NATIONAL AUDIT OFFICE

Report by the
Comptroller and Auditor General

The Contributions Agency

The Newcastle Estate Development Project

HC 16 Session 1999-00
25 November 1999

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John Bourn
Comptroller and Auditor General

National Audit Office
November 1999

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Executive summary

1 In January 1998, the Contributions Agency, (the Agency), let a Private Finance contract for the redevelopment and maintenance of the Newcastle estate of the Department of Social Security (the Department). The Contributions Agency were one of the Department's agencies and, with three other agencies (the Benefits Agency, the Child Support Agency and the Information Technology Services Agency), they occupy most of the Newcastle estate. In letting this contract, they acted on behalf of the Department as a whole. Since 1 April 1999 they have been an Executive Office of the Inland Revenue, called the National Insurance Contributions Office.

2 The Newcastle estate housed over 13,000 of the Department's staff and comprises over 2.5 million square feet, 627,000 square feet of which comprised single storey buildings at Longbenton, on the outskirts of Newcastle, which had been constructed as temporary accommodation during the 1940s.

3 To replace the ageing premises at Longbenton, the Department was advised by the Treasury to explore the Private Finance approach, under which a private sector supplier would contract to design, build and finance new buildings and to operate them and the remaining buildings for a period of years. It was a pioneering Private Finance project in the office sector. Acting on Treasury advice, and in order to increase the attraction of the project to the private sector, they included the whole Newcastle estate, which comprised both freehold land and buildings owned by the Department and leased premises.

4 The contract was awarded to a consortium formed for the purpose called Newcastle Estate Partnership, (NEP). The shareholders in NEP are AMEC Developments Ltd, a subsidiary of a UK-based international construction and engineering group, and Building and Property Group, a facilities management company.

5 From January 1998, NEP took over the ownership of elements of the Department's freehold estate in the Newcastle area and are responsible for redeveloping it during the following five years. The contract requires them to provide offices for the Department over a period of 31 years from 1998. In return, the Department will pay NEP at a predetermined price according to the availability of the space. At the end of the contract, the Department have various options, including renewing it, occupying the buildings on a traditional lease arrangement at a predetermined rent, or moving elsewhere. The expected net present cost of the deal is £241 million.

6 We examined whether:

a) the contract will deliver the accommodation service sought;

b) the Contributions Agency's conduct of the procurement was satisfactory; and

c) the contract would achieve the objective to provide the best value for money to the taxpayer and the Department.

The methodology for this examination is described at Appendix 1 of this report.

The contract should deliver the accommodation service sought

7 The Contributions Agency sought to negotiate a contract on behalf of the Department which would:

a) provide good quality accommodation in the Newcastle area, which will provide an adequate working environment for staff;

b) reduce escalating maintenance costs;

c) provide accommodation which is adaptable both in terms of movement between business units and future reductions in staffing;

d) reduce the number of sites housing business units;

e) provide accommodation which is IT-friendly and capable of further IT expansion; and

f) harness private sector skills and innovation.

8 Many of the existing premises are old and in very poor condition. This means that new accommodation will almost inevitably yield major operational benefits. The contract provides for the number of sites to be reduced from 12 to 5. Some flexibility if staff numbers fall is given by providing for the Department to vacate up to 20 per cent of the accommodation free of charge over the 25 years that the buildings are occupied. The Department can also request construction of a further new building during the first seven years of the contract should that be necessary.

9 The Contributions Agency sought to allocate risks to the party best placed to manage that risk, because such an allocation of risk is most likely to provide value for money. The contract does allocate the major risks appropriately and in accordance with this principle.

10 The Department have transferred to the private sector the risk that the Department might vacate up to 20 per cent of the office space available under the contract. This decision was informed by:

a) the known and possible major changes affecting the Department and its staffing levels;

b) discussions with the three bidders about the likely level of flexibility which they would be able to fund at a reasonable price, before asking all of them to include such flexibility in their final bids; and

c) historical movements in staffing levels since the early 1970s.

11 The Department were aware that a number of major changes were under consideration, such as the introduction of major IT systems and possible greater use of outsourcing, including (for example) Child Benefit work which accounted for some 1,850 staff on the Newcastle estate. The Department therefore felt that the future was very uncertain and all business units felt unable to make realistic long-term forecasts of their requirements for office space. Because of this uncertainty the Department saw flexibility as mandatory. The Contributions Agency also saw flexibility as inherent to their understanding of the Private Finance Initiative. They did not, therefore, ask bidders how much it was adding to their prices. This approach means that the Agency did not know, with certainty, whether the Department were likely to need the flexibility over the life of the contract – it was a matter of judgement – and they did not know how much it would cost the Department.

The procurement took longer than planned

12 When the Contributions Agency began work on the project, there was no precedent for seeking to use the Private Finance approach to provide office space. This absence of direct precedents was a factor in planning and managing the procurement.

13 The Contributions Agency set up an appropriate team to manage the procurement and sought to use what wider Private Finance precedents they had to conduct the procurement effectively. By including the whole Newcastle estate in the project, they responded to earlier advice that a Private Finance solution was not viable for the Longbenton site alone. They issued an output or performance specification that gave bidders an opportunity to offer innovative solutions to the Department's requirements. They achieved some significant advances in Private

Finance Initiative practice including better approaches to dispute resolution, and a clause that allows the Department to occupy space free of charge when temperature limits are breached.

14 The procurement took three years from the Contributions Agency inviting interest to signature of the deal, compared to an initial timetable of nine months which they acknowledge, with the benefit of hindsight, was too short. The effect of this was to involve bidders and the Agency in much higher procurement costs than they had expected and to delay the start of the redevelopment. The preferred bidders, and others, were concerned about the costs they had to bear, although six of the eight bidders stated that they would still be interested in bidding for future Private Finance projects.

15 The length of the procurement left little time between the award of the contract and the expiry of the leases on some existing buildings. The Agency and NEP worked together to minimise the operational consequences of the delayed start and NEP decided to begin detailed design work before the contract was awarded, with the confidence of having agreed commercial terms. At the time of writing, construction of the new buildings is progressing well and the National Insurance Contributions Office do not expect to have to renew any of their current leases for this reason.

16 In a ground-breaking procurement such as this one, it is inevitable that issues will arise for the first time and the tackling and resolution of these issues will extend into the procurement period. The main issues to arise during procurement were:

a) important requirements developed after the start of the formal procurement process;

b) difficulties of inter-agency co-operation within the Department, principally obtaining information on the conditions of existing buildings on the estate;

c) moving to negotiate with a preferred supplier while there remained important areas for negotiation. However, the National Insurance Contributions Office believe that the preferred supplier was appointed at an appropriate time and after a rigorous evaluation process;

d) the Contributions Agency continuing negotiations until satisfied with both the deal and the contract details; and

e) following commercial agreement, NEP took five months to conclude its external funding arrangements.

The Department consider that the deal represents value for money and is within probable budgetary allocations

17 The Department's main financial objective was to provide a solution which offers best value for money to the taxpayer and the Department. The Department took assurance on value for money through what they considered to be a competitive process and a comparison of the costs and benefits of the deal with those of remaining in the existing, dilapidated estate.

18 This comparison showed that the direct cost to the taxpayer of the Private Finance deal of £241 million (in present cost terms) was £51 million more than remaining in the existing premises. But the Department estimated that efficiency improvements of only three per cent of annual running costs would enable them to contain this extra cost within their budgetary allocations. There are a number of benefits arising from the replacement of the dilapidated estate, including improved working practices and working environment, and freeing the Department from the risks of property ownership. As a result, the Department concluded that the extra cost of the Private Finance deal was justified by the operational and risk transfer benefits it offered.

19 The Department decided not to prepare a full Public Sector Comparator, which would have estimated the costs of publicly financing a redevelopment of the estate. As a result, we are unable to say whether the deal is likely to deliver better value than a conventionally financed redevelopment of the estate. The Department's decision not to use a Public Sector Comparator was consistent with Treasury guidance extant at the time, which did not require the preparation of a Public Sector Comparator. The guidance has subsequently been withdrawn,[1] and the use of a Public Sector Comparator to demonstrate value for money of Private Finance deals is now standard.

1 This guidance was contained in *Private Opportunity, Public Benefit* (published by HM Treasury in November 1995). This guidance was subsequently replaced by new general guidance from the Treasury PFI Taskforce: *Step by step guide to the PFI procurement process* (first issued in July 1997 and revised in April 1998); *Partnerships for Prosperity* (November 1997); and specific guidance dealing with the preparation of public sector comparators *Public Sector Comparators and Value for Money (March 1998)*.

Recommendations

Preparing for procurement

1 It is important that departments considering the potential for Private Finance projects think sufficiently widely about their requirement.

This project demonstrates how, in accommodation projects, departments can improve the feasibility of their projects by applying an output specification, and by including a wide portfolio of property to enable the private sector to make innovative proposals.

2 Departments should undertake a comprehensive strategic review of the fundamentals of the service they require before they begin formal procurement.

In this project, in line with the Contributions Agency's understanding of the negotiated procedures, many fundamentals of the deal were developed after the Contributions Agency issued a notice inviting private sector interest. This is because they were concerned that the private sector were becoming aware of the project and that they needed to issue the notice quickly to preserve fairness between bidders. The contract notice reflected all requirements known to them at the time and provided the flexibility to develop key requirements as the procurement progressed. This approach reflects the ground-breaking nature of the project and the negotiated procedures procurement route followed by the Agency.

3 Where large projects are undertaken involving the accommodation of several executive agencies, they should have the appropriate level of corporate management and support. This should help reduce the scope for dispute and poor co-ordination between the participating bodies.

This project was managed by the Contributions Agency on behalf of other parts of the Department, although other users, the Department's central administration function, and other parts of government were represented on the project board. The project team encountered some co-ordination difficulties during the procurement, but such difficulties may be encountered by any team procuring a service on behalf of a number of autonomous agencies.

4 Departments should exercise caution when setting project procurement budgets and timetables. Using budget and timetable data from other projects can be helpful but sufficient attention must always be paid to differences between projects.

The Contributions Agency initially set too short a timetable and too small a budget, largely because of the lack of useful precedents to guide the estimates. They adjusted their timetable and budget as soon as they realised that their initial estimates were overly ambitious.

5 The risk that business requirements, such as the way space is used or staffing levels, may change is one of the most important risks facing departments when they enter into Private Finance contracts for office accommodation over a long period. Departments must adopt the same approach to this risk as to any other: identifying the most likely outcome, considering who is best placed to manage that risk, and considering how to mitigate any residual risk remaining with the public sector.

In this case, the Department considered that the staff numbers and known and possible changes to the business were the key drivers of accommodation requirements. To inform their judgements about this risk, the Agency sought to obtain staffing projections from all business units using the accommodation, but, given uncertainties affecting the Department's overall business strategy, considered that any staff projections beyond a five-year horizon would be speculative and unrealistic. But, after discussions with bidders, they concluded that the private sector could manage an overall level of flexibility at 20 per cent of total office space, and requested bids on this basis.

6 Departments should consider inviting variant bids from suppliers in key areas of accommodation deals, such as flexibility to vacate space without payment and whether to require a capital payment for property transferred to the supplier. On flexibility, variant bids would enable departments to assess the price they would pay in higher basic charges in order to reduce the risk of having to pay for surplus space. On capital payments, variant bids would enable departments to assess the amount they would pay in higher basic charges if they require an up-front capital payment from the supplier.

The Department considered flexibility as a mandatory requirement and therefore saw no need to request variant bids. However, they will receive discounts from accommodation charges should they not use, or surrender their rights to, flexibility. On capital payments, the Department obtained variant bids showing the additional cost of requiring an up-front payment and decided on that basis not to require one.

Managing the procurement

7 It is vital that client departments eradicate major uncertainties from suppliers' bids before awarding one preferred bidder status.

The Agency appointed NEP as preferred supplier having identified uncertainties relating to NEP's bid, principally concerning the proposed design for the new buildings they planned to construct. The Evaluation Panel considered that these were negotiable at a cost which would still mean NEP provided best value for money. The Agency was successful in limiting the cost of resolving these uncertainties during negotiations with NEP to a level below that assessed by the Panel. This also reflected their wish to limit bidders' costs.

Achieving value for money and a sound deal

8 Where, as in this case, the Private Finance option has a higher direct cost to taxpayers, departments should, before signing the deal, consider carefully the indirect benefits in terms of risks reduced or transferred to the private sector and the value to their operations of higher service quality. If quantification is not possible, they need to set out clearly and comprehensively how they have arrived at the conclusion that the unquantifiable benefits outweigh the quantifiable costs.

In this case, and in accordance with then-extant guidance, the Agency took assurance on value for money through competition. Comparisons conducted by the Department showed that the Private Finance deal had a higher direct cost than the alternative of remaining in existing accommodation. But they considered that the extra direct cost of the deal was justified by the operational benefits they expected it to bring.

Part 1: The contract should deliver the accommodation service sought

This part of the report shows that the Contributions Agency, acting on behalf of the Department of Social Security, have agreed a contract which should deliver the accommodation service that they sought from the project. At the time of writing, good progress had been made with redevelopment and timescales have been met. The contract places major risks relating to the project to whichever party is best placed to manage them.

The Newcastle estate presented severe and growing accommodation problems

1.1 The Department of Social Security's Newcastle Office was originally established in 1948 on a 64-acre site at Longbenton in the northern suburbs of the City. It was one of the main offices for administering the National Insurance and benefits system introduced after World War II. As the business of the Department expanded, additional accommodation was provided through the construction of three multi-storey buildings at Longbenton during the 1960s and 1970s, and by leasing or construction at 11 further sites within a 12 mile radius. By 1998, some 13,300 staff, mainly from four of the Department's Agencies, plus contractors' staff and some other civil servants, were housed in over 2.5 million square feet of accommodation in and around Newcastle.

1.2 By 1993, major problems arising from the age and condition of the estate prompted the Department to re-examine their accommodation needs and provision. The problems included:

a) roof leaks and heating system failures leading to loss of productivity;

b) increasing running costs and maintenance commitments;

c) substantial work needed to comply with disability legislation;

d) difficulties installing modern information technology in unsuitable premises; and

e) a lack of adaptability in existing buildings to cater for changes such as reductions in staff numbers.

1.3 These problems acquired greater significance when seen in the context of the overall Business Strategy of the Department of Social Security, which assumed:

a) reductions in staffing;

b) increased use of information technology;

c) greater emphasis on professionalism, valuing staff and providing modern, flexible and functional working environments to maximise productivity; and

d) constraints in capital and running cost allocations.

1.4 The estate's problems, and the Department's business strategy, led the Department in the mid-1990s to start seeking ways of redeveloping some or all of the properties on the estate. The Contributions Agency, as the largest occupier of the Longbenton site, had the responsibility for managing and delivering this estate development project. But all important decisions relating to the project were made by a project board which included representatives from other Agencies using the estate. The membership of the project board is described in greater detail in Part 2 of this report. Figure 1 shows the organisation structure of the Department as a whole, and the main functions and budgets of its Executive Agencies.

