis.
The value of the leases with non-related parties will be referenced to commercial rates.
The value of the leases with start-up biotech companies associated with the related parties will be referenced to commercial rates and other negotiations relating to participation in the commercialisation activities of the start-up biotech companies.