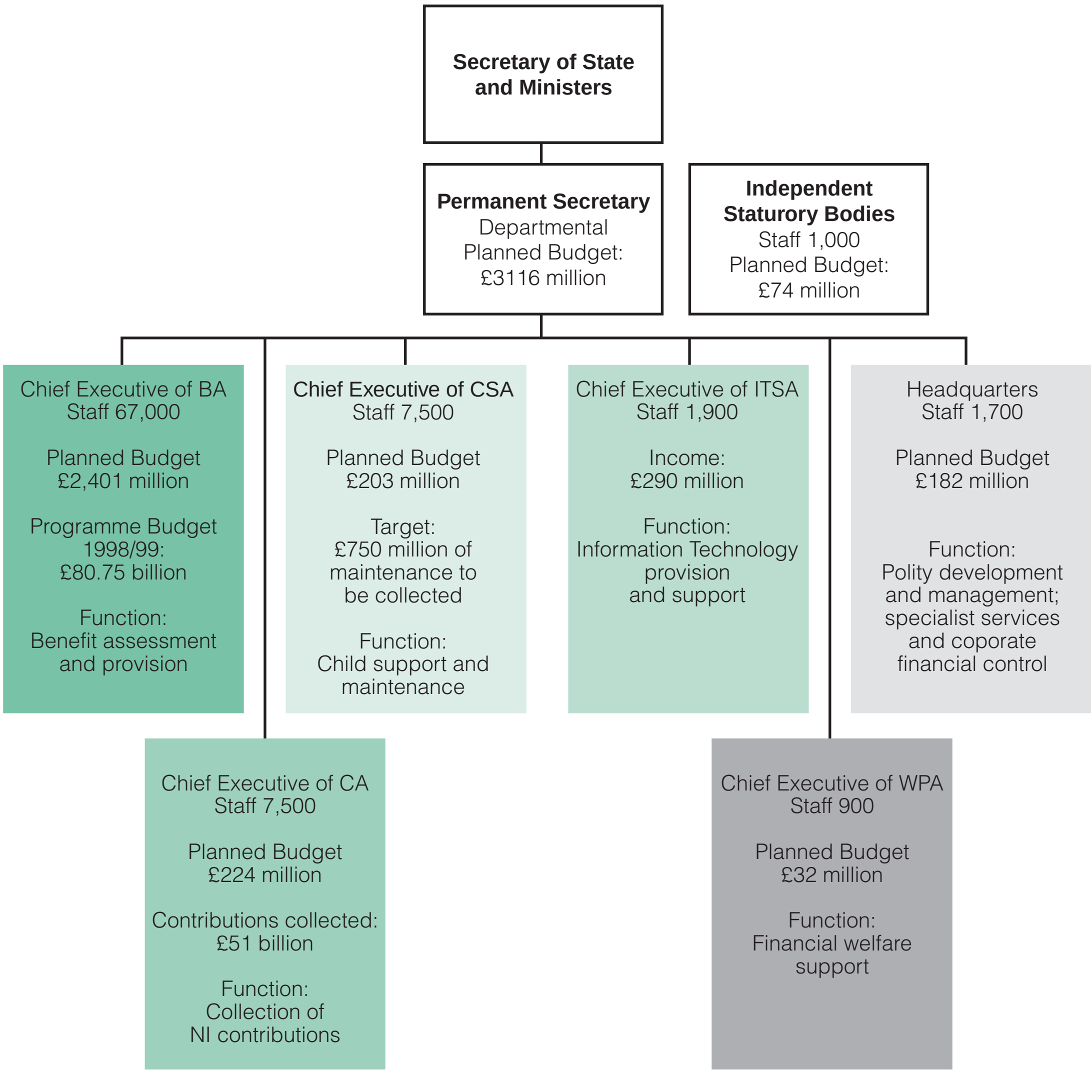
1.5 On 1 April 1999 the Contributions Agency transferred from the Department of Social Security to the Inland Revenue in order to achieve a closer alignment of the tax and National Insurance systems in the longer term. It is now called the National Insurance Contributions Office and no longer has its own Accounting Officer. At the time of writing, this change has not led to specific or immediate alterations to the Newcastle Estate Development project. Responsibility for the project and its contract management has transferred to the Inland Revenue under the merger.

The private finance scheme superseded an earlier less comprehensive conventional proposal

1.6 The Agency commissioned a feasibility study of options for the Longbenton site from a team of property consultants. In November 1993, the team recommended phased demolition and rebuilding of part of the Longbenton site only between 1995 and 2003 at a capital cost of £83 million. Their recommendation covered only a limited part of the Newcastle Estate and did not include replacement of the ageing multi-storey blocks at Longbenton or the sites at Kenton Bar, Broadway West, or Emerson. The Agency calculated that the cost of this option over 25 years would be almost the same as that of continuing with the existing buildings, but would offer a much improved working environment for some of its staff.

Figure 1

The organisation and roles of the Department of Social Security and its Agencies



The Benefits Agency's purpose is to assist the Government in establishing a modern welfare state by helping to create an active modern social security service, which encourages and enables independence and pays the right money to the right money to the right person at the right time; all the time.

The Contributions Agency's role is to collect and record National Insurance Contributions; ensuring compliance with the law, maintaining individual national insurance accounts, and providing an efficient and effective service to customers. On 1st April 1999, the Agency transferred to the Inland Revenue and is now called the National Insurance Contributions Office.

The Information Technology Services Agency's mission is to work with all parts of the DSS group to maximise business efficiency through the secure and cost effective use of information systems and information technology.

The Child Support Agency's business is to deliver a consistent, accurate, timely and cost effective service in the assessment, collection, and payment of child maintenance, ensuring that children receive the financial support to which they are entitled.

The role of the War Pensions Agency (not accommodated at Newcastle) is to adminster the War Pensions Scheme and provide appropirate welfare support to war disablement pensioners and war widows.

DSS Headquarters supports ministers on both policy and legislation, provides corporate management covering the allocation and accounting for resources, targets and performance measurement, and provides financial, legal, medical, statiscal and analytical services to the Department as a whole.

Source: Social Security Departmental report and Expenditure Plans 1999/2000

1.7 The Agency recommended this option to HM Treasury in May 1994. While not explicitly rejecting the Agency's capital bid, Treasury asked in June 1994 that they investigate a Private Finance Initiative solution. This investigation was concluded in September 1995 when the Agency evaluated indicative bids and concluded that a Private Finance solution was viable. This decision was endorsed by the project board and reported to Ministers. The Treasury were represented on the project board that pursued this option up to the signature of the deal.

1.8 The essence of a Private Finance Initiative deal is that the private sector supplier receives a contract to Design, Build, Finance and Operate an asset, and is paid for the provision of the service only as it is delivered to the public sector client. In the context of office accommodation deals, government departments pay for the availability or use of space that meets all legal and health and safety requirements; heated, lit and serviced to the standards laid down in the contract. In this way, many risks that would normally be borne by the taxpayer, such as higher than expected construction or running costs, should be borne by the private sector supplier.

1.9 The Private Finance deal in this case had a much wider scope than the earlier, conventional proposal, which had a capital cost of £83 million. It included the replacement of existing multi-storey blocks at Longbenton, and also included the freehold sites at Kenton Bar, Broadway West and Emerson.

The contract provides a solution to the accommodation problems

1.10 The Department entered into a contract with the chosen consortium, Newcastle Estate Partnership (NEP), which took effect on 8 January 1998. The contract specifies the Department's properties transferred to NEP, the construction works to be undertaken, the calculation of the payments to be made by the Department, and the estate management services to be provided by NEP over the course of the contract. The documentation is extensive and establishes the action to be taken in a wide range of events or changes, and the Agency told us that it has proved extremely helpful during the implementation of the project.

1.11 In accordance with what is now normal Private Finance Initiative practice, the contract defines objectively when accommodation is "unavailable", due for example to breach of legal or health and safety regulations, ingress of water or to lack of power or lighting. In these circumstances, the Department do not pay for the space if they vacate it. This represents a major improvement in the Department's position compared to that under a standard lease for rented accommodation. In addition, the Agency have negotiated the right to continue to occupy unheated space without making a payment. This reflected their concern that vital social security operations should be maintained wherever possible. The key features of the deal are shown in Figure 2.

Key features of the Private Finance arrangement

Figure 2

The Department transfers to NEP the ownership of the freehold sites, and responsibility for dilapidation liabilities on leased buildings. The Department retain a right to occupy the redeveloped estate for 25 years.

NEP will demolish all existing buildings at Longbenton, and design and construct new office buildings there and at a green field site at Waterview Park (which will replace Emerson House on the existing estate) to the south of Newcastle. NEP expect that the total capital cost will be £163 million at 1997 prices.

NEP can commercially redevelop surplus land on the Newcastle estate. Some £9.4 million of the proceeds from this redevelopment are guaranteed and will be used to reduce the cost of the Private Finance service to the Department. The Department will also share equally in redevelopment gains if these exceed £9.4 million.

NEP will maintain the existing premises transferred to it over a 25-year period starting in January 1998, and the new buildings for 25 years after each is completed.

Payment for maintenance services can be reduced by up to 15 per cent in the event of failure to achieve performance targets.

The Department will pay only for the space that is available for them to occupy. If an area is deemed to be unavailable for over 24 hours, based on objective tests of heating, lighting and other standards, payment is cancelled.

The Department may vacate without charge up to 20 per cent (by value) of the space over the life of the contract. They receive a discount of 20 per cent of the accommodation charge for any area available for surrender which they continue to occupy, or a 40 per cent discount should they relinquish their right to hand back the space.

The contract makes provision for the Department's accommodation at the end of the 31-year period. The Department and NEP may enter into a further Private Finance-type arrangement for continued occupation. They may agree a traditional lease at a rent set at 50 per cent of prevailing rents for similar accommodation in Newcastle City Centre (that is a proxy for market rents on the outskirts of the city). Alternatively, the Department are free to seek such accommodation as they may need on the open market.

1.12 An illustration of how the Newcastle Estate is to be changed over the redevelopment phase of the project is at Figures 3 and 4. The latest estimate of the number of staff that may need to be accommodated in the redeveloped estate is some 13,200 by 2003/2004. This compares with the revised occupancy levels of 11,466 agreed in April 1998 and the estimate of 10,700 on which the deal was based. At present the current plans can accommodate 11,946 staff. This indicates that the Departments may require further space in the Newcastle area in the future, and the National Insurance Contributions Office are currently conducting for the Departments an evaluation of options for meeting this requirement. These could include retaining existing leased properties, acquiring extra space and making more effective use of the accommodation through improved working practices.

1.13 The Department set six operational objectives for the project. Although the redevelopment of the Estate will not be completed until 2002, it is possible to see now how far the contract addresses these objectives (see Figure 5). The achievement of value for money is examined in Part 3 of this report.

1.14 At the time of writing, the performance of NEP in operating the existing buildings has met contractual targets. On the construction of new buildings, the National Insurance Contributions Office told us that the redevelopment constituted a challenging process which has worked well to date, and that they continue to expect that they and the Department will start occupying the buildings at the originally planned dates.

Figure 3 The Newcastle estate before development

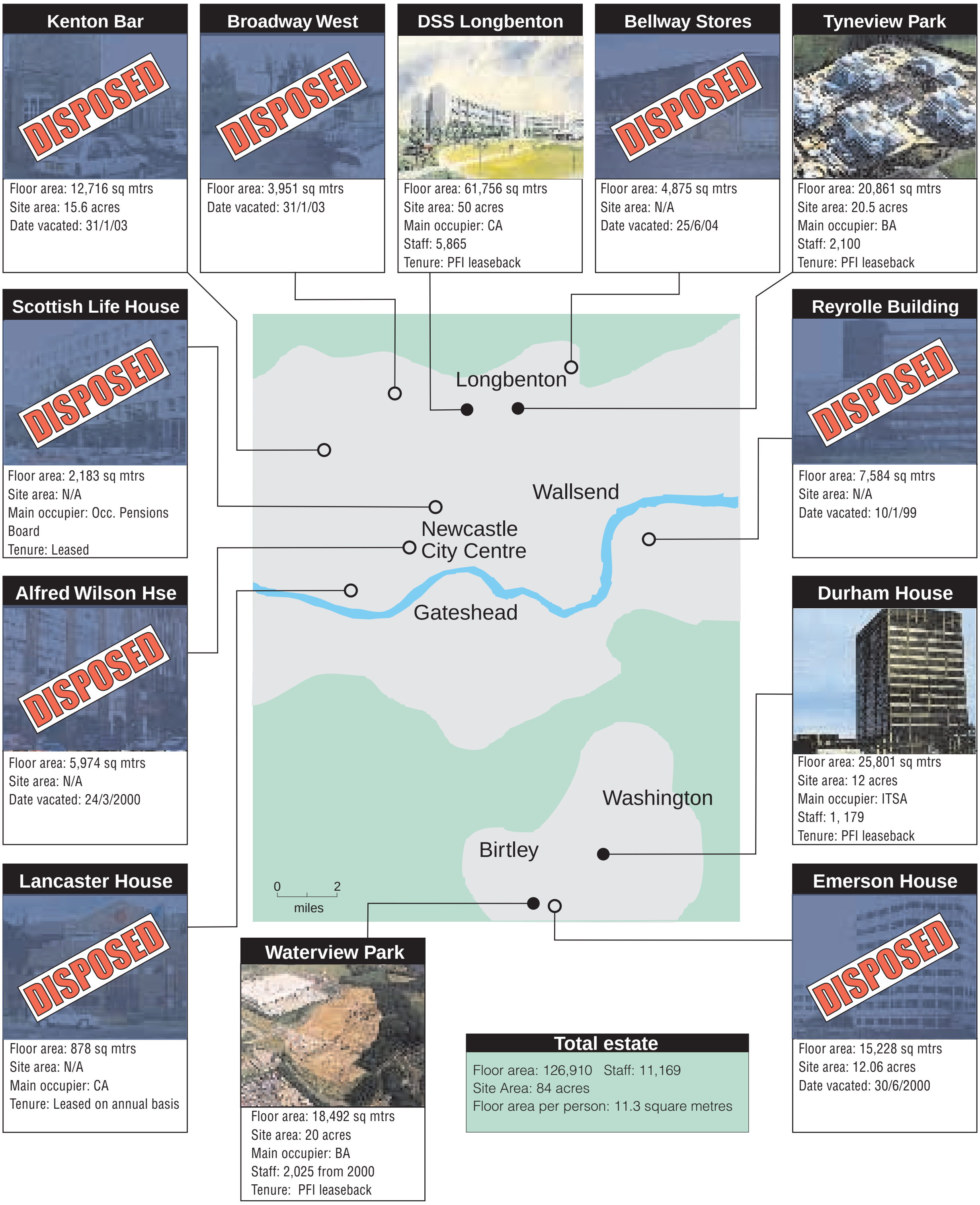
Note: Not shown: Bedewell Store, 2,174 metres. No permanent staff.

Sources: National Audit Office
Contributions Agency Briefing Document to bidders, February 1995

Figure 4

Newcastle estate, post development as at 1 April 2002

Figures 3 and 4 show that the redevelopment project results in a much smaller, more intensively occupied estate.



Source: National Audit Office

The achievement of the Department's operational objectives

Figure 5

The Department's operational objectives are likely to be achieved.

Objective	Prospects for achievement
Provide good quality accommodation in the Newcastle area, which will provide an adequate working environment for staff.	Most users should experience an improvement in their working environment. The achievement of this objective in terms of meeting the needs of users is described more fully in Appendix 2.
Reduce escalating maintenance costs.	Through this redevelopment, the Department will avoid having to undertake an extensive refurbishment and replacement programme at Longbenton, Emerson House, Tyneview Park, Durham House and Bedewell Store. Refurbishment and replacement is now the responsibility of NEP. The Agency estimated that over the next 10 years alone the minimum cost of refurbishment and replacement would be £96 million.
Provide accommodation which is adaptable both in terms of movement between business units and future reductions in staffing.	Unlike the existing blocks at Longbenton, the new accommodation will be predominantly open plan, and more easily subdivided using movable partitions. This could be important with the merger of the Contributions Agency and the Inland Revenue, and provides for further changes in staffing levels.
Reduce the number of sites housing business units.	The number of sites is planned to reduce from 12 to 5, reducing in particular the dispersal of the Benefits Agency and the National Insurance Contributions Office, and enabling common facilities such as staff restaurants and messenger services to be centralised.
Provide accommodation which is IT-friendly and capable of further IT expansion.	NEP will install and maintain IT cabling to the Department's specifications. This cabling will be capable of handling voice and data transmissions.
Harness private sector skills and innovation.	The chosen consortium, Newcastle Estate Partnership, comprises two companies: AMEC Developments Ltd, a subsidiary of an international construction and property development group, and Building and Property Group, a Facilities Management company. The Royal Bank of Scotland funds the consortium, AMEC Developments Ltd and Building and Property Group are equity providers and AMEC plc have provided subordinated loan facilities.

Source: National Audit Office

The contract allocates risks appropriately

1.15 The Department's ability to secure value for money from a Private Finance contract depends in part on the allocation of risk between them and the supplier. The Agency therefore adopted the working objective of seeking to allocate risk to the party best able to manage that risk. In practice the private sector should bear most risks arising from their ownership of both the new buildings they have designed and constructed and the existing buildings transferred to them as part of the deal.

1.16 A summary of the risks allocated through the contract is at Appendix 3. The Agency achieved an appropriate allocation of risks. This is similar to the allocation we have found on other Private Finance projects.

The Department are contracting separately for cleaning, catering and security and other services

1.17 One way in which a Private Finance arrangement may enhance value for money is to bring together under a single contractor responsibility for design, construction and operation. In principle, such a contractor might be expected to provide office accommodation that is economical to operate, particularly in terms of maintenance, cleaning, security and other important services, collectively known as facilities services. An important issue that many departments face is deciding which of these facilities services are so closely linked with the provision and maintenance of the building that they should be included in the scope of the contract. The Agency told us that, in their view, the value for money of total facilities management, by which all facilities services are provided by a single contractor, remains unproven.

1.18 The Agency received proposals from the three short-listed bidders to provide what they termed a total facilities management service, bringing together maintenance and all other facilities services. The Agency recognised that if such a service were not implemented, existing contracts for individual services could potentially be administered by four separate agencies on five sites with differing expiry dates. Therefore in September 1995, the Project Board devised a strategy for the delivery of accommodation and offices services across the Newcastle Estate. Their strategy separated services into two main categories: mandatory and optional. Mandatory services, which had to be included in the Private Finance project, related to the maintenance of the building fabric and mechanical and electrical systems. Optional services were those services, such as cleaning and security, which are less integral to the provision of the building itself. The Board expressed a long-term aim to move towards a total facilities management service for the whole estate, as long as it provided value for money.

1.19 When bids were received for "optional" services, the Agency's evaluation panel expressed concern at the private sector's ability to deliver total facilities management. There was a very wide range in the bids for optional services: from as little as £195,000 per annum from the NEP group, up to £900,000 per annum from the NERL consortium, implying to us that bidders had either:

a) widely differing perceptions about the level of service required by the Agency's output-based specifications; or

b) put less detailed work into pricing this optional part of the deal.

1.20 The Agency did not intend to rank the bidders on their offers for optional services, but to use them as a tie-break. In the event, because the NEP consortium bid was judged superior on the other elements of the deal, this did not prove necessary, and the Agency's decision became one of whether or not to accept NEP's offer for optional services. They discussed the optional services with NEP, after the latter's appointment as preferred bidder, but in September 1996 they decided for the following reasons not to include the optional services in the contract with NEP:

a) NEP had declined to provide staffing figures or a breakdown of how their prices had been calculated, which in the Agency's view cast doubt on their value for money;

b) the Agency were concerned about the impact that poor service could have on their business;

c) full assessment of the value for money of NEP's prices against alternatives would have required substantial work by the project team that would divert them from the remaining negotiations on the development of the estate and on mandatory services. It could hazard the intended signature date for the deal; and

d) the Agency chose the alternative approach of allowing the Department's business units to obtain optional services through either NEP or alternative suppliers as they wished, as existing contracts expired.

The contract gives some flexibility to surrender unwanted space

1.21 It is widely recognised that government departments should consider building into their property Private Finance deals the flexibility to vacate surplus space without further payment. Whether or not a department accepts bids offering flexibility should depend on the risks and benefits of each individual case. The Department regarded flexibility as mandatory in this case in view of the risk of possible staff reductions arising from the Departmental change programme and other initiatives. These included the possible greater use of outsourcing (Child Benefit work, for example, which accounted for some 1,850 staff on the Newcastle estate) and the introduction of major IT systems. The Agency also saw flexibility as inherent to the Private Finance Initiative. Figure 6 illustrates the flexibility available under the deal in terms of square metres of office space.

1.22 If their accommodation needs change, the Department can hand space back to NEP with a resulting reduction in the availability charges. And unlike a conventional lease, they do not have to pay a charge when doing so. The Department can surrender around two per cent of space each year from 2004, up to a maximum representing a 20 per cent reduction in availability charges. If they do not exercise this right they will receive a discount of 20 per cent of charges for any area available for surrender which they continue to occupy, and a 40 per cent discount should they relinquish their right to hand back the space. They may also request construction of an additional building if they require more space than currently expected, or cancel one building prior to construction if they require less.

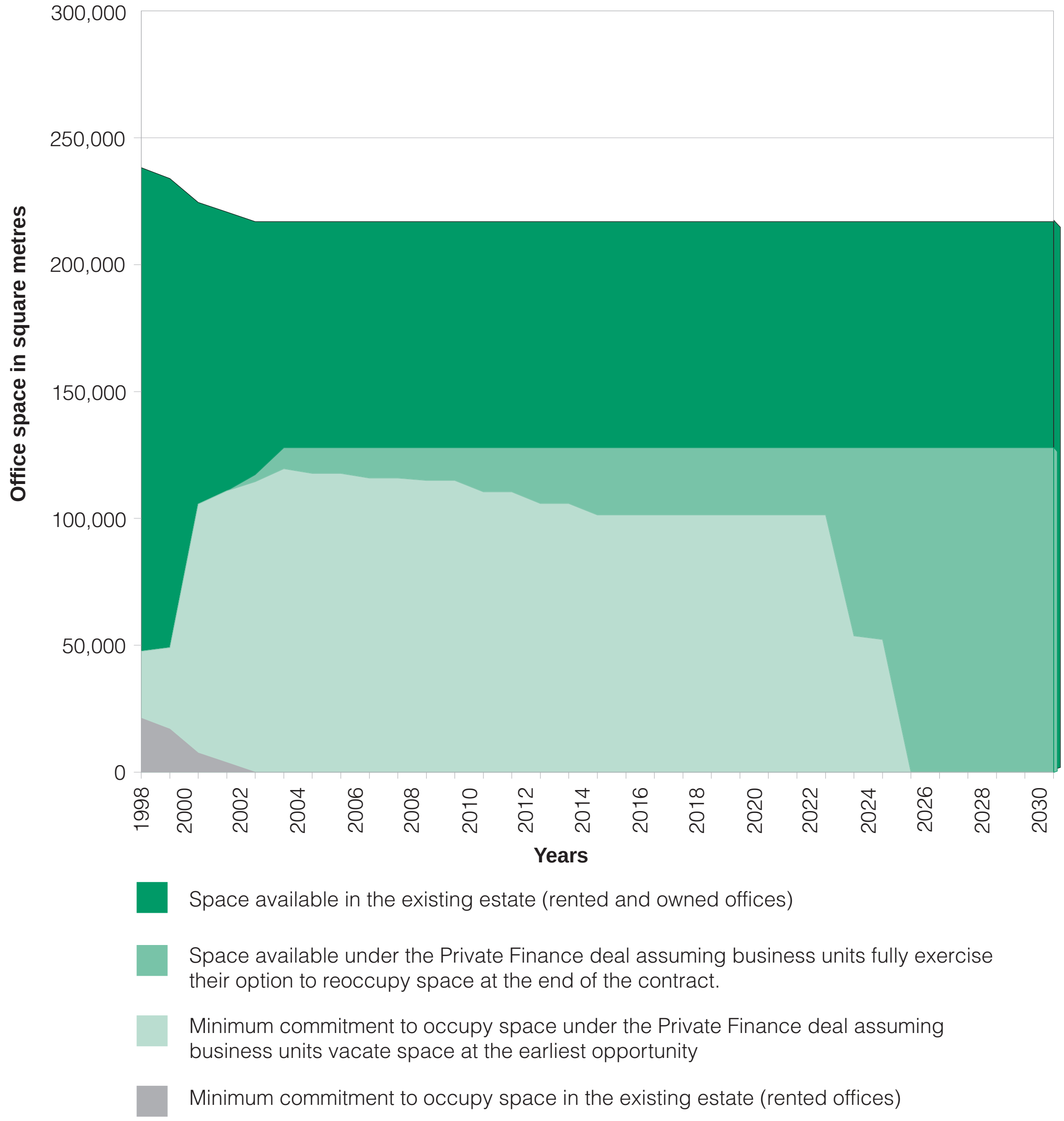
But the value and cost of this flexibility are unknown

1.23 The Department considered flexibility as essential in view of their overall business strategy at the time and the Contributions Agency also saw it as inherent to the Private Finance Initiative. The Contributions Agency therefore discussed with each of the three short-listed bidders how much flexibility they and their funders might be prepared to offer. The Agency subsequently instructed each short-listed bidder to build into their priced bids flexibility to surrender 20 per cent of space. They did not seek alternative bids offering no flexibility and therefore they did not know how much their requirement for this flexibility was adding to the cost of the project.

1.24 The Agency considered that they ensured value for money was achieved in obtaining flexibility through the project's competitive procurement process.

Figure 6 **Comparison of office space under the Private Finance deal and on the existing estate**

The Private Finance deal enables the Department to be housed in a much smaller, tighter estate, but with potentially less ability to dispose of surplus space without charge than they had under the previous, largely freehold, estate. This is because freehold properties can be normally disposed of, while most of the space acquired through the Private Finance deal represents a twenty five year commitment to occupy. However, the Agency told us that, because of the dilapidated state of the site and potentially high demolition costs, it would not have been easy to dispose of the freehold land at Longbenton and some other sites.



Note: This graph shows the theoretical maximum and minimum commitments to occupy space under the Private Finance deal. There are also a range of intermediate outcomes depending on how business units choose to exercise flexibility.

Source: The National Audit Office

1.25 To inform their view of how likely the Department was to use the flexibility they had required bidders to offer, the Agency tried to collect staffing projections from all of the occupants of the Newcastle estate. But all found it difficult to forecast realistic requirements over a 25-year period and therefore only five-year forecasts were obtained. The Agency estimated in 1995 that their own staff numbers might fall by 2,000 between 1996 and 1999, noting that even this extent of forward projection was extremely difficult. Forecasting staff numbers beyond then would be more difficult still.

1.26 Feedback from other parts of the Department suggested to them that these other business units felt unable to provide realistic staff projections for the period 2000 to 2025. Therefore, they did not obtain forecasts of what their staffing might be after the completion of the estate redevelopment. They noted that their staffing had reduced by some 20 per cent since the early 1970s and thought that a similar figure would be the best available estimate for the 25 years following the estate redevelopment.

1.27 It is in the interests of the Department to make the most efficient use of space available and to take advantage of the flexibility they have purchased if changes in their business reduce the space they require. They therefore need to ensure that their business units relinquish surplus accommodation whenever possible. The Department already have in place a number of incentives to encourage business units to minimise their requirements for space. In the National Insurance Contributions Office, for example, these incentives include:

a) A business management regime which charges out to business units the cost of support services including floor space;

b) Internal negotiations to reduce the unit costs of their main business activities, such as updating customer records or providing information to customers. These pressures on costs should ensure that accommodation costs are scrutinised;

c) A programme to minimise space requirements through the best use of space and consideration of new working practices;

d) The role of the contract management team to ensure that users consider exercising available flexibility; and

e) A user policy group set up to discuss estate-wide policy issues.

The Department will share in any further development gains of the consortium

1.28 As part of the Private Finance deal, NEP guaranteed the Department total proceeds of £9.375 million from the disposal of freehold land and buildings on four sites. These proceeds are not paid over in lump sums but are used to reduce the Department's continuing service charge. The level of guaranteed disposal proceeds were lower than the valuations obtained by the Agency, which assumed the most beneficial redevelopment potential. The Agency have negotiated a clawback arrangement whereby they will receive 50 per cent of the additional development proceeds above base values. At Kenton Bar, Broadway West, Emerson and Longbenton the Department and AMEC Developments Ltd will share in 50 per cent of any additional return if AMEC are able to obtain more valuable planning consents and commercially redevelop the site. This would be paid as a one-off payment.

1.29 The Agency undertook their own valuation of the sites based on best value for each site and, as part of the bid evaluation process, considered the bidders' valuation of the site as an overall package. As a result there is some disparity between some valuations obtained by the Agency and those offered by AMEC. At Emerson House, AMEC bid only £1 million based on the redevelopment value of the site. The Agency's land value only valuation was £950,000 and their best valuation, assuming continued use of the building, was £6.7 million. This best value may not be achievable in practice. In practice the building may not find a user because it has structural and functional shortcomings, and in AMEC's view is not in a recognised office location.

The Department transferred the estate in return for reduced rentals over the contract's life

1.30 The Department transferred the estate to the successful bidder in return for reduced rentals over the contract period rather than requiring an up-front payment. The Contributions Agency informed this decision by inviting the last three bidders to submit bids both with and without a payment. The Agency found that the winning bidder, NEP offered a payment of around £66 million (in present value terms), but that this payment would increase the Department's annual payments to NEP by £78 million (in present value terms) over the life of the contract. They therefore decided, in agreement with the Department and Treasury, not to require an up-front payment.

Contract management arrangements are in place

1.31 The contract covers the five-year construction period and defines the Department's occupancy rights for each part of the Estate over the 25 years from acceptance. To ensure that the contracted service is delivered effectively, the Contributions Agency have established a contract management team to manage the contract for operational buildings, and a separate implementation team for the redevelopment work. The implementation team's role is to focus in particular on minimising disruption to the Department's activities during the construction phase at Longbenton and to oversee the movement of staff and IT. The contract management team was established before the contract was signed. The team uses its knowledge of the contract and its links with users to ensure that buildings and facilities management services meet the standards required.

1.32 The Agency consider that termination of the Private Finance contract as a whole would result in considerable disruption to the Department's operations on the Newcastle Estate. They therefore sought to enter into arrangements for managing the contract in the event that something goes wrong that should, wherever possible, minimise disruption to the Department's core business.

1.33 The dispute resolution procedures embodied in the contract involve a series of stages, leading to the appointment of an expert whose decision will be binding on both parties. Only in the event that an expert cannot be appointed would a dispute be referred to the courts. Our advisers, Theodore Goddard, considered that this approach had definite advantages of speed, cost and certainty over alternative arrangements that allow arbitration or resolution by the courts if either party disagrees with the decision of the expert.

1.34 The contractual agreements lay down arrangements covering the rights of both parties to terminate the contract. Termination clauses are broadly in line with termination clauses on other Private Finance contracts. The arrangements, including which party has the option to terminate and whether the Department must make termination payments, depend on the cause of termination.

1.35 The Department's rights should the maintenance targets not be met by NEP are subject to certain constraints. The maximum deduction from the maintenance payment for failure to achieve performance targets in any year is 15 per cent, which the Agency managed to raise during negotiations from 10 per cent. They told us that a higher maximum penalty would have made it difficult for NEP to fund the deal.

1.36 Persistent failure to achieve performance targets could result in the replacement of the consortium's maintenance services provider, with the consortium itself selecting the replacement. This remedy is ring-fenced, so that failure to achieve performance targets in the buildings south of the River Tyne (the Southern Estate) would only lead to replacement of the facility management company for those buildings, and not for the buildings north of the Tyne (the Northern Estate). Only after three companies have been replaced for failing to achieve performance targets does the Department have a right to select a replacement provider itself. This replacement right is also ring-fenced between the Northern and Southern Estates.

1.37 If maintenance is below the agreed standards or not carried out, it may lead to buildings becoming unavailable and to the Department stopping the 75 per cent of the payment that is for availability of the buildings. This acts as an incentive to NEP to ensure that maintenance services are adequate.

1.38 At the end of the contracted period of occupancy of 25 years for each part of the Estate:

- the Department may continue to occupy any building on the Estate on terms based on the current agreement with NEP. NEP and the Department could agree to alter any terms, including how long the Department would be committed to reoccupy, as they see fit;

- if NEP and the Department were to fail to reach agreement, the Private Finance contract establishes a reserve position, in which the Department would enter into a standard commercial lease for 26 years, with a five-yearly break option. The Private Finance contract fixes the rent in these circumstances at half of the prevailing market rent for similar buildings in Newcastle City Centre. The parties considered that such rents would be in line with the market for the outskirts of the city; or

- alternatively, the Department could vacate the Estate which NEP now own, and seek accommodation elsewhere.

Part 2: The procurement took longer than planned

This part of the Report shows how the Contributions Agency managed the problem of negotiating a ground-breaking Private Finance deal, the first such deal aimed at providing office space. In the absence of direct precedents, the Contributions Agency proceeded cautiously, and were rightly unwilling to rush to close a deal on terms they regarded as not good enough. The procurement therefore took three years. It is not undesirable for departments to take time to make sure the deals they negotiate are right, but in our view getting good deals from the Private Finance approach depends upon securing vigorous competition between bidders. If prospective bidders expect long procurement times, then they may not wish to enter the bidding, and poor value for money may result.

Six out of eight bidders told us that they would be interested in bidding for future government accommodation projects. The remaining two said that the length and cost of the procurement in this case was such that they would hesitate to bid in future competitions unless the process could be speeded up.

A chronology of the key events in the project is at Appendix 4.

The Contributions Agency adopted sensible approaches to the procurement

2.1 The Contributions Agency set up an appropriate team to manage the procurement, which they conducted using the negotiated procedure under European Union procurement regulations, and sought to use what wider Private Finance precedents they had to conduct the procurement effectively. By including the whole Newcastle estate in the project, they responded to earlier advice that a Private Finance solution was not viable for the Longbenton site alone. They issued an output specification that gave bidders an opportunity to offer innovative solutions to the Department's requirements.

The Agency could not draw on direct precedents, but sought to use the closest available

2.2 When the Agency began work on the project, there was no precedent for seeking to use the Private Finance approach to provide office space. This absence of direct precedents was a factor in planning and managing the procurement. No other large Private Finance Initiative deals had been signed in the office property sector when the Newcastle project started. The furthest advanced Private Finance deals requiring construction of buildings were the first two "Design, Construct, Manage and Finance" Prisons, which were procured between November 1993 and December 1995. The Agency had limited discussions with the Prison Service during the procurement. These were initially around how to invite and evaluate bids on Private Finance deals, and, later on, about specifications for services provided and performance measurement. Private sector bidders and advisers were also unfamiliar with aspects of the Private Finance Initiative. Official guidance on the Initiative, mainly from the Private Finance Panel Executive, emerged and evolved progressively throughout the three years of the Newcastle project.

They set up an appropriate project team

2.3 The Contributions Agency, as the largest occupier of the Longbenton site, had the responsibility for managing and delivering the estate redevelopment project. But all important decisions relating to the project were made by a project board which included representatives from other Agencies using the estate, the Corporate Director of the Department's Estates, the Treasury, and the Private Finance Panel Executive. Other users of the accommodation include the Benefits Agency, the Child Support Agency, and the Information Technology Services Agency, and branches of the Department. The Agency's organisation to manage the project is shown at Figure 7.

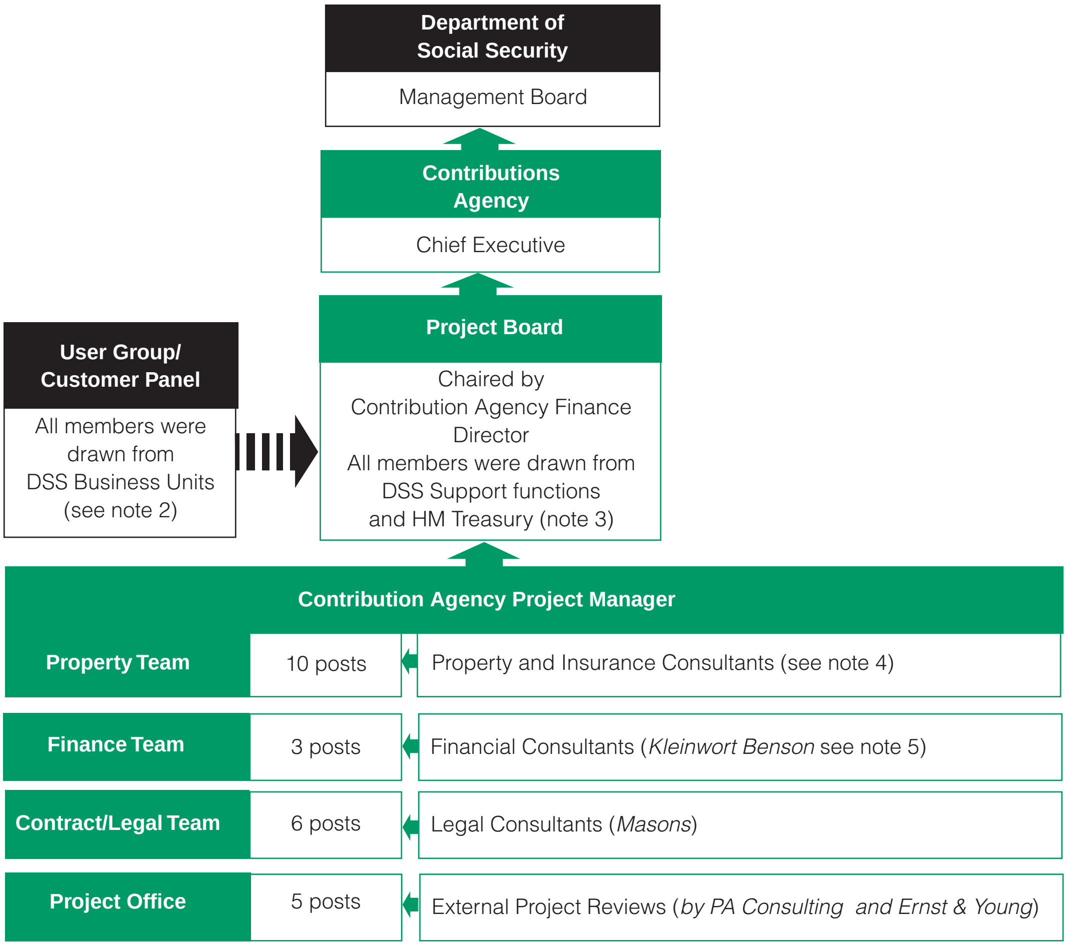
2.4 The project board was established in November 1994 to provide overall direction and management of the project. A senior official of the Contributions Agency chaired the project board, members of which had relevant expertise in the management of a Private Finance procurement. A representative of the Private Finance Panel Executive - the body regarded as the source of expert guidance on Private Finance issues - was a member of the project board throughout the procurement. A member of the board chaired a user group, which was established prior to commencement of the procurement. This was later replaced by a separate customer assurance panel, whose chair sat on the project board. These groups provided input to the project board and were advised by the board of the project's progress.

2.5 The project board reported progress to the Chief Executive of the Contributions Agency, who in turn reported to the Management Board of the Department of Social Security. Senior officials and ministers of the Department and the Treasury gave approval to key decisions at appropriate milestones in the life of the procurement, such as the issue of an invitation to potential bidders to express interest, and the signature of the contract.

Figure 7

Newcastle Estate Project Organisation Chart

The figure shows that the project was managed by the Contributions Agency, but with advice and input from representatives of other Department of Social Security Agencies affected by the redevelopment scheme, and HM Treasury.



Notes:

1. The chart above reflects the organisation that was in place for most of the duration of the project. When the Project Team was first set up in November 1994 it consisted of only five members. In early 1995 the team was gradually increased up to 25 members. During the preparation of detailed bids, the team reorganised into three separate teams to liase with each of the three short-listed bidders.

2. The Panel acted in a policy and advisory role and where necessary agreed Departmental policy for the estate.

3. Members of the Project Board included:

   3 - Contributions Agency (Office Services Director, Project Manager, Finance Director)
   2 - Benefits Agency (Corporate Director of DSS Estates, Financial Services Branch)
   1 - DSS Procurement
   1 - DSS Planning and Finance Division
   1 - HM Treasury
   1 - Private Finance Panel Executive
   1 - Child Support Agency (Finance Director).

4. Property and Insurance support was supplied by Baxter, Clark and Paul, Cundall Johnston & Partners, Graham Mather Associates, Mowlem, Gleeds, Turner & Townsend, Carl Pro Group and Willis Corroon.

5. A contract accountant was also provided by Hays Accountancy and Northern Recruitment Group (NRG).

2.6 We asked for comments from some representatives of the business units accommodated on the Newcastle estate on how the project management arrangements worked in practice. These are described at Appendix 2. Some recognised the hard work contributed by the project team, but most felt that communication between the project organisation and accommodation users could have been better. Those representatives we asked were not necessarily involved throughout the whole process but they were nominated by the Agency as the most relevant.

2.7 In November 1994 the project board considered the resourcing of the dedicated project team. They considered that in the absence of earlier similar projects to provide a benchmark any estimate might be only a best guess. But drawing on the Agency's experience in procuring NIRS2, the replacement National Insurance Recording System, through the Private Finance Initiative, they estimated a requirement for seven staff-years of Agency staff at a cost of £167,000, supported by up to £200,000 of consultancy support. By May 1995, when the complexity of the project was better recognised, it was clear that this provision would be inadequate. The project team was increased from 5 to 25 members and a new more senior project manager was appointed.

2.8 The project team staff were employees of the Contributions Agency or seconded to the Agency from other parts of the Department. The team members, including the project manager, had experience in property, finance and contracting and one of the project team members had previous experience of working on a Private Finance project (the National Insurance Recording system). The project team were supported by two lead advisers: Masons, who provided legal advice, and Dresdner Kleinwort Benson, who were the team's financial advisers. To obtain additional assurance, the Project Board commissioned advice at key stages of the process from PA Consulting, the Agency's own internal auditors, and Ernst and Young.

2.9 During the course of the project 14 external firms were appointed to provide the project team with assistance mainly on legal, financial, construction, property and insurance issues. The two external advisers dealing with legal and financial matters accounted for 93 per cent of total consultancy spend. The majority of the remaining seven per cent covered advice on construction issues from five separate firms. With the exception of one small contract for financial accountancy all the appointments were initially let following competitive tendering.

2.10 Six of the eight bidders who responded to our survey (Appendix 5) said that they found the management and decision making structure of the Agency and the Department either unclear or confusing. The other two bidders were not involved in the later stages of the procurement.

They responded to advice that a Private Finance solution for Longbenton alone was not feasible by widening the scope of the project

2.11 The Agency commissioned Storey Sons and Parker, chartered surveyors, "to investigate the potential of funding the redevelopment of the Longbenton site through the Private Finance Initiative and the disposal of other sites in Newcastle as appropriate". The report in September 1994 concluded that there was little potential for Private Finance on the terms suggested mainly because:

a) Longbenton was a bad location for office development to attract private sector tenants;

b) there was little scope to reduce construction costs below the level proposed by the Agency; and

c) the private sector would have no greater negotiating power than the Government to obtain more advantageous planning permission.

2.12 The Treasury and the Department considered that a project with a wider scope could be viable and decided to market-test the Private Finance option more fully by:

a) giving the private sector discretion to provide suitable accommodation anywhere within a 10 mile radius of Newcastle City Centre, not just at Longbenton; and

b) expanding the project to include three, later four, additional existing Department of Social Security sites in Newcastle, that the private sector could also propose to either retain or dispose of according to best advantage.

They sought to encourage innovation, with some success

2.13 Departments procuring Private Finance Initiative projects encourage innovation from private sector bidders by issuing output specifications. A good quality output specification states the service the client requires in terms of performance, without prescribing or even implying the way that it is to be provided.

2.14 The Agency produced an outline statement of requirements in early April 1995. This outline document was intended to find out how bidders would approach the project and whether they had a broad understanding of requirements. In some respects this statement of requirements was not an "output" specification. For example, it suggested the average floor area per person that the Agency believed they would need, including space for support services and general staff facilities. The Agency subsequently recognised that it was for bidders to propose how much space would be required and removed this element of prescription from the detailed statement of requirements that they issued to bidders in late June 1995. The value of allowing bidders scope to innovate in this area was demonstrated when the winning bid reduced the gross floor area of new construction that was necessary to meet users' requirements by over 25 per cent.

2.15 The procurement was affected by the Agency's and the private sector's lack of previous experience of the procurement of accommodation through an output specification. They wished to avoid getting so deeply involved in design as to stifle bidders' innovation or to undermine the transfer of design risk to the bidders. Given the ground-breaking nature of the project, they had to work towards the right balance. Two of the three short-listed bidders told us that they had had to ask the Agency to specify in greater detail their accommodation requirements, in order to construct compliant bids. The Agency told us that, at the outset, bidders had not fully understood the Private Finance approach to procurement and that one bidder had changed its bidding team as it developed a greater understanding of the complexities of the Private Finance approach.

2.16 Two-thirds of the bidders who responded to our survey expressed the view that the Agency's documentation had neither encouraged nor discouraged innovation. The bidders were evenly divided as to whether or not the Agency had been receptive or unreceptive to the innovations the bidders had proposed (Appendix 5, questions B4 and B5).

But the procurement took longer and was more costly than planned

The procurement timetable was extended on six occasions

2.17 At the outset of the procurement, the Agency expected that the deal could be closed within nine months. They extended the project timetable on six occasions:

a) In May 1995, the estimated contract award date was slipped to the end of December 1995 due to difficulties in preparing the Agency's statement of requirements and to allow more time for bidders to produce written proposals;

b) In October 1995, because of the development of a strategy on the services to be included in the project, and the realisation that more issues needed to be clarified in discussion with the three short-listed bidders, contract signature was put back until March 1996; and

c) After the appointment of Newcastle Estate Partnership as preferred bidder in June 1996, signature of the contract was deferred on four further occasions. In the original project timetable it had been assumed that contract signature would follow the selection of supplier within several weeks. In the event this stage required 18 months of difficult and complex negotiation, including five months in which NEP concluded obtaining external finance for the deal.

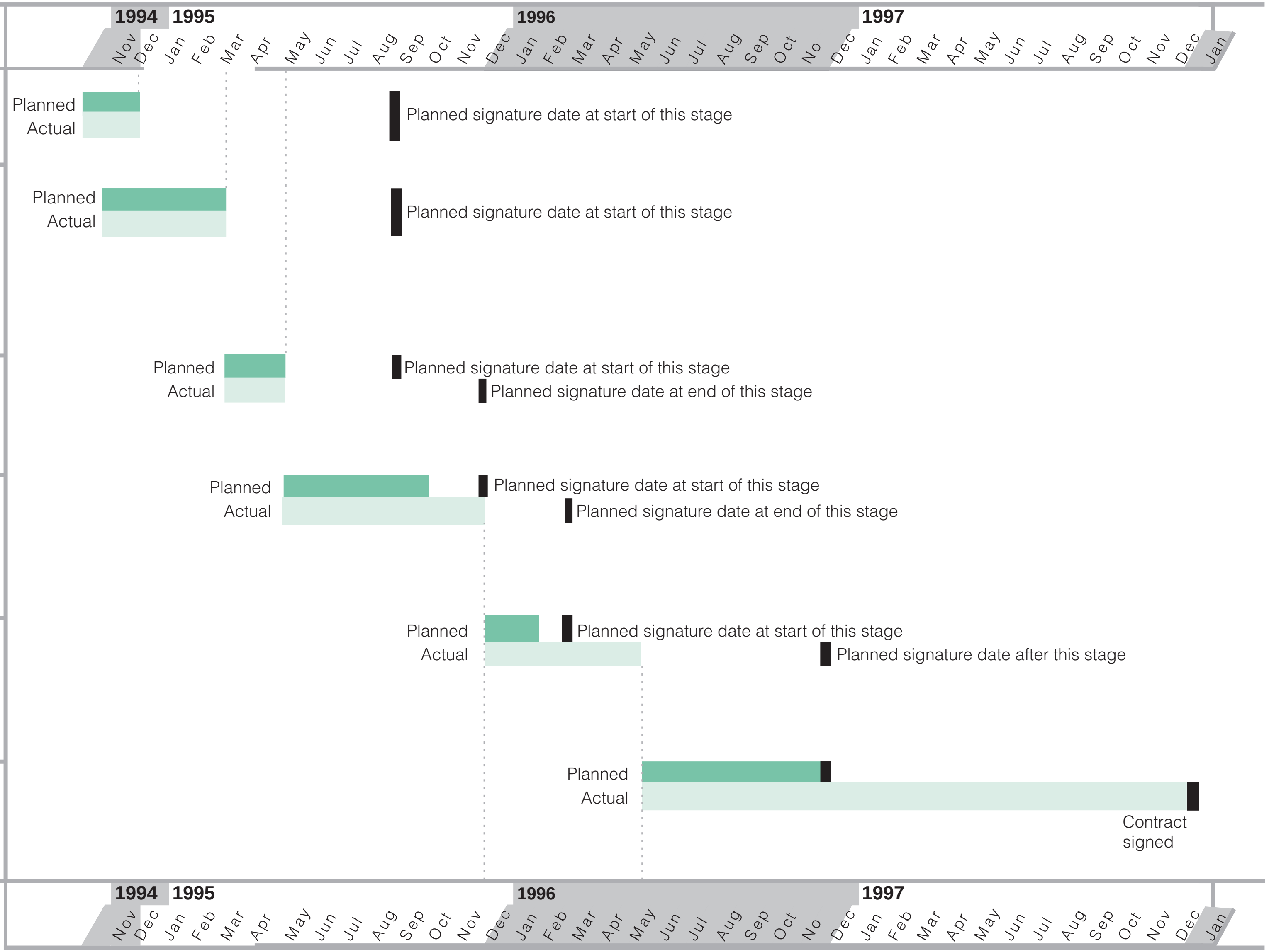
Figure 8 shows the progress of the procurement through its main stages.

2.18 The Department and NEP worked together to reduce the operational consequences of this delay. When the Contributions Agency first invited interest in January 1995 they drew bidders' attention to the need to rationalise the estate so as to be able to break or not renew existing leases from 1999 onwards. The original NEP proposal in February 1996 assumed that the new accommodation would be completed by September 2001. Though the negotiation period took a year longer than expected, and the programme as a whole will not be completed until July 2002, revisions to the construction plans agreed by the Agency and NEP mean that some 20 per cent of the new space will be provided 18 months earlier than originally planned.

2.19 NEP told us that they and the Agency were concerned to complete the project in time to enable existing leases to expire as originally planned. To achieve this, NEP decided to undertake detailed design work before the deal was signed but after they had the comfort of having achieved commercial close. This built on earlier design work required as part of the procurement process. Based on progress to date leases should not need to be renewed.

Figure 8 Comparison of project timetable vs outturn

Programme / Stages	No. of Bidders
Project planning stage *Main activities* Set project resources and timetable	Did not apply
Pre Qualification Stage *Main activities* Prepare & issue invitation for interest Issue questionnaires to respondees Brief respondees Evaluate the 14 responses Select longlist of firms to make proposals	58 reduced to 8
Outline Proposal Stage *Main activities* Issue Statement of Requirements Evaluate Responses Prepare Shortlist	8 reduced to 3
Detailed Proposal Stage *Main activities* Issue Service Requirement Evaluate indicative proposals & prices Decide on viability of PFI Complete negotiations & invite tenders	3 negotiate with Agency
Evaluation Stage *Main activities* Evaluate tenders Submission to Tender Board Seek Ministerial Approval Announce Preferred Supplier	3 reduced to 1
Final Negotiation Stage *Main activities* Formalise Contract Requirements Agree Legal terms and funding Sign Contract	1



Key

- Planned duration at the start of each state
- Actual duration
- Planned contract signature date

Source: The National Audit Office

The procurement took longer than other ground-breaking Private Finance projects

2.20 When the Contributions Agency formally invited private-sector interest in January 1995 their objective was to award the contract within nine months, by the end of September. This timetable was not questioned by any of their advisers or members of the Project Board with wider Private Finance experience. They had set it with reference to the timetable for procuring the Contributions Agency's new National Insurance Recording System through the Private Finance Initiative. In May 1995, they recognised that they had not appreciated the full impact of the following key differences between that project and the Newcastle Estate Development. The estate project:

a) potentially included a much wider range of services;

b) would involve several executive agencies; and

c) was likely to require the involvement of financial institutions to fund the projects, which adds significantly to the complexity of negotiation and is unusual in information technology projects.

2.21 The procurement took longer, however, than other ground-breaking Private Finance Projects, taking three years from the Agency inviting interest until signature of the deal. Because of acceleration in the programme of work, the impact of this slippage on the implementation of the project was limited to a 10-month estimated delay in completing the estate redevelopment.

2.22 The Department have engaged in another Private Finance accommodation project, called PRIME, on which we have also reported (The PRIME project: The transfer of the Department of Social Security estate to the private sector, HC 370). This project was similar in some ways to the Newcastle Estate project: both involved contracting for the delivery of office accommodation services. But there were also important differences between them. PRIME was much larger, involving over 700 buildings and numerous existing contracts. It covered a wider range of office services, including cleaning and security, but, unlike Newcastle, did not involve the design and construction of new buildings on existing or greenfield sites. PRIME also started later (in June 1996), and the PRIME consortium was, unlike NEP, led by financial institutions. The PRIME deal was signed in December 1997 (in the Newcastle case, the parties reached commercial agreement in August 1997 and signed the contract in January 1998) and the Department started receiving estate services under it from the private sector in April 1998 (immediately after contract signature in the Newcastle case).

The time taken to procure ground-breaking Private Finance Initiative deals

Figure 9

The first Private Finance Initiative deals for accommodation-related services took between 22 and 36 months to negotiate.

The Agency recognise the validity of the principle of using comparisons where appropriate. However, they believe that the results of comparisons should be treated with extreme caution because of the widely differing natures of the projects.

Private Finance Initiative Project	Procurement started	Date of deal signature	Months (note)
Newcastle Estate Development (Offices)	January 1995	August 1997 (commercial agreement)	32
		December 1997 (financial agreement)	35
		January 1998 (actual deal signature)	36[1]
Bridgend and Fazakerley Prisons	November 1993	January 1996, December 1995	25 and 26[2]
Norfolk and Norwich Hospital	February 1995	January 1998	35[3]
Dartford and Gravesham Hospital	September 1995	July 1997	22

Notes:

1. The elapsed time on the Newcastle project featured a five-month period when NEP sought funding for the project from financial institutions. The Agency consider that the Newcastle project was more complicated than other ground-breaking projects as it involved construction on an existing rather than a greenfield site, and included the logistical difficulties of reducing the number of sites occupied by the Department in the Newcastle area from 12 to 5.

2. The prisons projects included a much wider range of services than did the Newcastle Development, but the Prisons Service already had experience of negotiating contracts with the private sector for the management of existing prisons. The prisons were also greenfield developments, unlike at Newcastle where some bidders had to plan how to redevelop an operational site.

3. The Norfolk and Norwich project was delayed between November 1996 and July 1997 while the National Health Service resolved a generic issue relating to the powers of NHS Trusts to enter into Private Finance arrangements.

Source: National Audit Office

The Contributions Agency's procurement costs increased

2.23 Figure 10 shows the extent to which the Agency's initial estimate of the resources they would require to procure a Private Finance deal was exceeded. They subsequently revised this estimate (in May 1995) when they realised that the initial estimate had been optimistic. The main reasons for the overrun in procurement costs were as follows:

a) The Agency, like other clients for ground-breaking Private Finance projects, greatly underestimated the complexity of the project and therefore the extent of the support and information which bidders would require, as well as the difficulty and range of the contractual issues to be negotiated;

b) The assumptions made when the procurement started as to the project timetable and the size of the project team were proven to be too short and too small respectively;

c) The Agency initially felt that the role of Masons, their external legal adviser, could be limited to providing advice, transferring skills and conducting quality assurance on work done by internal contract experts, at a cost of £80,000. In November 1995, due to the specialist nature and complexity of the contract, the Project Board approved the extension of Masons' role to include negotiations with bidders and the drafting of the contract documentation. This additional work was estimated to increase Mason's costs to £220,000, but when the timetable was extended in 1996 and 1997, this estimate also proved to be too low; and

d) When the Agency appointed legal and financial advisers in competition in January 1995, they negotiated fee rates that were to apply only until the end of August 1995. After this period, the Agency needed to maintain the continuity and knowledge of their negotiating team and therefore reappointed the legal advisers without competition on four successive occasions and the financial advisers on five occasions. Over this period rates for provincial and London legal work increased on average by 9 per cent and 10 per cent and those for financial advice by 58 per cent.

Figure 10

Comparison of the original project cost estimate with outturn

This shows the increase in project procurement costs between the start of procurement work in November 1994 and the closure of the deal in January 1998. The Agency's procurement cost of £4.411 million represents just under two per cent of the £226 million discounted contract value.

Item	Original estimate (November 1994) £,000	Update (May 1995) £,000	Outturn (January 1998) £,000
In-house staff	**137**	**821**	**1,281**
Non-staff costs (eg travel, training)	**10**	**123**	**200**
External advice:			
Legal Advice (Masons)	70	453	2,335
Financial Advice: (Kleinwort Benson)	123	271	404
Other consultants (mainly property and insurance issues)	57	72	191
Total external advice	**250**	**796**	**2,930**
Total project costs	**397**	**1,740**	**4,411**

Source: Project Budgetary Control Reports

2.24 In commenting on the figures for fee rate increases, the Agency have said to us that:

a) in their view, the initial fee rates which they negotiated were very competitive; and

b) in relation to the rates for financial advice, these compared reasonably over the life of the project with similar rates negotiated by the Department under overall framework contracts with other advisers.

Bidders were concerned about the costs they incurred

2.25 Bidding costs have been a concern on many Private Finance projects. We asked the 14 companies and consortia that entered the bidding competition to disclose their costs. From eight responses, we estimate that total costs incurred by the private sector during bidding for this contract were between £11 million and £14 million, equivalent to around six per cent of the £226 million discounted contract value. The three short-listed bidders incurred the great proportion of these costs. Some of this cost relates to detailed design work that NEP told us they had needed to begin before they had a signed contract, in order to enable leases to expire as originally planned. This was a decision they took themselves with the confidence of having achieved agreement on commercial terms.

2.26 Excessive bidding costs are a matter for concern more generally because they will deter bidders and thus reduce or eliminate the competitive tension on which the public sector depends for good value for money in procuring these projects. However, six of the eight bidders confirmed that they had not been deterred from bidding for future Private Finance projects.

2.27 The three short-listed bidders expressed to us varying degrees of concern about:

a) fluctuating estimates between January and December 1995 of the numbers of staff to be accommodated;

b) the gradual emergence of key aspects of the Department's requirements as embodied in the Agency's specification, an aspect that one bidder said other government clients also found difficult to manage;

c) obtaining information on the condition of the existing estate, especially the recently built Tyneview Park;

d) insufficient communication with the Contributions Agency, mainly while bidders were awaiting decisions on their proposals; and

e) changing views in government on Private Finance practice, particularly risk allocation.

Notwithstanding these concerns, they agreed that the Contributions Agency's project team had worked hard to support bidders through a process new to both sides. In particular, they considered useful the system of nominating individual members of staff to act as liaison points for each bidder.

There were several reasons why the procurement took longer than expected

2.28 The duration of the procurement reflected the impact of several factors. The Agency sought to learn from the few precedents and limited guidance available to them at the time, but the process was new to both them and the private sector. Some difficulties in the procurement were attributable to the Department's circumstances at the time, including an environment of major change and uncertainty in their business. Some delay was attributable to the private sector who were also learning. And a major factor in the procurement was the Agency's understandable decision to continue negotiating until they obtained an acceptable deal as opposed to signing an earlier, less acceptable version of the contract.

2.29 The main issues to arise during the procurement were:

- important requirements developed after the start of the formal procurement process;
- there were some difficulties in inter-agency co-operation;
- moving to negotiate with a preferred supplier while there remained important areas for negotiation;
- the Agency continuing negotiations until satisfied with the deal; and
- the five-month period between August and December 1997 during which NEP concluded their external funding arrangements.

The Department's requirements developed after the Contributions Agency began formal procurement

2.30 On 4 January 1995, the Agency, acting on behalf of the Department's agencies accommodated in Newcastle, formally invited private sector interest by placing a contract notice in the Official Journal of the European Union. The notice is reproduced at Appendix 6.

2.31 The Contributions Agency told us that there were pressures on them to commence the procurement quickly. In particular, the market was becoming aware of the potential project and the Contributions Agency were keen to be fair and open to all potential bidders. When issuing the contract notice, and consistent with the negotiated procedures they had chosen, the Agency decided to adopt an open approach to allow the private sector to bring innovation in areas of service delivery and risk allocation. They felt that this approach also reflected the ground-breaking nature of the project and that it allowed them to identify requirements known to them at the time. In addition, it gave them the flexibility to respond to key changes as they occurred and to develop key issues as the project progressed. For example, the number of staff to be accommodated changed as a result of the introduction in February 1995 of the Departmental Change Programme.

2.32 We note that, after issuing the contract notice in the Official Journal, the Department's requirements developed in the following key areas:

a) **The number of staff to be accommodated.** The exercise of collecting staffing projections on a consistent basis from 35 points around the Department proved to be very difficult. The contract notice referred to the 14,000 staff accommodated in the Newcastle area at that time. In February 1995 the Department began a review that over the next year resulted in a Change Programme intended to reduce running costs by 25 per cent over a three-year period. Against this background, in April 1995 the Contributions Agency assembled projections that suggested a requirement to accommodate 13,200 staff by the year 2000. This figure was revised to 10,700 by December 1995 reflecting employee reductions due in part to the planned introduction of new information technology. Two of the three short-listed bidders made fundamental late changes in their bids because of this reduction in the staffing figures. Some of these reductions relating to the introduction of a replacement National Insurance Recording System were known to the Contributions Agency by the time of the contract notice but were not then public knowledge because the contract had not yet been let, and consequently could not be released.

b) **The range of office services to be included.** The contract notice invited interest for the supply of building and engineering works, but noted that the development could include the subsequent management or operation of the new facility. The Contributions Agency considered from an early stage that the maintenance of the buildings would be included. But it was not until September 1995 that the project team devised a strategy in which the three short-listed bidders would be given the option to bid to provide security, cleaning and other facilities services.

c) **A proposed allocation of risk between the Department and the chosen supplier.** The Contributions Agency did not construct a register identifying the foreseeable risks associated with the project until June 1995, and did not propose an allocation of risks to bidders until November 1995 in the Invitation to Negotiate. This was an understandable approach in this case given the scarcity of precedents on which to base an allocation. But it would now be good practice in Private Finance Initiative procurement to state the client's preferred allocation of risks at the start of the process.

d) **Key terms and conditions of contract.** Work did not start on an outline of the contract until May 1995. Bidders therefore did not see draft heads of terms until the Contributions Agency issued the first Invitation to Negotiate document in November 1995. The Contributions Agency consider this reasonable given the absence of good practice and guidance for them to follow.

Inter-agency co-operation within the Department proved difficult

2.33 The Contributions Agency project team encountered several difficulties in managing the procurement of the project on behalf of other agencies and the Department's headquarters. In our view, these were principally:

a) addressing the concerns of other agencies which, although represented on the Project Board, saw the project as being owned by the Contributions Agency and as representing a loss of control over their accommodation and operations;

b) collecting current and projected staff numbers on a consistent basis;

c) identifying and responding to the differing accommodation requirements of each agency; and

d) obtaining information in certain key areas about buildings that were to be retained in the redeveloped estate.

The Agency told us in the course of our investigation that they considered that only the fourth of these points (obtaining information about retained buildings) materially increased the time taken to complete the project.

Important issues remained to be settled when the Department appointed a preferred supplier

2.34 The Agency received formal expressions of interest from 58 companies, 14 of whom submitted themselves for assessment of their technical capacity and financial standing. They then selected a long list of eight property or construction firms to be evaluated through written and oral presentations and interviews, and following this short-listed three companies to enter detailed negotiations.

2.35 The Department appointed a preferred supplier only after a comprehensive evaluation of all bids. They set up specialist teams to consider the following areas:

a) technical, construction, sites and planning;

b) legal and contracts;

c) finance and funding; and

d) services.

2.36 Each team identified and established detailed evaluation items with weighted scores for each item and presented their findings to an experienced Evaluation Panel, made up of representatives of the main business units on the Newcastle estate and from other parts of the Department.

2.37 The Evaluation Panel considered the technical, legal and services aspects of the bids before they had sight of any financial information. They considered, through a system of "alerts" raised by the specialist teams, any proposals which would require improvement through further negotiations. In NEP's case, the Panel were concerned that the design of the buildings might not meet certain output specifications. They were also concerned about compliance with aspects of fire safety provisions.

2.38 The Panel concluded from financial information that NEP's bid represented the best price. After including costs that would be incurred directly by the Department, and discounting over 31 years they estimated NEP's bid would cost £244.6 million, Tyne Partnership's £282.4 million and NERL's £354.5 million. The Panel then considered further the issues with NEP's design. They recognised that improvements were necessary and that fire provisions would need to be met. They therefore sought advice from their technical advisers, who considered that the improvements could be achieved at a cost of no more than £10 million. Even allowing for this increase, the Panel calculated that NEP's price remained below the other bids and still represented best value.

2.39 The Panel therefore recommended to a separate Tender Board, whose role was to validate the evaluation process and consider the recommendation of the Panel, that NEP be selected as preferred supplier. The Tender Board was made up of representatives of the Department, Private Finance Panel Executive, and the Treasury. The Tender Board, and subsequently the Project Board, confirmed that NEP should be appointed as preferred supplier.

2.40 The cost of addressing the design issues raised by the Evaluation Panel was therefore determined during exclusive negotiations with NEP. Changes made to meet fire requirements added £2.8 million to building costs. The Agency also requested the inclusion of air cooling systems to provide a more comfortable working environment, adding £2.7 million to building costs. Overall, the actual cost of design changes was lower than the £10 million maximum estimate made by the Evaluation Panel.

2.41 The period during which NEP and the Agency negotiated lasted much longer than expected. As this was the first Private Finance deal of its kind, there were few templates for the two parties to refer to in order to resolve disputes. There were lengthy discussions over important issues, often being encountered for the first time, including:

a) the terms on which NEP would take ownership and structural risks of existing buildings on the Estate, in particular Tyneview Park and Durham House. Prior to the Private Finance deal, the Agency bore the full financial consequences of structural problems on the estate, and they regarded this element of risk transfer as a key issue, given the known structural defects at Tyneview Park and Durham House;

b) the definition of when space became "unavailable";

c) which party would assume risks if insurance to cover them were to become unavailable in the market;

d) the availability of alternative accommodation in the event of the project's facilities becoming unusable;

e) the responsibility for cost increases should ground conditions on the Estate make construction more complicated than expected;

f) the output specification of the offices, clarifying aspects of the performance required by the Department; and

g) the need to develop a performance measurement system for the accommodation service in partnership with the preferred supplier.

2.42 Furthermore, changes in the Department's requirements during this period included:

a) the replacement of an existing sports hall at Longbenton planned for demolition, and earlier completion of the construction phase of the project;

b) initial inclusion, then exclusion in May 1997, of the provision of office furniture as part of the Private Finance deal;

c) a change in requirements in March 1997 through which NEP, after negotiation, agreed to delete provisional sums and instead assume the additional risk of providing a fixed cost for remedial and other works; and

d) a change of requirements as to whether NEP should assume the full risk of decanting all staff into new buildings at a fixed price. The Invitation to Tender had envisaged the supplier assuming this risk, but in negotiation with NEP it became evident that only the Department could control the number and phasing of decant moves.

The Contributions Agency continued negotiations until satisfied with the deal

2.43 During the phase of negotiating with a preferred bidder during a Private Finance procurement, it is important that departments seek to maintain pressure on the bidder to minimise cost increases, because that bidder no longer faces the incentive of direct competition. Generally, the longer the negotiation phase with a single preferred bidder, the harder it becomes for a department to maintain competitive pressure. To protect their position in this case, the Contributions Agency chose to continue negotiations until fully satisfied with the terms of the deal. For example, they continued negotiating until fully satisfied with transfer of the risk of structural defects at Tyneview Park and Durham House, and they decided not to reach final commercial agreement in March 1997 while certain elements of expenditure in NEP's bid were expressed as estimates rather than binding figures.

2.44 When the Department appointed NEP as preferred bidder in June 1996, the Agency recognised that preferred suppliers benefit from a strengthened negotiating position. The Agency expected to sign the Private Finance deal in late 1996. They sought to maintain negotiating pressure on NEP by:

a) using their own analysis and the input of the appointed experts to challenge NEP's proposals where they were unacceptable; and

b) by retaining the second placed bidder, Tyne Partnership Limited, as a reserve supplier until January 1997. The retention of a reserve supplier is a technique which has not been common practice in Private Finance procurements but which the Agency developed as part of this project.

2.45 The Agency decided to stand Tyne Partnership down in January 1997, after receiving a letter confirming NEP's commitment to the deal in December 1996. At that time, they expected to sign the deal by March 1997. After standing Tyne Partnership down, the Contributions Agency could not invoke the threat of replacement to increase pressure on NEP.

2.46 Over the period of negotiation, both the costs and benefits of the deal increased, with the estimated net present cost of the deal increasing from £219.3 million to £226.1 million. This increase comprised additional costs for extra services and earlier occupation of the estate, which meant that important risks were transferred to NEP earlier than originally expected and that the Department enjoyed earlier the benefit of moving into better accommodation. The increased cost as a result of negotiations between the Contributions Agency and NEP amounted to £36.2 million (15 per cent), of which £14.8 million was as a result of earlier transfer and occupation of buildings.

2.47 The overall increase was counteracted by the concurrently favourable impact of reductions in market interest rates, which reduced costs by £29.4 million (13 per cent). Figure 11 summarises these changes.

2.48 Not all changes in the deal over the period of the negotiations with NEP were quantified. The Contributions Agency adopted a variety of approaches to negotiation: including a trading approach, a persuading approach and the standard approach whereby a fair price is negotiated for a new requirement. In the trading approach, they only agreed to concede an issue to NEP in return for concessions by the consortium. Because the Contributions Agency did not place a monetary value on most of the concessions it made to or won from NEP, it is unclear how these affected the value for money of the deal.

NEP took five months to conclude its external funding arrangements

2.49 The Contributions Agency and NEP reached Commercial Close, agreement on the key commercial and contractual issues, in August 1997. NEP needed to secure finance from external financial institutions to undertake the construction phase of the project and to operate the buildings over the following 25 years. Once this support was obtained, the project would reach Financial Close, and all parties would sign binding contracts. At this time the Contributions Agency expected to sign the contracts in late November or early December 1997.

Figure 11 **Changes in the cost of the deal during the 18 months that NEP were preferred bidder**

The estimated net present cost of the deal changed during the negotiation period as a result of changes in the nature of the accommodation provided, concessions to NEP and changes in interest rates. The Agency estimated when signing the deal that the overall cost, including costs to be borne by the Department such as travel costs for relocated staff, amounted to £241 million. NEP also made some concessions to the Agency during procurement.

	Net Present Cost (£m)	Comment
Net present cost at best and final offer	219.3	This was NEP's bid when in competition.
Price movements attributable to the project Increase in availability charges as a result of earlier than planned occupation of premises	14.8	Decision made by the Department for operational reasons. Earlier occupation means important risks will be transferred to NEP sooner than originally expected.
Increase in availability charges as a result of concession to NEP on inflation during construction period	3.8	Concession made to NEP by the Contributions Agency in exchange for other mostly unquantified concessions by NEP.
Increases in availability charges as a result of changes in construction costs	13.4	Result both of changes in the Department's requirements and of rectification of design problems with NEP's Best and Final Offer.
Increases in condition payments resulting from changes in building design	4.2	The maintenance consequences of the above.
Revised cost at original interest rates	255.5	
Price movement for external reasons Impact of falling interest rates over negotiating period	(29.4)	External factor beyond the control of either party.
Revised net present cost at actual interest rates	226.1	
Increase in Net Present Cost as a result of factors within the Department's control	36.2	
Increase in Net Present Cost as a result of all factors	6.8	

Note: The gross increase of £36.2 million is based on interest rates quoted by NEP in their Best and Final Offer. The net increase of £6.8 million reflects the lower interest rates obtained by NEP at the time of signature of the contract.

Source: Ernst & Young, Post Completion Report to the Department

2.50 NEP had put forward, as part of their final bid, an innovative funding package through Royal Bank of Scotland. During the negotiations period, NEP had explored the possibility of using three banks to deliver this option: Royal Bank of Scotland, Midland Bank and Bankers Trust. In September 1997, NEP replaced Bankers Trust as a funding provider because they were not sufficiently confident that Bankers Trust could provide the finance in time for contract signature in December 1997. NEP then reverted to a more conventional funding package provided solely by the Royal Bank of Scotland, who were already familiar with the proposed deal. This change extended the time taken to close the deal by about one month. The deal was closed with guaranteed funding on 8 January 1998.

2.51 The agreed funding package was as follows:

- £1 million of equity, provided on a 50:50 basis by AMEC Developments Limited and Building and Property Group;
- a subordinated loan of up to £15.3 million from AMEC plc; and
- a loan facility of up to £169.8 million from Royal Bank of Scotland.

2.52 As regards the estimated rates of return of these investors, the equity and subordinated debt would earn an estimated rate of return of 14 per cent before tax if the Department exercises its maximum flexibility to vacate space. This is a relatively low return by the standards of other Private Finance projects we have examined and NEP confirmed to us that their intention is to encourage the Department not to vacate space, by building discounts into the prices of flexible space.

Part 3: The Department consider that the deal represents value for money and is within probable budgetary allocations

This part of the report shows how the Department reached the conclusion that the benefits of the deal would outweigh its extra direct costs to the taxpayer and therefore would represent value for money when compared to other bids. Figure 12 illustrates the process undertaken by the Contributions Agency, acting on the Department's behalf, to reach this conclusion.

An early comparison suggested that the Private Finance approach could be good value for money

3.1 In September 1995, and in line with Treasury advice, the Contributions Agency conducted an evaluation of the feasibility of a Private Finance solution to their accommodation problems. The study included a comparison of the three short-listed bidders' indicative (non-binding) prices with the updated cost of the original 1993 plans to redevelop the estate. This would have been a conventionally-funded project using capital provided by Treasury.

3.2 The Contributions Agency estimated that, over 25 years, the conventional project would cost £338 million. They concluded that one of the three bidders had quoted indicative prices lower than this (Taylor Woodrow at £271 million), with the others, AMEC (£391 million) and Tyne Partnership (£493 million), quoting higher prices. But the Contributions Agency considered it was highly likely that these opening estimates could be reduced through competition and negotiations and as proposals became firmer, and noted that bidders' prices incorporated a greater degree of risk transfer than the conventional project. They therefore concluded that there was every likelihood that the Private Finance solution would result in better value for money for the taxpayer, and decided to continue with the project.

Figure 12

Summary of the process undertaken by the Contributions Agency for assessing value for money during the procurement process

The Contributions Agency's approach to evaluating value for money on behalf of the Department developed as the procurement progressed.

Stage of the procurement	Assessment methodology	Assessment tools	Results and conclusions
Feasibility stage September 1995	Comparison of non-binding indicative bids from the private sector with the cost of a publicly-funded new build, over 25 years.	I) Net present costs of prices quoted by private sector bidders. II) Net present costs of the 1993 proposals to redevelop the estate, appropriately updated.	One bidder quoted lower prices, and the other two higher prices, than the publicly funded alternative. The Contributions Agency, acting on behalf of the Department, considered that bids should reduce in competition, and that a Private Finance deal would in every likelihood offer value for money.
Evaluation of Best and Final Offers March/June 1996	Evaluation and comparison of competitive bids from three private sector bidders to identify which one offered best value for money.	Evaluation based on four key criteria: risk transfer, meeting user requirements, cost and deliverability.	The Contributions Agency, acting on behalf of the Department, concluded that, comparing the bids with one another, NEP offered the best value for money of the three.
Assessment of whether the deal was within probable budgetary allocations March 1996/July 1997	Comparison of the likely cost of the Private Finance deal with probable budgetary allocations for accommodation if the deal did not go ahead, over 31 years.	I) Net present cost of the Private Finance deal. II) The Do Minimum Option, an estimate of likely budgetary allocations in the absence of a private finance deal, including internal rents payable to Treasury.	The cost of the deal to the Department was estimated to be less than the cost of continuing with the existing estate including the Department's payments of rent to Treasury. The Contributions Agency concluded that the deal was affordable to the Department.
Assessment of value for money July 1997	Comparison of the cost of the deal with the cost of remaining in existing accommodation, over 31 years.	I) Net present cost of the Private Finance deal. II) The Do Minimum Option, excluding internal rents payable to Treasury.	The deal cost more than remaining in existing accommodation, but could be justified by the significant operational benefits that arose from the replacement of outdated accommodation.

Source: The National Audit Office

Later the Agency compared the deal with the minimum cost of existing accommodation

The Agency relied on competition to provide value for money

3.3 In the absence of a Public Sector Comparator, the Contributions Agency relied on competition between bidders to ensure value for money. This approach complied with the Treasury's guidance at that time, which stated that, where capital for a conventional procurement was unlikely to be available, departments did not need to demonstrate value for money against a conventional approach (called a Public Sector Comparator).[2]

3.4 This means that the Agency did not update their September 1995 comparison between a conventionally-funded project and a Private Finance deal. We acknowledge that the Agency acted in accordance with guidance existing at the time. But, in our view, the September 1995 comparison (shown in Figure 13) does not conclusively demonstrate that the Private Finance approach would offer value for money and we consider that the exercise provided insufficient justification for ceasing to evaluate a conventionally-funded option.

The Department's 1995 Evaluation

Figure 13

One indicative PFI bid suggested a lower cost than a conventional project, and two indicative bids suggested a higher cost.

Proposed project	Indicative cost estimate (£ millions net present value)
Tyne Partnership PFI	493
AMEC PFI	391
Conventionally funded	**338**
Taylor Woodrow PFI	271

Source: The National Audit Office

2 This approach complied with the guidance on assessing value for money in Private Finance deals available at the time, contained in *Private Opportunity, Public Benefit* (published by HM Treasury in November 1995). This guidance was subsequently replaced by new general guidance from the Treasury PFI Taskforce: *Step by step guide to the PFI procurement process* (first issued in July 1997 and revised in April 1998); *Partnerships for Prosperity* (November 1997); and specific guidance dealing with the preparation of public sector comparators *Public Sector Comparators and Value for Money* (March 1998).

3.5 We also consider that the September 1995 estimates cannot be used as a point of comparison with the final cost of the signed Private Finance deal because they include a number of items excluded from the scope of the final deal, including furniture costs, heating, lighting and fuel costs, and rates, and were based on providing accommodation for 14,000 staff, against 10,700 in the final deal. We are therefore unable to conclude from the September 1995 figures that the signed deal represents value for money.

3.6 Design and Construction and its financing represents around three quarters of the cost of the Private Finance service for the Newcastle Estate Redevelopment. Some other clients for Private Finance projects, such as the Prisons Service and Hospital Trusts, have compared building costs against their own benchmarks in order to help them identify excessive cost estimates or over-specification of the required asset. In this case, although the Contributions Agency did not compare the construction costs proposed by NEP against standard building cost benchmarks for offices, their evaluation was closely supported by quantity surveyors. They focused on whether the required quality of building was achievable at the stated cost, and concluded that it was. They considered that competitive pressure would deter bidders from inflating building costs.

The Agency estimated the cost of occupying existing accommodation

3.7 To provide additional assurance on whether the Private Finance solution was likely to be within probable budgetary allocations and on value for money, they estimated the likely costs of remaining in occupation of their existing, generally dilapidated estate for another 31 years. Since this approach involved only the minimum investment in the Newcastle Estate, and because it did not incorporate any investment in improved quality of accommodation, the Contributions Agency called it the Do Minimum Option. They considered this Do Minimum Option the next most likely option in the absence of a Private Finance deal.

3.8 In preparing the Do Minimum Option, the Contributions Agency's primary focus was on affordability; that is, whether the likely costs of the Private Finance solution could be borne within probable budgetary allocations. Although they did not know what the future level of budgetary allocations would be, the Do Minimum Option represents an attempt to estimate their requirements over the next 31 years. At that time, the Department's running cost allocations included around £11 million a year paid as an internal charge to Treasury as rent for freehold properties on the Newcastle Estate. The Contributions Agency accordingly included these internal charges in the Do Minimum Option as a cost to them of remaining in existing accommodation. The Treasury agreed with this approach.

The deal is more expensive in direct cost terms than continuing in existing, outdated accommodation

3.9 The Contributions Agency estimated that, including these rents to Treasury, the cost of continuing in existing accommodation was £346 million compared to a cost for the deal signed with Newcastle Estate Partnership of £241 million. This analysis confirmed to them that the deal was within probable budgetary allocations. They recognised, however, that for the purposes of considering value for money, the rent payments to the Treasury were irrelevant, since they were an internal cost to government with no impact on the taxpayer. They found that excluding these payments, the Private Finance deal (at £241 million) is £51 million, or 27%, more expensive than remaining in existing accommodation (£190 million). Figure 14 shows the results of this exercise.

The Agency's comparison of the cost of the Do Minimum Option with the deal signed with Newcastle Estate Partnership

Figure 14

The Agency's appraisals show that the deal costs more than remaining in existing accommodation if internal rent payable to the Treasury is excluded from the calculation.

Estimated cost of remaining in existing accommodation (including rent payable to the Treasury)	Estimated cost of remaining in existing accommodation (excluding rent payable to the Treasury)	Estimated cost of the private finance deal signed with NEP
(£ millions in present value)	(£ millions in present value)	(£ millions in present value)
346	190	241

Note: These figures exclude the market value of the existing estate based on alternative use, ie the opportunity cost of continuing to occupy it. This item is common to both options and does not therefore alter the relationship between them. It also excludes the residual value of the estate at the end of the deal which would reduce the cost of the do minimum option relative to the Private Finance option because DSS, not NEP, would own the estate. This value is uncertain, but, after discounting for 30 years, should not be large.

Source: The National Audit Office

But the deal provides benefits in comparison with the existing, outdated accommodation

The new accommodation should enable the Department to increase its operational efficiency

3.10 The Department and the Contributions Agency concluded that the Private Finance deal was worth signing notwithstanding its greater direct costs to the taxpayer because of its many advantages compared to remaining in existing, outdated accommodation. They noted that efficiency gains equivalent to only three per cent of annual running costs would offset the additional costs of the deal, and concluded that the new, modern accommodation would enable efficiency gains of at least this magnitude to be realised.

3.11 During the course of our examination, the Contributions Agency were able to identify the following factors that could potentially produce such savings. These savings apply principally to the business units that will occupy newly-built accommodation at Longbenton and Waterview Park:

a) **Information Technology** is a key driver in achieving operational efficiencies. The new accommodation provided by the Private Finance deal ought to allow the Department to provide, maintain and update an efficient Information Technology infrastructure. The existing accommodation is unsuitable for modern cabling.

b) **Improved working practices** such as shift-working, desk sharing, and open-plan working should enhance productivity. Such practices should enable closer teamwork and enhanced communication. These practices would be harder to introduce if the Department stayed in existing premises.

c) **The improved working environment** is expected to reduce the incidence of staff sickness, absenteeism, and low productivity. The new buildings are also much less likely than existing buildings to suffer from major defects, such as heating failure, that lead to staff being sent home.

d) **Better location of business units,** which are currently dispersed, hindering communication and co-ordination. The new accommodation will allow the Department to locate each business unit more coherently and logically, and should also permit easier reorganisation when necessary.

e) **Reduced facilities costs:** During our examination, the Contributions Agency estimated the likely savings on facilities costs from having a more compact and efficient estate. They estimated that these savings could amount to

£16.9 million over the life of the deal, arising from reduced costs for mail services (£4.5 million), administrative functions (£0.8 million) and less travelling time between different sites on the estate (£11.6 million).

The Private Finance deal frees the Department from risks of property ownership

3.12 The Contributions Agency have obtained a deal that reduces the Department's exposure to the risks arising from property ownership. This reduced exposure has a value. The Department did not have this quantified because in their view such an estimate could have been a costly and subjective exercise and was unnecessary following consideration of all proposals. During our examination they estimated the value to the taxpayer of avoiding some of the risks.

3.13 Some avoided risks relate to maintaining the fabric of the Estate:

a) Health and Safety legislation may change, requiring extensive additional expenditure. Under the Private Finance deal, Newcastle Estate Partnership bear some of this risk;

b) the costs of structural risks of existing buildings on the estate and the costs of required remedial works at the Durham House and Tyneview Park properties may exceed estimates. The Contributions Agency have valued the risks transferred to NEP at £2.6 million over the life of the contract;

c) maintenance and replacement costs of other buildings may have exceeded estimates. The Contributions Agency recognise that this element of the costs of remaining in existing accommodation was conservatively estimated;

d) the inflation element of costs relating to the construction of replacement buildings should the decision have been taken to remain in the existing estate; and

e) the cost of works required to any underground infrastructure (for example, pipes and cables) and to carry out any mandatory work to rectify inferior ground conditions.

3.14 Other risks transferred to NEP relate to managing a portfolio of property and include:

a) the risk that surplus property on the estate will be difficult or impossible to sell. After signing the deal, the Contributions Agency estimated that the benefit to the taxpayer of transferring this risk to Newcastle Estate Partnership was worth £3 million; and

b) the risk that the Department incurs a large repair liability when it vacates rented accommodation. Under the Private Finance deal, Newcastle Estate Partnership will pay any repair liabilities incurred by the Department. The Contributions Agency have estimated the value of this risk transfer at £1.48 million.

Glossary of Terms

Availability charge	The charge payable by the Department to Newcastle Estate Partnership for space provided. The space must pass certain objective tests to be deemed "available".
Change of law risk	The risk that future changes in legislation, for example, health and safety law, may lead to higher costs or loss of income for the owner of the building.
Condition payment	The charge payable by the Department to NEP for the condition of the space occupied. The condition payment covers building maintenance, mechanical and electrical and other types of maintenance, and insurance.
Crown Build	A building project where a government body commissions and finances construction. The public sector retains the risk that buildings will not be delivered on time or to cost.
Dilapidations	Disrepair on a leased property for which the outgoing tenant must reimburse the landlord.
Do Minimum Option	Option appraised by clients in comparison to Private Finance deals when insufficient capital funding is available for a redevelopment project. Assumes continued occupation of the existing premises with the only essential repairs or replacement.
Facilities management	Management of services relating to the operation of a building. Includes such activities as maintenance, security, catering and external and internal cleaning.
Force majeure	Events over which the parties to the contract have little control, but which could have serious impacts on performance of the contract. These may include war, rebellion, nuclear explosion, earthquakes and pressure waves from aircraft.
Full Repair and Insure Lease	Lease where the tenant agrees all internal and external repairs and all related insurance. It is the standard form of commercial lease in the United Kingdom.
Latent defect	A defect in retained buildings which had not been detected before contract signature; or a defect which emerges after construction in the new buildings.
Lease receivables funding	A method of funding a construction project whereby a bank pays a lump sum to the owner of the property for the right to receive future lease payments from tenants occupying the building. The owner uses the lump sum it receives to pay off debts incurred during construction of the building.

Newcastle Estate	Properties owned or leased by the Department of Social Security and its agencies in the Newcastle upon Tyne area. Before the signature of the Private Finance deal, the Newcastle Estate comprised 12 sites.
Opportunity Cost Rentals	Charges levied by the Treasury on departments occupying freehold land and buildings. A non-cash transfer between Treasury and Departments.
Public sector comparator	An estimate of what a project would cost if traditional public sector procurement methods were used.
Reserve bidder	The second place bidder retained by the client to replace the preferred bidder in the event of a breakdown in negotiations with the first place preferred bidder.
Risk transfer	The passing of risk under the contract between the public sector and the Private Finance service provider.

Appendix 1

Scope and Methodology of the National Audit Office's examination

Scope of this study

1 We examined how far the Contributions Agency, acting on behalf of the Department of Social Security, were likely to achieve their objectives for the project. At the time of the examination in early 1998 the contract with Newcastle Estate Partnership had just been signed and preliminary demolition and construction work had begun on site. The sites at Tyneview Park, Durham House, Bedewell and Longbenton had passed into the legal ownership of the consortium on 8 January 1998. The redevelopment of the Estate is not scheduled for completion until 2002. Therefore our work focused on the signed deal, and in particular the way it addresses the following aspects:

- The achievement of operational objectives – particularly the extent to which the contract provides for the sustained availability of good quality, flexible accommodation; and

- Value for money the extent to which the deal is likely to be a more economical, efficient or effective solution than the Department's alternative options for the Newcastle Estate, taking account of the transfer of risk to the private sector.

Main aspects of the National Audit Office's methodology

2 The examination covered:

- **The conduct of the procurement**: how the Contributions Agency went about the task.

  The purpose of this part of the examination was to assess whether the Agency's approach was well planned and implemented and likely to produce an outcome in line with their objectives. The process impacts on:

- **Outcome**: how far the outcome should meet the objectives.

This part of the examination focused on the extent to which the signed deal should meet the Department's accommodation needs within a price that provides value for money compared with alternatives.

3 To carry out the examination we followed the approach laid out in our recently published report on our methodology for examining Private Finance deals (Examining the value for money of deals under the Private Finance Initiative (HC739, 1998/99)). In particular, we:

- Designed the examination using experience acquired on our several earlier studies of Private Finance Initiative deals;
- Collected information about the procurement process and the deal;
- Used three external firms expert in aspects of the Private Finance Initiative to advise on specific issues;
- Obtained advice from an authority on economic appraisal; and
- Evaluated the information and advice received.

Collection of information

4 We collected information from the following sources:

- A review of the Agency's project management papers, bidders' submissions and of the legal agreements underpinning the deal;
- Interviews with members of the Agency's Project Team, officials and advisers, on how they handled the negotiation of the deal;
- Interviews with the Department's user representatives, whose main role in the procurement was to represent users' requirements to the Project Board and project team;
- A questionnaire sent to each of the 14 organisations that had responded in detail to the Agency's invitation to express interest, (results are summarised at Appendix 5); and

- Discussions with each of the three short-listed bidders.

Use of external expertise

5 We engaged Theodore Goddard, a firm experienced in acting as legal advisers on Private Finance projects, to examine the contract for the Newcastle Estate Development and advise on how well it protected the Department's position.

6 We also engaged King and Co, a firm with expertise in financial and property aspects of Private Finance projects, to advise on issues to do with the funding of the Newcastle Estate deal.

7 We obtained advice from National Economic Research Associates on the economic appraisal of the Private Finance deal and the alternative Do Minimum option.

Appendix 2

The main agencies to be accommodated, and their accommodation requirements

We consulted senior officials who represented, through the Newcastle Estate Customer Assurance Panel, most of the staff housed on the estate, to obtain their views on the project. Not all of them would have been involved in the project throughout. The redevelopment of the estate is summarised in Figures 3 and 4 of the main report.

The Contributions Agency

The Contributions Agency's role: The Agency is responsible for administering the collection of National Insurance and for maintaining National Insurance records. Most of their staff are based in the Newcastle area. Work includes the update and maintenance of the accounts of over 62 million individual customers, and the management of contracting out arrangements for occupational and personal pensions. They ensure conformance with legislation, records maintenance and information provision. Their stated business aims are to:

- manage their business more professionally providing value for money for the taxpayer;
- improve standards of service for customers by consulting with them; and
- provide staff with the equipment and training to improve services.

The Agency transferred from Social Security to the Inland Revenue in April 1999.

Accommodation requirements: The Contributions Agency will be based at a redeveloped Longbenton site. User representatives told us that existing accommodation at Longbenton was untenable in the long run. One described it as a "nightmare", leading directly to lost productivity. For example repeated boiler failures had caused staff to be sent home. The Agency required a solution to these problems. They also needed flexible accommodation that could cope with reconfiguration into cellular and open-plan space and use of "hot-desking" (desk sharing). They required high specification IT cabling, secure access and support for flexible shift-working.

The Contributions Agency's views of the Private Finance project: They felt that the deal would deliver these requirements and expressed no major concerns with it. They felt that at the outset the Department's strategy on staff numbers had not been sufficiently thought through, but said that the Private Finance deal would allow more flexibility to relinquish unwanted space than under a traditional deal. Some agreed with other Agencies that communication with the project team could have been better.

The Benefits Agency

The Benefits Agency's role: The Benefits Agency are responsible for the effective and secure management of the distribution and payment of social security benefits. They give advice and information about benefits, handle claims reviews and appeals, and arrange nearly 1,000 million payments and recoveries a year. Their aim is to streamline the way business is delivered, ensuring that improved services, better security and value for money are provided to all their customers. On the Newcastle estate, some 4,500 of their 67,000 staff in the UK administer retirement pensions, several centrally-managed benefits such as those for widows and overseas recipients, and provide certain central services for the Department.

Accommodation requirements: Some 2,100 of the Benefits Agency's staff in the Newcastle area are accommodated in Tyneview Park. These premises were built in the early 1990s as the first stage of a programme to redevelop the Longbenton site. They already provide the working environment the Benefits Agency require and are to be retained in the redeveloped estate. The Benefits Agency also have around 900 staff on the Longbenton site. The main objectives for the Benefits Agency under the new arrangements are to ensure that they receive a good quality of maintenance at reasonable cost at Tyneview Park.

The Benefits Agency's views of the Private Finance project: The Benefits Agency's representative felt that:

- there should have been closer appraisal of the decision to include Tyneview Park in the Newcastle Estate Project, given its status as a Benefits Agency building;
- the Project Board should have included more user representation;
- there should have been better communication between users on one hand and the project team and board on the other, on a range of issues; and

- the project team should have had greater technical expertise in areas of accounting, estates management, finance, legal and procurement practice.

Benefits Agency: The Child Benefit Centre:

The Centre's role: The Centre is part of the Benefits Agency but has a distinct identity in administering the only universal social security benefit, which is paid to all parents regardless of their income.

Accommodation requirements: The Centre regard their current accommodation as adequate but not sustainable beyond the year 2000 because cabling could not be installed at its Emerson House building and maintenance costs were rising annually. The project will move them to new premises at Waterview Park.

The Centre's views of the Private Finance project: The Centre's representative indicated to us that the project should provide a solution to the inflexibility and rising maintenance cost of Emerson House. But they had had less influence over the building design than would have been the case in a traditional project. Their membership of the Customer Assurance Panel had helped them keep up to date with events. The project should also provide the opportunity to bring together at Waterview Park staff currently spread over three sites, though a 10 per cent shortfall in space would have to be resolved through changes in working practices.

The Information Technology Services Agency

The Agency's role: The Information Technology Services Agency works with all parts of the Department of Social Security group to maximise business efficiency through the secure and cost effective use of information systems and information technology. In this area it aims to set the strategic direction for the Department, secure the cost effective delivery of systems, maximise the effectiveness of Information Technology in improving operations and work with external suppliers in the development of services. Staff numbers have fallen due to the transfer of staff to external suppliers in 1995.

Accommodation requirements: Some 1,000 of the Information Technology Services Agency's 1,900 staff work on the Newcastle estate, mostly at Durham House, a specialist computer centre which is to be retained by NEP in the redeveloped estate. In addition to general requirements similar to those of other agencies, Durham House requires a steady flow of electricity supplies and back-up generators in the event of interruption. Computer downtime is extremely expensive to the public purse.

The Information Technology Services Agency's views of the Private Finance project: The Agency regarded Durham House's inclusion in the project as an inducement to interest bidders in the Longbenton site redevelopment. They felt that the project team had worked very hard, though they lacked sufficient "informed customer" expertise. Communication had been poor, particularly during the development of requirements. Communications had been much improved once contract management of the Private Finance service for Durham House had started. The representative of the Agency expressed a concern that the contract penalties to the Private Finance supplier may not recover the full cost to the taxpayer if the suppliers caused the computer system to go down.

The Child Support Agency

The Agency's role: The Child Support Agency administers the assessment, collection and payment of child maintenance, with a view to ensuring that parents maintain their children where they can afford to, and that the burden on taxpayers is kept to a minimum. Their main activities include identifying and dealing with absent parents, collecting and passing on maintenance payments and keeping maintenance assessments up to date. Some 700 of their 7,500 staff work on the Longbenton site.

Accommodation requirements: The Child Support Agency requires accommodation that would resolve current problems with:

- recruitment and retention of quality staff;
- expense in the installation and maintenance of Information Technology cabling;
- overheating of offices in summer and coldness in winter due to poor design and repeated heating system failures;
- excessive corridor space; and
- difficulties in maintaining contact across and between sites.

The Child Support Agency's views of the Private Finance project: The Agency's representative told us that the project would deliver a much better working environment than current arrangements and the earlier "Crown Build" proposals. They expressed concern that the management of the Private Finance service would be complex and felt that the Contributions Agency's contract manager would have to be knowledgeable about the contract and commercially astute. They praised the hard work of the project team but drew attention to activities that could have been done better including:

- greater representation of users on the project board; and
- earlier strategic thinking about staff numbers.

Appendix 3

The allocation of key risks between the Department and the NEP consortium

Key risk	DSS	Mainly DSS	Shared	Mainly NEP	NEP	Comments
Risks that apply in the Design and Build Phase						
Vital planning consents not forthcoming				●		Each side bears their own costs if the project is ended by lack of planning permission.
Planning consents less favourable than expected				●		NEP guarantees minimum development proceeds of sites. The Department shares in additional gains.
Bad ground conditions lead to construction difficulties				●		The Department retains some risk for the discovery of unknown structures below ground on existing sites.
New build or refurbishment costs are higher than expected					●	
Refurbishment or new build is delayed				●		NEP is not responsible for "excusable delay". Otherwise payment begins when the Department accepts premises.
Cost of Department's accommodation if new premises are delayed				●		Excusable delays not borne by NEP. Otherwise, the Department has legal remedies.
Risks in the Operational Phase						
Rental and maintenance cost of leased properties that are retained for the Department's use		●				Risk rests with the Department unless any costs might fall within the scope of dilapidations, which are NEP's risk. NEP bears the costs if new buildings are delayed and leases must be extended.

continued...

Key risk	DSS	Mainly DSS	Shared	Mainly NEP	NEP	Comments
Long-term building defects emerge, or reduced asset life					●	NEP bears the costs of replacement or renewal
Basic maintenance costs are higher than expected					●	
General inflation of maintenance costs is higher than expected	●					Borne by the Department through indexation of this element of NEP's prices.
Information Technology cabling does not perform as required.					●	NEP bear the risk in the passive IT systems such as cabling.
Technology/ obsolescence		●				Mainly DSS's risk. However, cabling used will support all IT developments foreseen at the time of completing the deal.
Insurance for damage and 3rd party risks					●	NEP's risk, except where insurance is not available in the market in which case Department acts as insurer of last resort.
Accommodation unavailable					●	No payment by DSS if the space is deficient, subject to the *force majeure* arrangements.
Space not required by DSS/Government			●			DSS can surrender 20% space-by-value-free of direct charge.
Space is more intensively used by DSS than planned				●		DSS can make maximum proper use of the accommodation.
DSS require different services or methods	●					The contract change mechanism comes into play.
DSS terminates contract without operator default	●					The Contributions Agency told us that it is unlikely that the Department will exercise its right to terminate the contract voluntarily. The risk of operator default is borne mainly by NEP.

continued...

Key risk	DSS	Mainly DSS	Shared	Mainly NEP	NEP	Comments
Prices of optional facilities management services, eg cleaning are higher than expected	●					These services are outside the scope of the signed Private Finance contract, and will be contracted for separately by DSS.
A general change of law, eg health and safety in offices, increases costs			●			NEP's liability is capped.
Taxation increases operators' costs			●			As per change-of-law risk.
Force majeure			●			
Risks that apply throughout the contract						
Financing costs are higher than expected				●		Borne by NEP, unless a Change of Law affects funding.
The condition of existing buildings is worse than was known at bid stage, or latent defects materialise at a future date					●	Latent defect risks are borne by NEP.
A change of law specific to DSS increases costs	●					
Risks that apply at the end of the contract						
Residual value of the buildings at the end of the contract is lower than expected					●	Residual value is set at 20% of historic cost.

Source: Examination of the contract by the National Audit Office and Theodore Goddard, and a Post-Completion Review of Contract Documentation by Ernst & Young.

This analysis is intended to provide an overview of the allocation of risks under the contract, and is not intended to give comprehensive coverage of this complex contract.

Appendix 4

Chronology of key events

Phase	Date	
Feasibility and preparation	May 1994	Contributions Agency submit a proposal for a traditional Crown Build redevelopment of Longbenton to the Treasury.
Feasibility and preparation	September 1994	A Report by Storey Sons and Parker recommends that a Private Finance solution is not feasible for the Longbenton site alone.
Feasibility and preparation	November 1994	Agency establishes a Project Board for the redevelopment of the Newcastle Estate as the scope of the Private Finance solution is widened to include other sites in the Newcastle area in addition to Longbenton.
Competition	January 1995	The Agency formally invite private sector interest in the Official Journal of the European Community.
Competition	7 February 1995	The Agency issue a briefing document and questionnaire to firms expressing interest.
Competition	10 March 1995	Closing date for returned questionnaires. 14 responses received.
Competition	4 April 1995	Agency issues Department's outline service requirement to the eight consortia they had selected to make proposals.
Competition	May 1995	Presentation and evaluation of indicative proposals by the eight consortia, from whom the Agency select a short list of three.
Competition	July 1995	Agency issues Department's detailed service requirement to the three short-listed consortia.
Competition	September 1995	Evaluation of indicative prices submitted by the short-listed bidders, and comparison with the earlier, Crown Build scheme.
Competition	15 November 1995	Agency issues Invitation to Negotiate to the short-listed consortia.
Competition	25 January 1996	Agency issues Invitation to Tender, requesting firm priced bids (Best and Final Offers) from the consortia.
Competition	16 February 1996	Best and Final Offers received from the three short-listed consortia.
Competition	February-May 1996	Agency evaluates Best and Final Offers and requests clarification of aspects of each bidder's proposal.
Negotiation	20 June 1996	Agency announces that the Newcastle Estate Partnership consortium are the preferred bidder, with whom negotiations begin, and Tyne Partnership are the reserve supplier.
Negotiation	January 1997	Agency releases Tyne Partnership as reserve supplier.
Negotiation	15 August 1997	The Department and the Newcastle Estate Partnership reach commercial agreement on the terms of the PFI deal, leading to the signature of conditional contracts ("Commercial Close").
Arrangement of funding	September 1997	The Newcastle Estate Partnership replaces Bankers Trust as funding bank, so that the deal in its entirety becomes funded by the Royal Bank of Scotland.
Completion	30 December 1997	Contracts signed by the Department.
	8 January 1998	Contracts become effective as funding arrangements completed ("Financial Close") and Newcastle Estate Partnership sign the contract.

Appendix 5

Responses to the National Audit Office survey of bidders

We surveyed the 14 entities that expressed serious interest in bidding by filling in the Contributions Agency's questionnaire. Eight firms responded to our survey, including six of the eight that the Contributions Agency selected to make proposals.

Part A: Pre-qualification stage

These questions were answered by all eight respondees

A1. How did your interest in the Newcastle Estate project arise?

Official OJEC Invitation	Consortium member	Press and media	Contact by HM Government	Other
7	1	3	1	

Some respondees identified the project from more than one source.

A2. How do you rate the initial information made available to prospective bidders by the Contributions Agency in the OJEC notice, the questionnaire, oral briefings, site visits and the briefing pack issued to OJEC respondees?

	Excellent	Good	Adequate	Inadequate	Poor
Information on the existing DSS estate.		4	2	2	
Information on the services that the Department required; eg the extent and type of accommodation, the range of facilities management services, timescales etc.		3	5		
The risks and responsibilities that the Agency expected bidders to assume.		2	4	2	
The criteria under which potential bidders would be assessed to proceed to the next stage.		1	7		

A3. How would you describe the timescale allowed by the Contributions Agency for this stage of the bidding process, (OJEC issued 4th January 1995 to 10th March for return of OJEC questionnaires)?

Too long	About right	Too short
1	7	

A4. Were the Agency's requests for information from you at this stage:

Very excessive	Excessive	About right	Too little
		7	1

A5. What were your consortium's full costs of pre-qualification for the project?

Up to £100,000	£100,001 to £250,000	£250,001 to £500,000	Over £500,000
8			

A6. Do you consider that you were treated fairly by the Contributions Agency in their consideration of proposals?

Yes	No	Non-committal
6	1	1

Part B: The bidding process

These questions were answered by the six respondees who had reached the long-listing stage.

They cover the procurement process from the Contributions Agency's issue of outline service requirements, through to the issue of an invitation to negotiate to the three short-listed bidders, the Invitation to Tender, Best and Final Offers, and the preferred bidder stage and contract signature.

B1. How would you describe the timescales allowed by the Contributions Agency during the following stages of the bidding process?

Stage	Too long	About right	Too short	Did not apply to you
From issue of Outline Service Requirement (4/4/95) to producing Short-list of three bidders (6/95).		6		
From Short-list to receiving Best and Final Offers (16/2/96).	3	2	1	
Best and Final Offers to announcement of preferred bidder (20/6/96).	3	3		
Preferred bidder to full signature with finance (8/1/98).	5	1		

B2. Were the Contributions Agency's requests for information from you at the Outline Service Requirement stage:

	Very excessive	Excessive	About right	Too little
Design and construction		2	4	
Redevelopment opportunities		1	5	
Consortium structure		2	4	
Risk allocation	1	1	3	1
Project Financing	1	1	2	2
Maintenance		2	4	
Other facilities management services		2	3	1
Other		1	2	

B3. What were your consortium's full bidding costs after qualification?

Up to £500,000	£500,000 to £1 million	£1 million to £2 million	£2 million to £3 million	Over £3 million
1	4			1

B4. To what extent was innovation encouraged in the Contributions Agency's documents in the following areas?

	Greatly encouraged	Encouraged	Neutral	Discouraged	Greatly discouraged
Design and construction		3	2	1	
Redevelopment opportunities		2	4		
DSS flexibility to shed surplus accommodation		2	4		
Consortium structure		1	4	1	
Risk allocation (5 firms)		1	3	1	
Project Financing		2	3	1	
Maintenance		2	4		
Other facilities management services		2	4		
Other			1		

B5. How would you describe the Contributions Agency's attitude towards any innovations suggested by you in the following areas? (five firms answered this question completely, one firm referred only to one aspect).

	Very receptive	Receptive	Not receptive	Opposed	Not applicable
Design and construction		4	1		
Redevelopment opportunities		3	2		
DSS flexibility to shed surplus accommodation		3	3		
Consortium structure		3	2		
Risk allocation		1	3	1	
Project Financing		2	2	1	
Maintenance		3	2		
Other facilities management services		3	2		
Other			1		

B6. In your view, how should risk be allocated so that it is with the party best able to manage it?

Risk	Wholly with the DSS	Mostly with the DSS	Shared	Mostly with private sector	Wholly with private sector
Design and construction				4	2
Redevelopment opportunities				6	
DSS flexibility to shed surplus accommodation	1	1	2	2	
Residual Life after contract term		1	1	4	
Legislative/regulatory changes		3	2	1	
Project Financing				4	2
Maintenance				3	3
Other facilities management services (5 responses)				4	1
Decant of DSS staff (4 responses)	1		1	1	1

B7. How would you describe the allocation of risk proposed by the Contributions Agency in their Invitation to Negotiate? (five firms responded).

Risk	Wholly with the DSS	Mostly with the DSS	Shared	Mostly with private sector	Wholly with private sector
Design and construction				1	4
Redevelopment opportunities				2	3
DSS flexibility to shed surplus accommodation			2	1	2
Residual Life after contract term				2	3
Legislative/regulatory changes				1	4
Project Financing				1	4
Maintenance				1	4
Other facilities management services (4 responses)					4
Decant (3 responses)				1	2

B8. Question to the three short-listed bidders. Were the Contributions Agency's requests for information from you at the Invitation to Tender stage:

	Very excessive	Excessive	About right	Too little
Design and construction			3	
Redevelopment opportunities			3	
Consortium structure	1		2	
Risk allocation	1		2	
Project Financing	1		1	1
Maintenance			3	
Other facilities management services			2	
Other			1	

B9. Question to the three short-listed bidders. How clear to you were the criteria by which bidders were assessed at the Best and Final Offers stage?

Very clear	Clear	Unclear	Confusing
		3	

Part C: General issues

These questions were answered by all respondees.

C1. How would you describe the quality of the Contributions Agency's debriefing? (seven responsed).

Satisfactory	Unsatisfactory
4	3

C2 . How clear to you was the management and decision-making structure of the Contributions Agency and the Department of Social Security throughout the process?

Very clear	Clear	Unclear	Confusing
	2	5	1

C3. ***As a result of the Newcastle Estate Development process,*** **how interested would you be in bidding in future for:**

a) Other Government Accommodation PFI projects

Very interested	Interested	Not very interested	Not interested
4	2	2	

b) Other PFI schemes

Very interested	Interested	Not very interested	Not interested
4	3	1	

C4. How would you describe your views of the Private Finance procurement process on this project?

No changes required	Minor changes required	Major changes required
	2	6

Appendix 6

The Contributions Agency's invitation to potential bidders to express interest in the project

Published in the Official Journal: January 1995

UK-Newcastle upon Tyne: construction work for buildings

(94/S 1-95613/EN)

Awarding authority: The Contributions Agency (CA) an Executive Agency of the Department of Social Security (DSS), Room A3335, Newcastle Estate Development Project Team, DSS Buildings, Benton Park Road, UK-Newcastle upon Tyne NE98 1YX. Tel (0191) 225 9214

Award procedure: Negotiated procedure pursuant to Regulation 10(2)(c) of the Public Works Contracts Regulations (1991), because the nature of the works and risks attached to the project are such as not to permit prior overall pricing.

Contract type: Building and civil engineering works contract for provision of office accommodation under Group 501 as described in schedule 1 of the Pubic Works Contract Regulations (1991).

Site: A site or sites to be provided which shall be within 10 miles (approximately) of the centre of UK-Newcastle upon Tyne and may include an existing building, a greenfield site or any of the 11 UK-government-owned or -leased sites in the vicinity of UK-Newcastle upon Tyne including the 64-acre site at UK-Longbenton currently occupied by the DSS. There is the possibility that freehold sites may be transferred to private-sector ownership or be available for alternative private-sector use. Long leases may also be available. Details of the various sites will be provided in the initial briefing document to be sent to respondents.

Works: To provide a suitable secure site(s) capable of 24-hour operation, which may involve developing or constructing a site or building or otherwise providing modern office accommodation for approximately 14,000 staff.

The development could also include the subsequent management or operation of the new facility or even involve the grant of a concession of the service provider. The development must satisfy the business needs of the DSS, but need not necessarily be on a single site and it may be combined with other users provided that the DSS's security requirements are met, details of which will be in the initial briefing document.

The development is to be financed by the private sector through the UK Government's Private Finance Initiative (PFI). The purpose of the PFI is to encourage the involvement of the private sector projects requiring substantial financial investment of their own resources in innovative schemes together with an acceptance of risk by the private sector.

Division into lots: Potential for subdivision into lots.

Completion deadline: The Contributions Agency requires the facilities to be available as soon as possible. If a solution involving the use of government-leased sites is forwarded, these various UK-government-leased sites may be available from 1999 onward through lease-breaks which will be detailed in the initial briefing document.

Legal form in case of group bidders: No special legal form is required of a group of works providers/contractors, but the awarding authority will require that a suitable prime contractor is provided prior to any award of contract where a group bid is made. In the case of a consortium, it will be treated as a joint bid on the basis of the consortium as a whole.

Deadline for receipt of applications: 7.2. 1995 (16.00)

Address: As in 1, Room A3335, Mr S. Baggaley.

Language(s): English.

Deposits and guarantees: Deposits are not required but guarantees may be, and will be detailed in the tender documents.

Financing and payment: The chosen service provider will be required to obtain the private sector the initial capital investment. Proposals are sought on potential methods of remuneration to the provider of the office accommodation.

Qualification: Respondents to this notice will be issued a questionnaire to provide the Contributions Agency with information as to the rejection criteria, economic and financial standing and their technical capability under Regulations 16 of the Public Works Contracts Regulations (1991). In addition an initial briefing document will be issued to respondents which will give details of the Contribution Agency's requirements. The potential service providers with whom the Contributions Agency will enter into negotiations will be chosen on the basis of their responses to the questionnaire.

Variants: The new office accommodation must be provided within an approximate 10-mile radius of UK-Newcastle upon Tyne city centre. As stated in 3 (a), consideration will be given to development of existing UK-government-owned sites, greenfield sites or any combination of locations. Tenderers will be able to propose suboptions to the main proposals provided they are separately identified and costed.

The constructing authority recognises that it may be possible to forward a solution to this proposal without the undertaking of works. However, at this stage a works contract seems most likely and the Works Directive procedure has, therefore, been utilised.

Other information: An initial briefing document will be issued with the questionnaire.

Notice postmarked: 22. 12. 1994

Notice received on: 22. 12. 1994

Reports by the Comptroller and Auditor General, Session 1999-2000

The Comptroller and Auditor General has to date, in Session 1999-2000, presented to the House of Commons the following reports under Section 9 of the National Audit Act, 1983: