NATIONAL AUDIT OFFICE

ACCOMMODATION SERVICES FOR THE DEPARTMENT FOR WORK AND PENSIONS

Transfer of property to the private sector under the expansion of the PRIME Contract

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 181 Session 2004-2005 | 26 January 2005

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John Bourn
Comptroller and Auditor General
National Audit Office

12 January 2005

The National Audit Office study team consisted of:

Doug Neal and Sofia Hussain under the direction of James Robertson

This report can be found on the National Audit Office web site at www.nao.org.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Email: enquiries@nao.gsi.gov.uk

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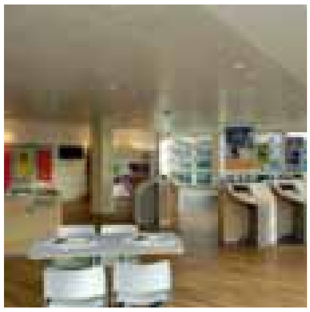
   

Photographs courtesy of Alex Beaton and Land Securities Trillium

EXECUTIVE SUMMARY

1 In 1998, the then Department of Social Security transferred the ownership and management of its estate to a private sector company, Trillium, now Land Securities Trillium (LST) in a PFI deal, the Private Sector Resource Initiative for the Management of the Estate, known as PRIME.[1]

2 The creation of the Department for Work and Pensions (the Department) in June 2001 brought together the PRIME estate (private sector) and the former Employment Services estate (public sector). In December 2003, the Department for Work and Pensions transferred the former Employment Services estate to Land Securities Trillium, under an expansion of the PRIME contract that had been agreed by negotiation rather than through a competitive process.

3 The main elements of the new contract are:

- Land Securities Trillium has paid the Department £140 million in net present value terms to buy the former Employment Service estate;
- as owner of the former Employment Services estate Land Securities Trillium will provide serviced offices until 2018 for the Department in return for payments of some £1.2 billion in net present value terms; and
- at the end of the contract, the Department will retain the right to occupy the buildings it then wishes to continue to occupy with leases based on market terms then current.

4 We found (for methodology see Appendix 1) that:

a it was reasonable for the Department to expand PRIME rather than go to competition;

b the deal gives the Department what it wants; and

c does so at a reasonable price.

Expansion of PRIME was preferable to competition

5 The Department had to act: it could not practicably occupy one estate owned and managed by the private sector and another managed by itself to different standards. It did not have the expertise to manage an estate especially when its accommodation needs were undergoing significant change, requiring a significant number of disposals and acquisitions.

6 The Department concluded that the expansion of the PRIME contract through a non-competitive negotiation with the incumbent supplier, Land Securities Trillium, was legally permissible and the way to achieve best value for money:

- it considered a wide range of options and rightly concluded that a single contractor offered cost advantages - and that expanding the contract with Land Securities Trillium as incumbents would bring economies of scale, synergies and efficiencies through the integration of the estates, which no other suppliers could do;
- it used the lure of the prize of an expanded contract as a lever to gain improvements to the original PRIME contract; and
- Land Securities Trillium was delivering on the PRIME contract and had the capacity to take on the extra estate.

The deal gives the Department what it wants

7 The Department, after seeking variant bids, was paid an appropriate amount for the transferred estate, with a valuation of £140 million confirmed by advisers and the District Valuation Office. It received £100 million up front with the balance taken as a reduction in the annual Unitary Charge payment to Land Securities Trillium for accommodation services.

8 One of the Department's main needs is flexibility in the amount of accommodation it uses. The Department sought variant bids to determine the value for money impact of buying different levels of flexibility. It bought the right to vacate space in the contract price within specified time periods. It recognised the risk that too much flexibility might be bought up front through the Unitary Charge and then not used, as happened in the first years of the PRIME contract. The Department can buy and sell the right to vacate property, at the same price, which declines as the contract progresses, is not property specific and which reflects the impact on costs for Land Securities Trillium.

1 We reported on the transaction in our report The PRIME Project: The transfer of the Department of Social Security estate to the private sector, HC 370 Session 1998-99.

9 The Department succeeded in its aim of gaining significant improvements to the original PRIME contract: through providing Land Securities Trillium with an incentive to improve performance and a new approach to the management of the contract and relationship. The Department also gained new value for money mechanisms including a parent company guarantee, the right to voluntarily terminate the PRIME contract, and recognition in the price that the Department will occupy some of the estate beyond expiry of the contract.

10 Following the Mapeley STEPS deal, through which Inland Revenue and Customs and Excise properties were transferred to a company based outside the UK, the Government required a new clause for future PFI contracts limiting the ability of contractors to go offshore. In this deal, the Department determined that all the PRIME companies in Land Securities Trillium's corporate structure are registered in the UK, and the contract places restrictions on Land Securities Trillium's ability to transfer any property to an offshore entity.

The price is reasonable

11 The Department adopted an appropriate governance structure for the project and appointed advisers in good time.

12 To achieve and demonstrate value for money the Department obtained a high degree of transparency and openness from Land Securities Trillium.

13 In the absence of true competition the Department simulated competitive tension by defining a should cost model distinct from the public sector comparator as the primary financial test, and a separate credible commercial alternative to the expansion. In implementing the should cost model, the Department applied our recommendations from other examinations of PFI deals to pool resources with the contractor to obtain relevant common information through jointly commissioned surveys where commercial conflicts of interest were not an issue.

14 The Department used appropriate benchmarks for most elements in the should cost model. The Department applied its estimates of the savings Land Securities Trillium could make through economies of scale, efficiencies and synergies in combining two estates. Where the Department could not benchmark the services it had specified, such as security requirements, it undertook a detailed review of Land Securities Trillium's underlying pricing assumptions to satisfy itself that its approach was reasonable.

15 The negotiations were well conducted. The Department and Land Securities Trillium found it necessary to spend time in detailed discussions to come to a mutually agreed understanding of what was required from the output specification and of the assumptions each had made in their respective financial models. The Department took steps to ensure the integrity of the negotiations was not compromised, and there was no collusion to reach a satisfactory result.

16 After extensive negotiations the should cost price converged with Land Securities Trillium's until the latter's price was 3.5 per cent less than the should cost model being £1,194 million compared to £1,236 million in net present value terms. The total net savings Land Securities Trillium's price provided was estimated at some £220 million in net present value terms, compared to £178 million for the should cost model.

RECOMMENDATIONS

17 It is very likely, as the PFI initiative matures, that other Departments will want to expand existing contracts. There are a number of good practice lessons from the Department's experience of expanding the PRIME contract that should be noted and applied by others, especially if non-competitive negotiations are pursued.

In seeking a non-competitive negotiation

18 Normally, a non-competitive negotiation to expand a contract would not be regarded as the best route to achieve value for money. Departments, therefore, need:

a **to ascertain whether the non-competitive route really is the best option to achieve value for money by assessing all the options legally open to them**;

b **to assess whether the contractor has merited a non-competitive negotiation to expand the contract by satisfying themselves that the contractor has delivered the performance expected of it, and provided value for money to date; and**

c **whenever possible, to use the opportunity of an expansion with an incumbent contractor to secure improvements to the original contract**.

In the negotiation of a non-competitive procurement

19 Departments will not be able to achieve and demonstrate achievement of value for money if they have not created a competitive dynamic to incentivise competitive behaviour from the contractor. To achieve that competitive dynamic, departments must:

a **develop a should cost model - their estimate of how much it ought to cost the contractor to deliver the required outputs - which is used as the primary financial comparator; and**

b **develop a credible alternative commercial solution, which can be invoked if the contractor does not rise to the department's expectations**.

20 The should cost model will be of little use if it has not been properly prepared. To achieve this, departments must:

a **obtain common information relevant to the department's should cost model and the contractor's bid in conjunction with the contractor**;

b **use appropriate benchmarks, and, where it cannot do so, undertake detailed reviews of the contractor's underlying pricing assumptions to satisfy itself that its approach was reasonable; and**

c **assess the savings the contractor can make through economies of scale; efficiencies; and synergies**.

21 To conduct negotiations well, departments must:

a **achieve a high degree of openness and transparency from the contractor**;

b **gain a mutually agreed understanding with the contractor of what is required from the output specification and of the assumptions each had made in their respective models; and**

c **maintain the integrity of the exercise so it is not compromised**.

PART ONE

Expansion of PRIME was preferable to competition

This part of the report examines the rationale for the expansion of the PRIME deal and for it to be done through a non-competitive negotiation with the incumbent supplier. It shows that the Department had to act, and examined a wide range of options before deciding that the non-competitive negotiated route was most likely to lead to the achievement of value for money.

The Department had to act

1.1 In April 1996, after a Cabinet Office Efficiency Scrutiny of the Civil Estate, the Department of Social Security inherited responsibility for over 700 buildings across Great Britain, managed before then by Property Holdings. The estate was the largest civil estate in Government and consisted mainly of traditional office buildings located in or close to the centre of all major towns and cities throughout Britain.

1.2 The Department of Social Security, DSS, recognised that this estate had major problems including:

- a requirement for extensive refurbishment and maintenance. The Department expected to have insufficient resources to refurbish the estate and maintain it at a sustainable level;
- some 158,000 square metres of vacant space, costing the taxpayer over £12 million each year; and
- a complex and fragmented network of at least 160 service contracts, let mainly at local level and considered to be inefficient and costly to manage.

1.3 DSS took the view that it did not have the skills to manage a complex property portfolio and needed to concentrate on its core business of managing the social security system. A departmental feasibility study to assess whether the DSS could simply be an occupier of space and not involve itself in property ownership confirmed that the private sector was willing to take over the ownership and management of the estate. It, therefore, sought a private finance solution for the provision and management of the estate.

1.4 DSS transferred its estate under a PFI deal known as PRIME (Private Sector Resource Initiative for the Management of the Estate) to a private sector consortium known as Trillium in April 1998. Land Securities bought Trillium in November 2000, and the PRIME supplier is now Land Securities Trillium. Under the PRIME deal, Trillium acquired the ownership of the freehold premises, and responsibility for rental costs, dilapidation liabilities on leased buildings and the cost of upgrading the buildings. For a price of £2 billion in net present value terms, Land Securities Trillium operates the whole estate, providing services including cleaning, maintenance, catering and security for 20 years.

1.5 On 1 April 2002, the Government created the Department for Work and Pensions (the Department) through the amalgamation of the Department of Social Security, Employment Services and parts of the former Department for Education and Employment. The new Department was then in the position of providing services through two separate estates: the PRIME estate comprising 676 buildings with a total area of some 1.7 million square metres, and the additional estate, referred to as the PRIME expansion estate. This latter comprised 1,108 buildings with a total area of some 0.9 million square metres, which in combination with the PRIME estate accounted for 24 per cent of the total central government estate.

1.6 The Department retained asset ownership and full property risk, and directly managed the PRIME expansion estate, through a group of inherited facilities and property management contracts. The two estates had different accommodation and service standards, which was particularly noticeable in Jobcentre Plus districts where buildings could comprise both PRIME and PRIME expansion property.

Accommodation needs were undergoing significant change

1.7 The Department's estate strategy needed to take account of a number of developments:

- planned staff reductions of up to 13 per cent by March 2006;
- the rollout of Jobcentre Plus implementation by March 2006, requiring large numbers of property refurbishments, disposals and acquisitions;
- rollout of the Pension Service model, which aims to develop a "local national network" to provide a high quality service for pensioners by whatever means of contact they prefer requiring the consolidation of backroom processing into some 26 centres, rather than 400;
- implementation of Child Support Reform;
- rollout of Debt Management business involving recovery of overpayments, both when incorrectly paid and when fraudulently claimed, requiring nine new debt centres; and
- the introduction of new IT systems with implications for accommodation needs.

1.8 Between March 2003 and March 2006, the Department wished to reduce its accommodation needs by some 440,000 square metres or 17 per cent, equivalent to a fall in the space requirement per person of 4.4 per cent over the period, **Figure 1**.

A wholly private sector solution was required

1.9 The Department expected that a large number of acquisitions and disposals would be necessary to meet the property management challenges it faced, requiring perhaps as many as 600 disposals and 400 acquisitions. In addition, 72 per cent of the estate was leasehold, with 550,000 square metres on leases with more than ten years to run. These leases needed to be assigned, sublet or surrendered, requiring considerable expertise to manage the substantial exit costs well.

1.10 The Department concluded that the work involved represented a scale of activity significantly greater than could be met by its internal capacity. Such work was also not a part of its core business and the Department therefore took the decision to seek a solution involving the private sector.

The Department saw expansion of the PRIME contract as the best option, subject to price

1.11 The Department examined a wide range of options, drew up a shortlist for detailed assessment and decided that expansion of PRIME was the best option. Expansion of PRIME offered wider advantages too, and legal advice confirmed that a non-competitive expansion would be permissible. Therefore, the Department sought to negotiate such an expansion at the best acceptable price available.

The Department developed a wide range of options, as the basis for a short list

1.12 The Department's business advisers, IBM Consulting, identified 30 procurement options in conjunction with the Department. As the PRIME contract did not have provision for voluntary termination, there was no option to put a contract out for competition for the two estates combined. Subject to this, the identified options were wide ranging and provided a suitable basis for further consideration.

1 The Department's initial and forecast space, staff and space per person requirements

	2003	2004	2005	2006	Percentage reduction 2003-2006
Total DWP space requirement, thousand square metres	2,554	2,355	2,264	2,117	17.1
Forecast staff numbers '000s	140	135	130	122	12.9
Forecast square metres per person	18.2	17.4	17.4	17.4	4.4

Source: Department for Work and Pensions

1.13 In our view the Department shortlisted for further analysis the seven options, as shown in **Figure 2**, likely to be most economically advantageous in providing economies of scale, efficiencies and synergies, and most likely to meet the Department's business needs.

1.14 IBM used a high level financial model to estimate the relative cost savings achievable under the different short listed options, and further assessed their ability to meet the Department's core business needs. These encompassed the options' responsiveness and simplicity for the Department's staff, their ability to support current initiatives such as the rollout of Jobcentre Plus, and their flexibility in expanding or contracting the estate in response to future initiatives. The Department also assessed the potential management burden of each option, and how deliverable they were.

2 The Department's short listed options

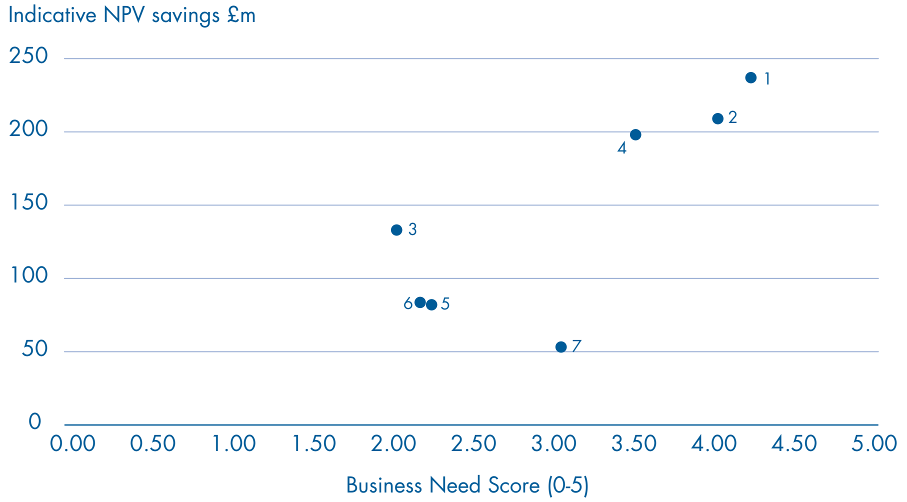
1. Expand PRIME with Land Securities Trillium.
2. Expand PRIME with Land Securities Trillium excluding soft facilities management services for Jobcentre Plus.
3. Second PFI contract for the PRIME expansion estate.
4. Land Securities Trillium win second PFI contract for the PRIME expansion estate.
5. Separate assets and services contracts for the PRIME expansion estate.
6. Single contract without asset transfer for the PRIME expansion estate.
7. Separate projects and services contracts for the PRIME expansion estate.

1.15 **Figure 3** shows that expanding PRIME through negotiation (option 1) was the option that best met the Department's business needs and provided the highest forecast savings.

There were additional advantages in expanding PRIME

1.16 In addition to its other benefits, the Department was quick to see that the prize of an expanded PRIME contract with Land Securities Trillium could be used in negotiations as a lever to gain improvements to the original contract. Moreover, all else being equal, there were advantages in having a single provider of accommodation. A second contractor would have provided no aggregation benefits, and the Department would have found it much harder to gain improvements to the PRIME contract with Land Securities Trillium. Two suppliers would also have risked integration problems and day to day confusions for the Department's staff, for instance in getting accommodation problems rectified.

3 The evaluation scores for the short-listed options shows that a non-competitive negotiation was the best option



Source: Department for Work and Pensions

NOTES

1 Expand PRIME with LST.

2 Expand PRIME with LST excluding soft facilities managment services for Jobcentre Plus.

3 Second PFI contract for PRIME expansion estate.

4 LST wins second PFI contract for PRIME expansion estate.

5 Separate assets and services contracts for PRIME expansion estate.

6 Single contract without asset transfer for PRIME expansion estate.

7 Separate projects and services contracts for PRIME expansion estate.

1.17 The Department's forward planning also showed that a non-competitive negotiation with Land Securities Trillium would lead to far earlier transfer of the estate to the private sector than a full competition. Early completion was seen as a strong factor, enabling the implementation of the new Jobcentre Plus initiative to be achieved with least delay. The Department estimated that the competitive option was likely to take two years before a supplier was appointed, a typical timescale for the procurement of large accommodation projects. In the event, negotiations with Land Securities Trillium from the issue of the Invitation to Negotiate to the signing of the contract expansion took twelve months.

1.18 Before it could pursue a non-competitive negotiation, the Department obtained legal advice to assure itself that it was legal to do so. The Public Services contract regulations 1993 allow the non-competed expansion of an existing services contract only under certain limited conditions: circumstances have changed in unforeseen ways, or additional services are required and procurement of which from a new supplier would represent great technical or economic inconvenience - but provided the aggregate value of the consideration to be given under contracts for the additional services does not exceed 50 per cent of the value of the consideration payable under the original contract.

1.19 The proposed contract expansion met these criteria. Land Securities Trillium's eventual price for the contract expansion at April 1998 prices, £938 million in net present value terms, is 46.7 per cent of the £2 billion value of the PRIME contract.

Negotiation could give a better price than competition

1.20 The Department recognised that, through combining the PRIME and PRIME expansion estates in an expanded PRIME contract, Land Securities Trillium could provide savings through economies of scale, efficiencies and synergies. These might not necessarily have been obtained if Land Securities Trillium had won a competition as it need not have offered them all to beat its competitors who would not have been able to offer the benefits of integration.

1.21 Furthermore, the Department's review of the supplier market indicated that the field of credible potential bidders for the project was very small. In any case, it was likely that other bidders would have been discouraged from competing with Land Securities Trillium, given the latter's significant competitive advantage as the incumbent supplier.

1.22 The key question was whether Land Securities Trillium had a motive to bid competitively. It was clear to Land Securities Trillium that not winning the expansion of the PRIME contract, which it regarded as the flagship in its portfolio, would seriously have risked damaging its credibility with other potential clients and with the stock market. Land Securities needed to demonstrate to its investors that the price it had paid for Trillium was justified and it, therefore, needed Land Securities Trillium to maintain the momentum it had built up. Expanding PRIME would be a good way for it to achieve that.

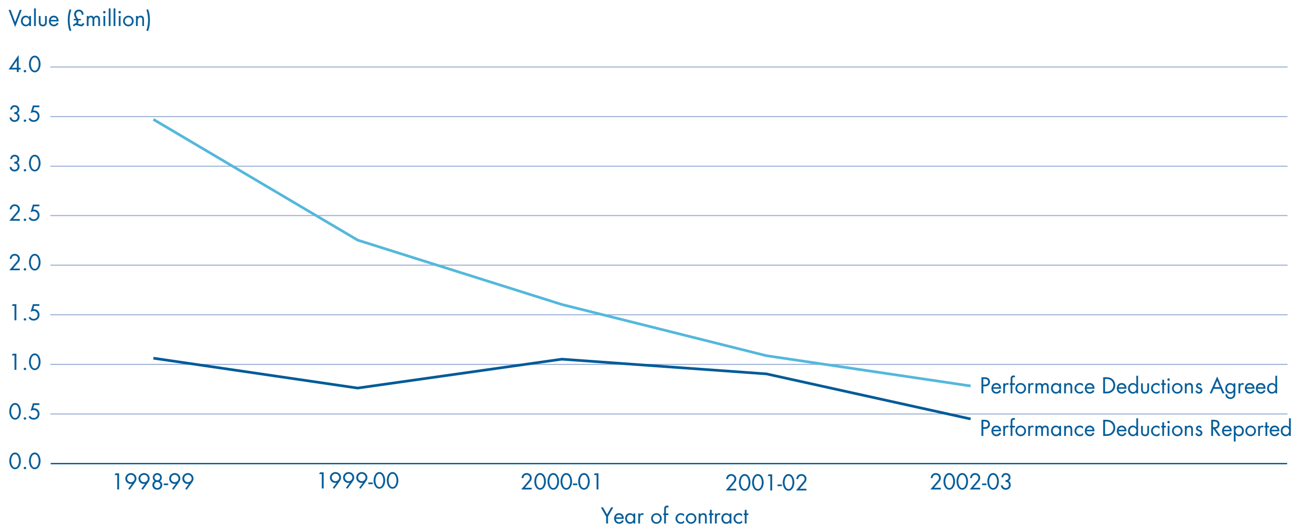
Land Securities Trillium seemed capable of doing the job

1.23 Although the Department could foresee advantages in taking the non-competitive negotiated route with Land Securities Trillium, it would not be worth doing so if it was failing to deliver on the PRIME contract. Land Securities Trillium operates the contractual performance measurement system, but the Department has access to the information produced and rights to audit it and in certain circumstances at Land Securities Trillium's expense. The Department exercised these rights early on in the contract, and continues to do so, as it was concerned that the level of deductions Land Securities Trillium was reporting was not consistent with the standard of service its staff were reporting. To date, Land Securities Trillium has contributed just over £1 million to the cost of the Department's audit of Land Securities Trillium's performance.

1.24 Initially in the PRIME contract, Land Securities Trillium relied on paper-based systems to record performance, which did not allow it to readily identify problem locations and service partners, and access the detail behind each of the performance issues. Performance in the early days suffered as a result.

1.25 In March 2001, Land Securities Trillium introduced Athena, a web based application to measure its own performance and its service partners' against agreed contract key performance indicators. This allows much better monitoring of buildings and the actions needed to prevent problems. Since the introduction of Athena, performance deductions have declined and there is a smaller gap between reported and actual deductions. At the time of the negotiations to expand the PRIME contract, performance was strong enough to give the Department confidence that Land Securities Trillium could deliver an expansion of the contract in a satisfactory way. **Figure 4** shows that agreed performance deductions have fallen substantially from some £3.5 million in 1998-99 to

4 Actual performance deductions have declined under the existing contract



Source: Department for Work and Pensions

£0.775 million in 2002-03. The reported performance deductions have fallen from £1.1 million in 1998-99 to £0.4 million in 2002-03. The agreed performance deductions represent a performance achieved by Land Securities Trillium of 93.5 per cent in 1998-99 and 94.7 per cent in 2002-03, when a performance of 95 per cent would result in no performance deductions. At the same time, unavailability deductions have ranged from £128,000 to £731,000 a year.

1.26 In view of the performance problems, Land Securities Trillium and the Department clarified ambiguities within the contract to make clear to all staff what they could expect from the contract and what had to be supplied. At senior levels a good relationship developed in both organisations and the links between the two parties strengthened. While both parties agreed that further improvement was possible, they considered at the time of the negotiations that the relationship was and remains a good honest one which had matured significantly over time, with good issue resolution procedures.

1.27 To implement the PRIME contract in a single stage was a major undertaking. Despite issues about performance against contract early on, the Department recognised Land Securities Trillium's achievement in delivering required services across its estate from 1 April 1998. Land Securities Trillium has since then implemented other similar deals with the BBC and BT with few problems. As a result the Department did not expect Land Securities Trillium to have any major difficulties in implementing the PRIME expansion. In the event, Land Securities Trillium experienced few problems with implementing the PRIME expansion.

1.28 The PRIME contract included a number of value for money mechanisms designed to incentivise Land Securities Trillium to make savings which it would share with the Department. To date, the Department has received some £46 million through the operation of those mechanisms. Land Securities Trillium has made savings on energy use and business rates, life cycle capital expenditure, and gains on disposal of surplus property.

PART TWO
The deal gives the Department what it wants

This part of the report shows that the Department has gained the flexibility it thinks necessary to meet its future needs for serviced accommodation. It also shows that the Department was able to improve the original PRIME contract through securing new value for money mechanisms and improvements to existing ones, and that the deal protects the Department's position in a number of important respects.

The necessary accommodation flexibility

2.1 The Department based its flexibility needs on its estate strategy, has struck a balance in the ways it pays for flexibility, and expects to have sufficient flexibility for the foreseeable future, including to meet government wide initiatives such as the Lyons and Gershon reviews.

2.2 Flexibility in this context means the ability to vacate space. The Department has acquired flexibility in two broad categories: that for which the cost is included in the Unitary Charge; and that for which the Department pays an additional cost on vacation. The former can be considered as 'included' flexibility, and the latter 'pay as you go' flexibility. The flexibility in the deal is summarised in **Figure 5** and described in more detail in the following paragraphs.

5 The Department may vacate up to 54 per cent of the space it occupied when transferred to Land Securities Trillium

Figure A: Space usage by the Department

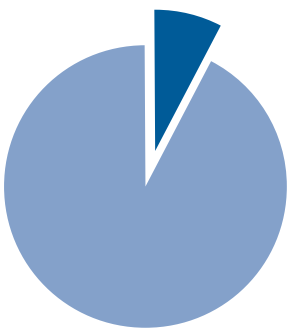


Figure B: Of this 92 per cent space occupied by the Department, the following table indicates the square metres that the Department can vacate:

Square Metres the Department can Vacate		% of total combined estate occupied by the Department
PRIME[1]		
■ Flexible	493,320[2]	22
PRIME expansion estate[1]		
■ Flexi-core	228,000	10
■ Additional flexi-core	62,000	3
Core[3]	495,740[4]	22
Less: Flexible space used to date	-47,000	-2
Net Total Space to vacate available	1,232,060	54[5]

Source: Department for Work and Pensions

NOTES

1 Paid for in the unitary charge.

2 For the PRIME estate, the Department can vacate up to 32,888 square metres a year for each of the first 15 years of the contract. If the Department does not use the flexibility in any one year, it can be carried forward for use in subsequent years.

3 Land Securities Trillium's Unavoidable Costs paid when the property is vacated.

4 The total amount of core space the Department can vacate is calculated as 20 per cent of the total area transferred to Land Securities Trillium.

5 Figure may not add up due to rounding.

2.3 The Department chose the balance between the two types of flexibility to reflect the fact that it knew that it needed to vacate a certain amount of space within a given timeframe, and that it would gain a cheaper price for the right to vacate by giving Land Securities Trillium certainty. It did, however, follow our past recommendations and sought variant bids from Land Securities Trillium to determine the cost of buying different levels of flexibility. The purchase of 228,000 square metres of allowance, it described as flexi-core, provided the best value for money, and the Department can choose such properties to vacate from a pool of 290,000 square metres. The Department, however, could not forecast how much of the remaining space it would require over the life of the contract. It, therefore, negotiated the right to vacate space it defined as core on a pay as you go basis. It can vacate ten per cent of core space through the payment of unavoidable costs, and a further 10 per cent if it pays a premium on unavoidable costs.

2.4 Pay as you go payments comprise Land Securities Trillium's unavoidable costs including its loss of profit, but mitigated by any additional revenue it can generate from the vacated space, for example, from sublet income or sales proceeds brought forward. Once the Department has vacated a property that proportion of the unitary charge relating to that property, its facility price (FP), is no longer paid.

2.5 Before the signing of the expanded contract, the Department had only used 47,000 square metres of the 197,328 of the flexible space it had purchased the right to vacate on the PRIME deal. At the time, the purchase of this much flexibility seemed reasonable, but as circumstances changed not so much was required. The Department could not reduce the amount of flexibility it had purchased under the PRIME contract as this would have been regarded as a fundamental change to the contract which could not be done through the non-competitive negotiation of the expanded PRIME contract. Following our past recommendations, however, the Department structured the flexibility package on the PRIME expansion estate to mitigate the risk that too much flexibility was bought "up front" through the unitary charge and then not used but balanced it against the higher cost of "pay as you go" flexibility. The Department can:

- acquire more flexi-core vacation allowance, or sell back unused allowance. The price is the same for purchase and sale, is not property specific, and declines as the contract progresses;
- vacate flexi-core space as if core by paying Unavoidable Costs (UACs), once all the flexi-core allowance has been used. This mitigates the risk that the Department needs to vary its "pre-paid" flexi-core allowance; and
- reduce the costs of "pay as you go" flexibility by offsetting UACs against the cost of new acquisitions.

Improvements to the PRIME contract

2.6 In negotiation with Land Securities Trillium, the Department secured improvements to existing value for money mechanisms within the PRIME contract as well as new mechanisms.

Better value for money mechanisms in the original PRIME contract

An incentive to improve Land Securities Trillium's performance

2.7 Full potential earnings in a month are not paid to Land Securities Trillium if performance drops below 95 per cent of contractual obligations, as measured using the performance measurement system. In the expanded contract, that score for PRIME estate will rise to 97 per cent over the three year period to 2007. In addition, the PRIME performance measurement system simply made deductions for poor performance and did not provide incentives to recover standards. The new system will do so. Following a performance deduction, if Land Securities Trillium delivers a performance score in excess of 95 per cent for three months it can earn back 90 per cent of the deductions for the period in which they applied. The 95 per cent threshold for winning back performance deductions will though rise in line with the threshold for performance deductions.

A better onward sale sharing mechanism

2.8 The Department did not benefit from Land Securities purchase of Trillium for £160 million and the take over of its debt of £165 million in November 2000, despite the inclusion of a sharing mechanism allowing the Department to receive ten per cent of any excess gain made on disposal of the business before 1 April 2003. The Department did not benefit because the threshold on the windfall gains provision of 125 per cent of the exit Internal Rate of Return was not reached. The Department told us that it accepted a high hurdle in the PRIME contract because the expected price of the deal would have been higher if it had not done so. Now, the hurdle above which Land Securities Trillium, if it were to sell the business within five years of the contract expansion date, has to share sale proceeds has been lowered. **Figure 6** shows the percentage gain for the Department depending on the level of exit Internal Rate of Return gained by Land Securities Trillium in a sale.

A new approach to the management of the contract and relationship

2.9 The Department and Land Securities Trillium are jointly developing a partnering agreement to formalise the principles and protocols by which the contract and relationship have been and will continue to be managed in future. The agreement will define the roles and responsibilities of the supplier, the contract manager, and the customer (both the individual "end" customer and the focal point or intelligent customer), and set out what is expected of each, including behaviours. It will re-emphasise the positive action required of the supplier in service delivery and estate portfolio management, and the active engagement with customers that will be expected. It will explain how the contract manager will monitor supplier performance at both strategic and detailed levels, and will provide relevant information about business objectives and planning with the supplier. The routes, process and timescales for escalating issues which cannot be resolved satisfactorily at initial levels will be described in the agreement. The objective is to have the agreement applied throughout the estates supply chain, and for it to be in place by autumn 2004. Other improvements to existing value for money mechanisms are detailed at Appendix 2.

6 The higher Land Securities Trillium's sale gains the higher the Department's share

Band	Exit Internal Rate of Return percentage	Department's share percentage
1	20 – 29	10
2	30 – 39	20
3	40 – 49	35
4	50+	50

Source: Department for Work and Pensions

New value for money mechanisms for the expanded PRIME deal

2.10 The Department secured a range of important new value for money mechanisms for the expanded PRIME deal, bringing the deal towards guidelines now for new PFI deals.

A Parent Company Guarantee to guard against losses on default or insolvency

2.11 The Department negotiated a Parent Company Guarantee (PCG) from Land Securities plc, the parent company of Land Securities Trillium, to cover both PRIME and PRIME expansion estates to the value of £95 million which declines over ten years. To bolster the PCG, the Department has a second charge, subordinate to the banks, on a further £40 million of property and a £25 million charge on assets such as furniture and equipment over the life of the contract.

The right to voluntarily terminate the PRIME contract

2.12 The PRIME contract did not contain a provision for voluntary termination compensation, the absence of which meant that the Department could not terminate the original contract and put a contract for the combined estates out to tender. Now the Department can voluntarily terminate the expanded PRIME contract. The Department negotiated the level of compensation payable on the principle recommended by the Office of Government Commerce that "the objective should be to ensure that the contractor and its financiers are fully compensated, that is to be no worse off because of Authority default than if the contract had proceeded as expected". Total compensation payable to Land Securities Trillium is set at some £230 million at the end of year 1 (31 March 2004) and reduces through the life of the contract to some £8 million in the last contract year. Under the terms of the voluntary termination agreement, the Department will pay Land Securities Trillium's outstanding debt, in respect of borrowings to purchase the estate at the start of the PRIME expansion contract, and in consequence, the properties transfer back to the Department at no cost. The Department will also pay to Land Securities Trillium any costs incurred in terminating the agreement, to put Land Securities Trillium back in the position it would have been if the agreement ran its full term.

Sharing in any refinancing gains

2.13 Once PFI projects are up and running, and the project risk has been managed successfully, it may be possible for the private sector to refinance the debt incurred in providing infrastructure or services under PFI contracts at more advantageous rates. When PRIME was negotiated, no arrangements for sharing refinancing gains were included in the contract. In October 2002, the Office of Government Commerce launched a voluntary code of practice for early PFI deals, whereby departments could seek to receive 30 per cent of refinancing gains on deals where the contract did not include an explicit sharing arrangement. The Department negotiated a 30:70 sharing of any refinancing gains on PRIME. In addition, the Department negotiated a sharing of a blended percentage of any gains (circa 39 per cent) from refinancing the combined estate, after the first anniversary of the expansion date, and a 90 per cent share of any qualifying gain occurring within the first 12 months of the contract expansion date.

2.14 The banks indicated to Land Securities Trillium that debt finance would be more expensive for the PRIME expansion estate than for the whole of the expanded estate. The PRIME deal had a strong five year track record whereas the expansion did not, and was a less attractive package than PRIME on which to raise finance. Land Securities Trillium accordingly decided to replace the funding it had raised for the PRIME deal with funding for the whole expanded deal. It held a funding competition to raise £280 million to cover the refinancing of the PRIME estate and the acquisition of the PRIME expansion estate, achieved through a locked-in fixed term deal over the life of the contract.

2.15 The Department, therefore, received a pricing benefit in Land Securities Trillium seeking new debt funding for the whole of the expanded estate. The transaction did not trigger any re-financing gains because the costs incurred by Land Securities Trillium in breaking the terms of the outstanding PRIME funding negated any notional gain that the new funding package would provide.

Recognition in the price that the Department will occupy some of the estate beyond expiry of the contract

2.16 Under the PRIME contract the Department did not receive any value for the probability that it would continue to remain in occupation of a proportion of the estate for a material period of time beyond expiry of the contract. For the PRIME expansion contract, the Department asked for such value to be reflected in Land Securities Trillium's financial model on the assumption that it would continue to occupy 50 per cent by value of the PRIME expansion core freehold estate for an average of ten years beyond the expiry of the existing PRIME contract. A reconciliation mechanism will be applied at the end of the contract to reflect the true position at that stage, protecting both parties. The value to the Department of the rebate is £1.36 million each year off the Unitary Charge.

Sale and leaseback gain sharing

2.17 The Department will share in 50 per cent of any gains made by Land Securities Trillium entering into sale and leaseback arrangements on core property.

Sharing any revenue from third party income schemes

2.18 Under PRIME, Land Securities Trillium was able to generate additional income through advertising hoardings, mobile phone masts, for example, within the PRIME estate without the Department's consent and without sharing any of the benefit. Under the PRIME expansion, the Department has to give its consent and shares 50 per cent of the income generated.

The value of the estate is protected and appropriate risks were transferred

2.19 The expansion of the PRIME contract required the transfer of properties to Land Securities Trillium. As with the PRIME deal the Department sought an up-front payment for the assets transferred to the private sector. Such a payment locks-in private sector funders, since they have capital invested in the project and can only earn this back over time through the annual Unitary Charge the Department pays for accommodation and associated services under the contract. It also ensures that risk is transferred, and will bring in debt providers whose monitoring of the deal to protect their investment is aligned with the Department's interests.

The Department determined that £100 million was an appropriate payment for the estate

2.20 The Department and Land Securities Trillium agreed a vacant possession value of some £140 million for the freehold and valuable leaseholds covered within the PRIME expansion contract. The Department decided to receive this amount split into an up-front payment of £100 million, after seeking variant bids, as we recommended in our report on PRIME, of £100 million, £150 million and £0, and a reduction in the annual Unitary Charge over the life of the contract, equivalent in present value terms to the £40 million balance.

2.21 The Department will gain 50 per cent in any increase in value achieved on the disposal of freeholds relative to contractual base values. To further safeguard its position, the Department has a First Charge on the £40 million of property value transferred not covered by the capital receipt, reducing to £1.4 million in the last year of the contract. Under PRIME a similar charge lasted for five years.

The contract allocates risk appropriately as in PRIME

2.22 For a non-competitive expansion of PRIME to be legal, the allocation of risks for the PRIME expansion estate needed to be broadly in line with the allocation under PRIME. Twenty eight risks were identified, borne variously by Land Securities Trillium or the Department entirely or to a greater extent, or by both parties. Of these, the balance of risk sharing is the same under PRIME and PRIME expansion, see Appendix 3.

The Department applied lessons learnt from STEPS

2.23 The Department determined that all the companies in Land Securities Trillium's corporate structure associated with the expanded PRIME contract are registered in the UK, and that it is operationally driven and not structured to deliberately avoid UK tax. The contract places certain restrictions on Land Securities Trillium's ability to transfer any property to an offshore entity:

- the PRIME contractor and or any project associates cannot transfer any property to an offshore entity without the prior written consent of the department and no property is to be provided from a site owned by an offshore entity; and
- the PRIME contractor or any project associates cannot transfer any properties to an offshore entity where the main purpose is to achieve a reduction in any UK tax that would otherwise be payable by the PRIME contractor.

The Department is actively managing realisation of the benefits

2.24 The Department recognises that without effective benefits management, it will be unable to demonstrate the benefits the project has delivered. To this end, the Department will put in place arrangements to monitor and measure the ongoing benefits that are being generated by the expanded PRIME contract.

2.25 A key element will be to monitor the amount of flexibility actually used against that bought or for which there are provisions for payment. This monitoring will be linked closely to the Department's extant estate strategy and property targets.

2.26 The Department has also set performance measures it will use to assess benefits achieved against its objectives and allocated ownership and responsibility for those performance measures. The Department will take steps to ensure that the performance measures continue to be relevant and focus on the key business drivers of the business. The Department is agreeing and putting in place new governance arrangements to ensure full reporting of results.

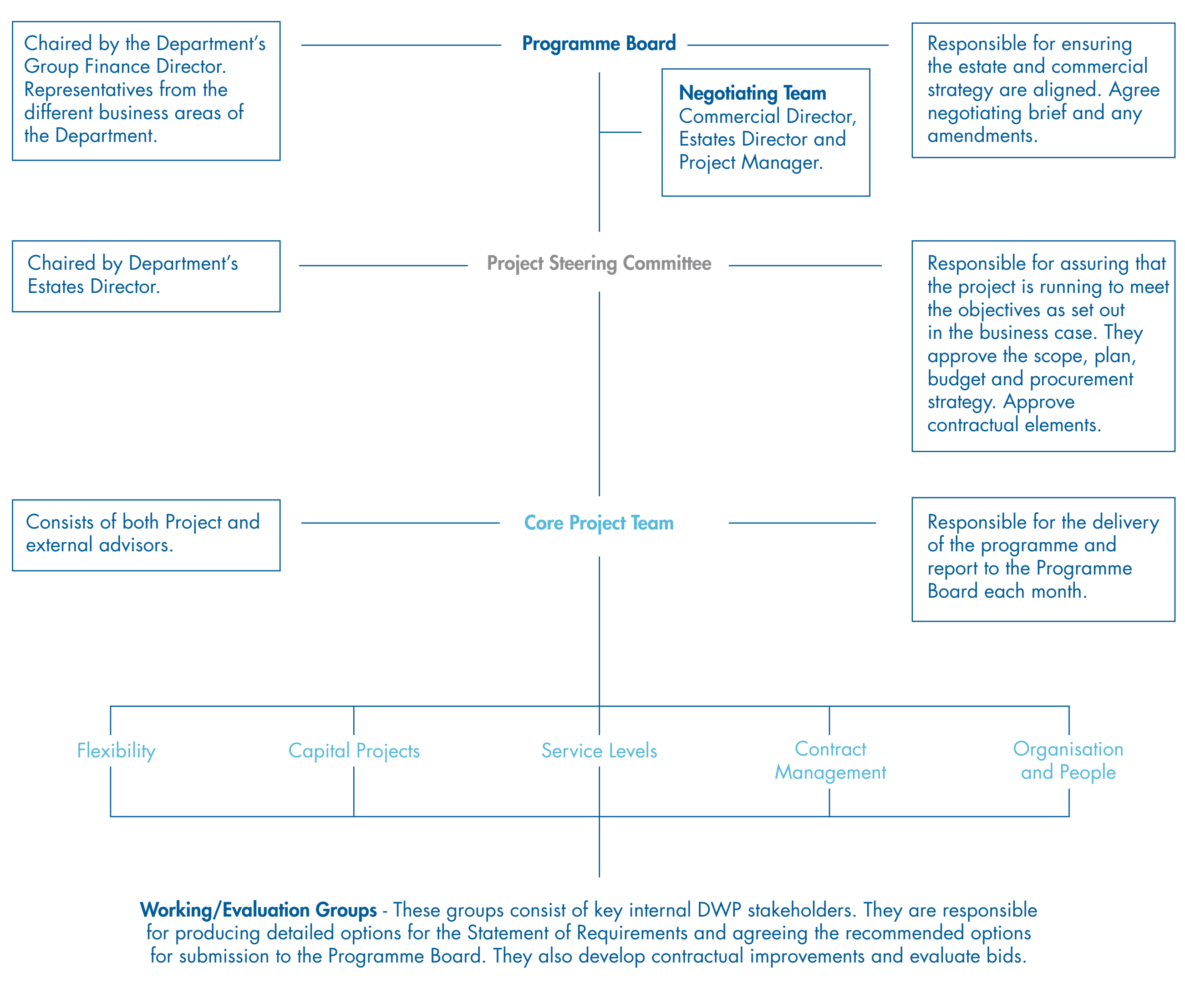
PART THREE
The price is reasonable

To achieve value for money, the Department created a competitive dynamic throughout and properly developed a should cost model as its primary financial comparator.

The Department established a sound basis for managing the procurement

3.1 The Department adopted an appropriate governance structure, as shown in **Figure 7**, for the project. In recognition that it was undertaking a non-competitive negotiation on a large project, the Department established a project management structure led by senior management to oversee the development and negotiation of the deal.

7 The Department's project management structure



Advisers were appointed in good time and in competition

3.2 The Department appointed its advisers in good time: three by competition, and one jointly appointed with Land Securities Trillium in competition. The Department used its existing property and legal advisers, though with some re-negotiation of rates. The cost of advice shown in **Figure 8** was £9.6 million, which exceeded the budget by £2.2 million. The budget was set prior to the full scope of the project being determined and extra work was needed on data certification and due diligence work. Another driver of the increased cost, however, was Land Securities Trillium's approach to its initial bid, which the Department did not regard as a suitable basis on which to commence negotiations. An extension of the bidding period was therefore required to secure better value for money.

The Department adopted an open and transparent approach to negotiations

3.3 The Department signed a tender process agreement with Land Securities Trillium which set out the negotiating process, the Department's objectives, the opportunities for Land Securities Trillium, and what it expected Land Securities Trillium to deliver, but made no commitment to Land Securities Trillium. The Department also considered that to achieve and demonstrate value for money, a high degree of transparency and openness on the part of Land Securities Trillium would be essential to the procurement process. Both parties told us that the negotiations had been open and transparent and the documents we examined confirmed that essential information had been exchanged between the two parties. The negotiations proceeded on the basis of:

- the same data on measurement, condition surveys and service charge data to be available to both sides;
- a format for financial submissions to minimise the scope for hidden excess profits;

8 Roles and costs of advisers

Adviser	Type	Competition for appointment	Initial Budget £'000	Outturn £'000	Overspend/ (Underspend) £'000
Lovells	Legal Adviser	Department's existing Legal Advisers. But rates were re-negotiated.	2,800	3,300	500
IBM Business Consulting Services	Business Advisers	Yes	2,100	3,100	1,000
Drivers Jonas	Commercial Property and Real Estate Consultants	Yes	1,400	1,000	(400)
PKF	Financial Advisers	Yes	600	1,200	600
Project Support	Consultancy and Administrative Support	Yes	200	400	200
Anite	Responsible for developing an Alternative Commercial Solution	Yes	200	100	(100)
Chesterton	Property Advisers	Department's existing property advisers	100	500	400
Government Actuary's Department (GAD)	Pensions Adviser	No			
Total			7,400	9,600	2,200

Source: Department for Work and Pensions

- a clear breakdown of Land Securities Trillium's facility management service partners' costs, between labour, materials management and margin;
- close contact between the Department's advisers and Land Securities Trillium to ensure the Department fully understood Land Securities Trillium's pricing and modelling approach;
- legal due diligence commissioned by the Department on behalf of both parties; and
- separate identification of specific risk premia.

The Department created a competitive dynamic throughout

3.4 The Department recognised that good value for money in a negotiated deal without competition depended on the clear and real prospect that Land Securities Trillium might not win the business. The Department, therefore, created a competitive dynamic by the development of a Public Sector Comparator (PSC), constructing a should cost model, and by creating a viable alternative commercial solution.

3.5 The Department made plain to Land Securities Trillium that it would be benchmarking Land Securities Trillium's bid against a PSC based on an estimate of the cost of delivering the PRIME Expansion contract using a traditional public sector procurement model. It was priced on the basis of the existing estate contract costs, and was based on the same level of service as the proposed contract expansion. This enabled costings to be compared on a like for like basis with the bid from Land Securities Trillium. The PSC also included enhancement to the provisions of the current PRIME contract for the existing PRIME estate where required by the Invitation to Negotiate.

3.6 The Department recognised that simply comparing Land Securities Trillium's bid against a PSC would not maximise value for money, as there would be no competing bids to compare it against. The Department, therefore, prepared a should cost model. This differed from the PSC, in that it included greater risk transfer and quantified the additional savings the Department estimated Land Securities Trillium ought to be able to offer as a result of its unique position as sole supplier to the expanded PRIME estate.

3.7 To further maintain the competitive dynamic, the Department developed an alternative commercial option, which it would use if the negotiations failed. In the event, the Department did not need to implement the alternative as the negotiations proved successful. The option nevertheless had credibility as Land Securities Trillium told us that it had been a serious element in its considerations during the negotiations.

The should cost model was a good basis for negotiations

3.8 The Department employed IBM Consulting to develop the PSC and should cost models, but rather than rely on one consultant it employed PKF to monitor IBM's development of the models to ensure that it was taking appropriate steps to develop them. We employed Operis to analyse the financial models constructed by the Department and Land Securities Trillium. Operis sought explanations for the differences in the models and concluded that IBM had well thought through justifications for each of the adjustments that it had introduced into its analysis.

3.9 The Department applied lessons learnt from PRIME. The Department and Land Securities Trillium did, as we recommended in our report on PRIME, pool their resources to obtain relevant common information through jointly commissioned surveys on which to price elements of the Department's should cost model and Land Securities Trillium's bid. For example, floor areas were based on a jointly commissioned measurement survey.

3.10 To enable a common basis for the pricing of Life Cycle Capital Expenditure (LCCE), Land Securities Trillium and the Department jointly commissioned, on agreed terms of reference, a condition survey of a representative sample of 224 properties out of 1,108, representing 40 per cent of the total estate floor area. Chesterton reviewed the condition appraisal work on behalf of the Department and Lovells undertook due diligence work on tenure, lease and sub-lease terms, providing Land Securities Trillium with a warranty on the accuracy of that information. LST commissioned valuations of the properties, and the Valuation Office conducted a sample crosscheck on behalf of the Department, and through negotiation agreed a value of £140 million.

Appropriate benchmarks of costs

3.11 **Figure 9** shows the key cost items, their percentage of the should cost model, the benchmark used, and the rationale.

3.12 The Department could not benchmark three cost elements of the services it had specified. Security, insurance and mobilisation, accounting for 14 per cent of total costs, were not benchmarked but were nevertheless reviewed to ensure that Land Securities Trillium's pricing approach was reasonable. The security requirements for Jobcentre Plus included a number of elements, in particular, a customer care role, which goes beyond a typical security specification in either an office or retail environment. The Department could not, therefore, benchmark Land Securities Trillium's security pricing against any external benchmark or to the original PRIME bid.

Estimates of the savings Land Securities Trillium could make

3.13 After it had established benchmark prices, the Department applied its estimates of the savings it considered Land Securities Trillium could make through the combination of the PRIME and PRIME expansion estates. The Department recognised three generic types of saving:

- Economies of scale: savings resulting from increasing the size of a contractual package for one particular service;
- Efficiencies: savings resulting from continuous improvement in the delivery of a particular service over a period of time; and
- Synergies: savings resulting from combining different activities within the same contractual package.

9 The benchmarks used by the Department were appropriate

Key cost item	Benchmark	Rationale	NPV of costs within should cost model (£m)	Percentage of costs within the should cost model
Rent net of sublet income	Lease data, estimated rental values, vacant possession values	Reflects how cost is determined	459	37
Life Cycle Capital Expenditure	Joint condition survey	To reflect actual condition of the estate	185	15
Security	TUPE data and LST detailed costings	No meaningful benchmark available	159	13
Overheads	Existing Employment Service estate costs and PFI costs	Based on current cost of delivery	123	10
Funding	Weighted average cost of capital: PRIME bid model adjusted	In the Department's view a competitively determined rate reflecting the risks and rewards in the transaction	100	8
Cleaning	Occupiers' Property Databank (OPD) data	Scope sufficiently generic	81	7
Maintenance	PRIME prices and OPD data	Scope sufficiently similar	86	7
Service charge	DWP budget figures and historic cost	In Department's view best guide to future liabilities	51	4
Estate management fees	Estate management contract rates on the Employment Service estate	Reflects current costs for the same service	8	1

Source: Department for Work and Pensions

3.14 The Department did not have any means of validating the detailed assumptions it made against any published benchmark, but its financial evaluation team, comprising representatives from Estates Strategy, Estates Finance, Corporate Finance, Jobcentre Plus Finance, IBM and PKF reviewed them and considered them to be reasonable.

Risk assessments

3.15 To reflect the transfer of risk, the Department applied risk adjustments to key cost items. These were discussed and agreed with representatives in its financial evaluation team. The should cost model included adjustments for two types of risk. The first, estimation risk, the extent to which base cost estimates are likely to be over or under-estimated, the Department priced at £23.6 million (NPV). The second, event risk, the Department priced at £21.3 million (NPV), to reflect the impact of uncertain future events. Land Securities Trillium made an overall risk adjustment of £27.7 million (NPV).

The negotiations were well conducted

3.16 In conducting negotiations on the basis of a should cost model, the Department recognised the need to keep its cards close to its chest and avoid any possibility of collusion. The Department told us that it:

- completed its own models before the receipt of bids;
- did not show the contents of its models to the bidder;
- did not indicate to the bidder, in negotiation, how much its price fell short of the should cost model price; and
- only equalised costs between the bid and its own models after it had assured itself that the bidder's price was soundly based.

3.17 To underpin the integrity of the process PKF, on behalf of the Department, managed a formal process whereby Land Securities Trillium's financial submission models were not released for evaluation until IBM Consulting, the Department's business advisers, had delivered versions of the PSC and should cost models to the Department. In addition, PKF managed a quality assurance process to ensure that subsequent changes to IBM Consulting's models had been fully documented, authorised by the Department's project manager and checked to the actual models. PKF reported to the Department at various stages its review of all model changes to ensure that the integrity of the process was maintained throughout the bid and evaluation process.

3.18 Land Securities Trillium confirmed to us that it was aware that the Department had prepared a should cost model to maintain competitive tension but that it was not aware of the figures contained within that model and that in negotiation it was not made aware of by how much its bid fell short of the should cost model price or of the individual components of the price.

3.19 During the course of negotiations, Land Securities Trillium and the Department found it necessary to spend several days in detailed discussions to come to a mutually agreed understanding of what was required from the output specification and of the assumptions each had made in their respective models. Both Land Securities Trillium and the Department found this dialogue to be constructive. For example, during the course of negotiations, Land Securities Trillium was able to demonstrate that it could not make the level of savings through economies of scale and synergies that the Department expected because of the large number of small buildings within the estate. Land Securities Trillium was also able to demonstrate that it had sought competitive prices from its suppliers against the output specification. These discussions did not involve the Department discussing the actual figures it had included in its should cost model.

Land Securities Trillium's initial bid was high but subsequent bids converged with the should cost model

3.20 The Department required Land Securities Trillium's initial bid on 28 February 2003, in response to the Invitation to Negotiate it issued on 20 December 2002. The bid had to be completed in a relatively short timescale for such a large deal and the Department had not been able to complete verification of some data issued at the time of the bid. This caused Land Securities Trillium to err on the side of caution and make prudent pricing assumptions. In addition, Land Securities Trillium told us that the specification set for the PRIME expansion estate was higher than that for PRIME. Land Securities Trillium reflected this in its initial bid which was 43 per cent higher than the Department's should cost model. The Department, therefore, did not regard Land Securities Trillium's bid as a suitable basis on which to commence negotiations.
It informed Land Securities Trillium that it would invoke its alternative commercial solution if Land Securities Trillium did not improve on its initial proposals. The provision of fuller information enabled Land Securities Trillium to submit a bid which the Department considered was an appropriate basis for negotiation in May 2003.

3.21 After receiving a revised bid in May 2003, the Department requested further revisions in July and September 2003 during extensive clarifications and negotiations. **Figure 10** shows how the price of both the PSC and should cost model came down in line with Land Securities Trillium's bid between May and July. Costs on the should cost model and PSC rose between July and September 2003, to exceed the Land Securities Trillium price, which continued to fall, by 3.7 per cent or £44 million in present value terms. **Figure 11** provides details of the reasons for changes in costs over the period between May and September 2003, together with their impact on costs.

3.22 Subsequent to Land Securities Trillium's September bid, the Department agreed to a higher flexi-core allowance to be spread over a longer period, and that the contract start date should be moved back from 3 November 2003 to 15 December 2003. These adjustments increased Land Securities Trillium's price to £1,194 million and the should cost model price to £1,236 million, a difference of 3.5 per cent.

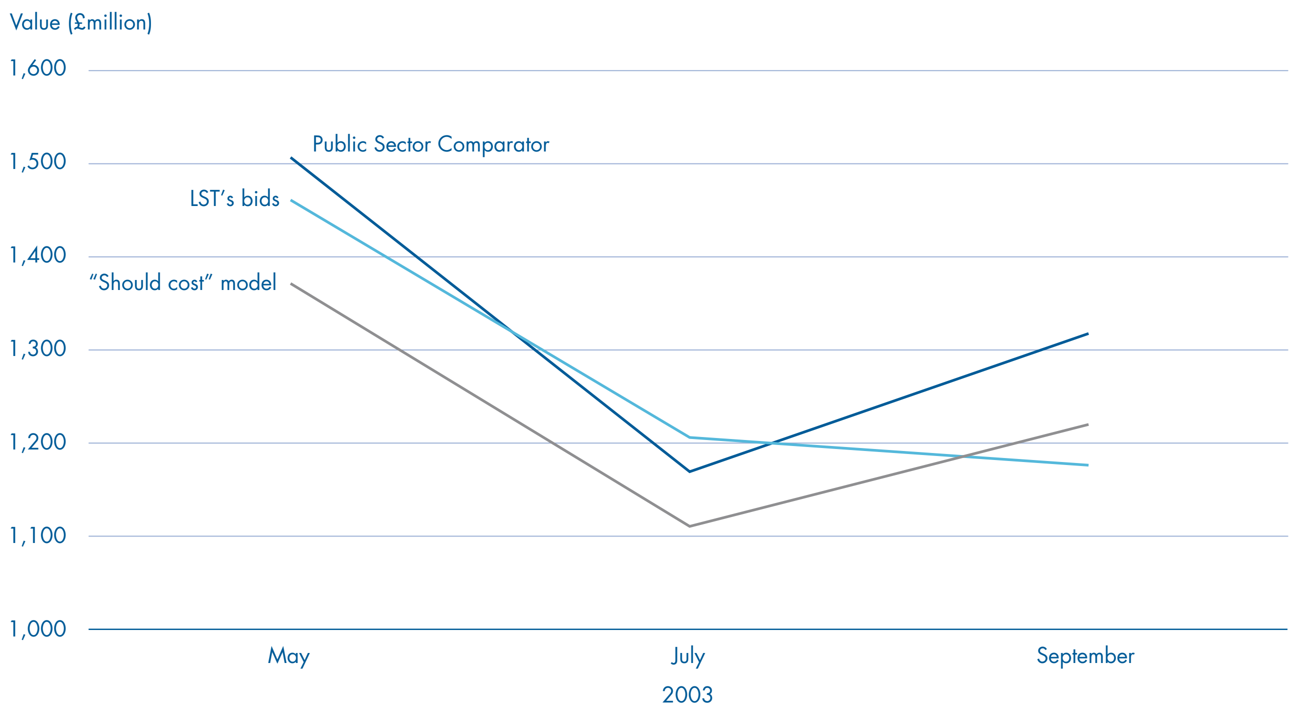
Land Securities Trillium's price provided greater savings than the should cost model

3.23 The Department's should cost model identified net savings it thought Land Securities Trillium could achieve through combining the PRIME and PRIME expansion estates as £178 million, relative to a total baseline cost (assuming no savings) of £1,413 million in net present value terms. Against the same baseline Land Securities Trillium's bid showed net savings of £220 million in net present value terms.

Land Securities Trillium's bid is robust

3.24 The Department assessed the financial robustness of Land Securities Trillium's bid through assessing the financial impact on profitability and funding requirements of changes to assumptions relating to a number of key risks, both individually and collectively. It shared and agreed the results of the analysis with Land Securities Trillium to ensure that the changes to the bid model had been correctly undertaken and for confirmation of the results. The analysis showed Land Securities Trillium's financial bid to be very robust in that it would take a fairly extreme set of circumstances to drive the project to losses.

10 Land Securities Trillium's price became lower than the should cost model price



Source: Department for Work and Pensions

11 Changes in Land Securities Trillium's bid and the should cost model prices between May, July and September 2003

Area of change	LST bid £ million (NPV)	Department's should cost model £ million (NPV)	LST reason	Department reason
May 2003 prices	**1,462**	**1,372**		
Jobcentre Plus refurbishment removed from deal	(383)	(383)		
Rent	(34)	(5)	As should cost model with additional reduction in rent net of sublet income due to rental indexation changes	Reduction to freehold values agreed in negotiations with LST
Overheads		86		Overhead costs not included before
Security	63	64	As should cost model	Change in scope from PRIME. Neutralised to LST price based on detailed review of LST cost assumptions
Life cycle capital expenditure	48	(10)	Life cycle upgrade to meet statutory costs	Net reduction in life cycle capital expenditure as costs included elsewhere in model
Change in expected vacation profile	86	86	As should cost model	Profile of expected vacation revised to latest Departmental forecast
Other	(36)	(100)		
July 2003 prices	**1,206**	**1,110**		
Rent		17		Change in impact of market downturn scenario, Refined dilapidation assumptions
Service charge	(3)	9	Updated to reflect new departmental data	Updated analysis based on latest PRIME expansion estate service charge data
Cleaning		20		Costs updated against benchmark data
Security	(12)	7	Revised data on TUPE transfer numbers	Further change to equalise with Land Securities Trillium's updated costs
Funding	(14)	8	LST cost of capital reduced in negotiation	Cost of capital assumption updated to reflect market changes in interest rates since PRIME
Unavoidable costs		15		Previously based on a PRIME benchmark; now equalised with Land Securities Trillium's price
Change to timing of NPV calculations		17		General assumptions of mid-year cashflows refined for large cost items with different timings
Other	(1)	17		
September price	**1,176**	**1,220**		

Source: Department for Work and Pensions

GLOSSARY

CILOR: Contributions in lieu of rates or any subsequent replacement, including Uniform Business Rates.

Core space: Space that the Department do not expect to vacate. The Department can, however, vacate an amount of core space through paying Land Securities Trillium its unavoidable costs.

Flexible and flexi-core space: Space that the Department expects to vacate and has bought the right to vacate through the unitary charge.

Facility price: The proportion of the unitary charge relating to a property.

Governance: System of joint working and responsibility for running the contract.

Invitation to Negotiate: A document giving detailed information about the services to be provided and the proposed PFI contract and inviting bidders to submit bids for the contract.

Life Cycle Capital Expenditure (LCCE): Expenditure to maintain the fabric of the estate including the replacement of building components, plant and equipment.

Net Present Value: The net present value of the contract price represents the amount that would have to be invested at the start of the contract to fund the expected future cash payments which an authority will be required to make to the contractor.

Performance measurement system: A system to measure the contractor's performance against specified criteria. Deductions from payments to the contractor can be made if performance falls below set levels.

Private Finance Initiative (PFI): A policy introduced by the Government in 1992 to harness private sector management and expertise in the delivery of public services, while reducing the impact of public borrowing.

Public Sector Comparator (PSC): A benchmark against which value for money is assessed. It is typically a cost estimate based on the assumption that assets are acquired through conventional funding and that the procurer retains significant managerial responsibility and exposure to risk.

Required Accommodation Standards (RAS): The standards, specifications, procedures and other requirements for the provision of the buildings.

Risk transfer: The passing of risk under the contract between the public sector and the private finance provider.

Termination: The ending of the contract before its contractual duration. It can be triggered by the Department or contractor.

Unitary Charge: The periodic payment that the public sector agrees to pay for the provision of services by the PFI contractor.

Value for money: Achieving the optimum combination of whole life cost and quality to meet customer requirements.

APPENDIX 1

Study scope and methodology

Study scope

The objective of the study was to examine value for money issues of this high profile transaction which did not involve any direct competition to achieve. We used an issue analysis approach to design the scope of the examination and the nature of the evidence required. For this methodology, we set a series of high level audit questions that we considered necessary for assessing whether or not the deal had been value for money. These questions were:

- Were the project objectives clear?
- Did the Department apply the proper processes?
- Did the Department select the best available deal put forward by Land Securities Trillium?
- Is the contract robust?

Study methodology

We collected evidence from a variety of sources to enable us to answer the questions set out above. These included:

- an extensive review of documentation held by the Department for Work and Pensions;
- semi-structured interviews with key members of staff within the Department and its advisers; and
- an analysis of the financial models constructed by the Department and Land Securities Trillium, undertaken on our behalf by Operis.

APPENDIX 2

Value for money improvements made over the original PRIME contract

Issue	PRIME position	PRIME expansion position	Benefit
Payment of LST overheads in Facilities Unit Price (FUP) adjustment for contract changes	Additional 23% added to cost of change to cover LST overheads and margin	Reduced to 7% for service changes and 12.5% for new properties	The Department estimates that this will save £9m a year by completion of the Jobcentre Plus rollout
Payment of Landlord's service charges	Service charges pass through cost with complex reconciliation mechanism	Risk transfer for service charges i.e. included in the Facilities Unit Price at buildings identified as having service changes This only applies to the PRIME expansion estate, agreement to be reached on the PRIME estate	This reduces contract management time and improves cost certainty
Business Rates Savings Sharing Mechanism	Mechanism for CILOR ■ Share reduction in Rateable Value ■ Year 1, 50% share, Years 2–5, 10% share ■ Plus reasonable costs (fees for rating surveyors)	Mechanism for Business Rates ■ Share of reduction in Business Rates payable ■ 20 % share ■ Inclusive of reasonable costs	This is an Incentive for LST to reduce the Department's Business Rates as it is updated and aligned to market norms
Timescale for supply of temporary accommodation	6 month timescale	If LST cannot supply temporary accommodation in 20 days the Department can use alternative suppliers	This is an incentive for LST to supply needs rapidly
Third party income schemes, e.g. mobile phone masts on buildings	LST had complete freedom to implement third party income schemes	LST now requires the Department's agreement to such schemes and will have to share income 50:50 with the Department	The Department has control over schemes that could cause staff issues or political concerns

Business Driven Capital Works	Fee rates specified, but few other provisions as anticipated volumes were expected to be low	Fee rates reduced and provisions added for management of process
		■ Separate provisions for Jobcentre Plus and large programmes
		■ Performance measures enhanced
		  ■ Opportunity to use another supplier if performance is poor
		  ■ Reporting system introduced based on customer feedback
		  ■ Compensation for loss for time overruns
		■ Abortive fee percentages agreed
		■ Contributions from LST's maintenance budget formalised and extended
			The Department benefits from reduced fees and improved process for managing projects

Issue	PRIME Position	PRIME expansion position	Benefit
Life Cycle Maintenance Regime	Complex reconciliation mechanism to ensure LST's budget is spent and share savings	Simplified reconciliation mechanism with greater transparency ■ Based on 3 year rolling plans ■ Reconciliation of budget to actual spend ■ £200,000 a year reduction in LST's price to reflect simplified management processes. The Department's potential liability for sharing in overspends capped at the lower of 25% or total savings for the previous two reconciliation periods	The Department benefits from ease of management, and transparency increases the incentive for LST to spend budget
Response Times	Specific response times e.g. for light bulb replacement	Priority response times driven by business need	Public areas will receive high priority response
Health and Safety	Extensive Health and Safety requirements, but some gaps	Addition of obligations: ■ LST to train managers in their responsibilities ■ LST to keep training records ■ Schedule of rates agreed for off-site risk assessments e.g. Department for Work and Pensions staff working in other organisation's premises	This supports the Department's Health and Safety strategy
Cleaning and Security	The specification did not provide for specific Jobcentre Plus requirements	Specification updated to include: ■ Cleaning of job points ■ Customer Care Officer (CCO) role included	Supports Jobcentre Plus implementation
Change Mechanism	Cost of Department's changes agreed on a case by case basis	Formulas agreed for changes to ■ Working/opening hours ■ Change to CCO role for Jobcentre Plus	This reduces contract management time to agree changes
Work order management	Customers are responsible for managing outcome of calls to the Customer Service Centre	LST Building Services managers now have explicit responsibility for managing the outcome of calls to the Customer Service Centre	This improves LST's management of reactive work
Accommodation Standards	Standard defined for ex DSS accommodation	Review showed that overall standards support Jobcentre Plus. Contract drafting to remove reference to old style accommodation	Updated RAS in line with Jobcentre Plus and expanded PRIME requirements

APPENDIX 3

Allocation of risks between the Department and Land Securities Trillium

Risk		DWP	Mainly DWP	Shared	Mainly LST	LST	Comments
Retail Price Inflation Risk	PRIME	●					Property component of Facility Unit Prices is indexed to RPI
	PRIME expansion	●					
Rents of leased premises rise above inflation	PRIME					●	For a number of properties on the Estate, the rent charged to the department was higher than the prevailing market rent. Under the contract, LST bears the risk of such 'overrenting'
	PRIME expansion					●	
LSTs life cycle capital expenditure is higher than budgeted	PRIME					●	Extent of risk transfer increased by PRIME expansion through changes to reconciliation mechanism
	PRIME expansion					●	
Costs of dilapidation are higher than expected	PRIME					●	
	PRIME expansion					●	
Accommodation is unavailable for reasons attributable to LST	PRIME					●	There are a number of relieving events
	PRIME expansion					●	
Failure to recognise surplus space for vacation	PRIME	●					
	PRIME expansion	●					
Service Charge Risk	PRIME	●					No risk was transferred under PRIME, but subsequent negotiations have resulted in a mechanism for sharing Service Charge savings
	PRIME expansion					●	
Rates Risk	PRIME			●			Proposed to continue benefit-sharing regime but continue to treat rates costs as a pass through
	PRIME expansion			●			
Residual Value Risk	PRIME					●	The Department have improved occupancy rights upon contract expiry under the PRIME expansion
	PRIME expansion					●	
DWP instigates vacation of core properties	PRIME			●			DWP pays LST's unavoidable costs
	PRIME expansion			●			
LST makes net losses on property development	PRIME					●	
	PRIME expansion					●	
LST makes net gains on property development	PRIME			●			
	PRIME expansion			●			

Risk		DWP	Mainly DWP	Shared	Mainly LST	LST	Comments
LST fails to make development gains on DWP property vacated at LST's request	PRIME					●	LST guarantees a minimum deduction of £1m in prices. Department will share any higher gain
	PRIME expansion					●	
LST makes losses through failure to find alternative tenants for surrendered space	PRIME					●	
	PRIME expansion					●	
Costs associated with the vacation of flexi-core properties	PRIME					N/A	New designation of property
	PRIME expansion					●	
Costs associated with the vacation of flexible properties	PRIME					●	
	PRIME expansion					●	
Insurable risks such as public liability	PRIME					●	But LST need not insure if cover is not available on commercial terms or if not obliged to insure under the relevant lease
	PRIME expansion					●	
Accuracy of information on titles and leases	PRIME		●				
	PRIME expansion		●				
Facilities costs rise higher than indexed in the deal	PRIME					●	
	PRIME expansion					●	
Service Delivery is below required standards	PRIME					●	There are a number of relieving events
	PRIME expansion					●	
Department requires different service	PRIME	●					Change mechanism comes into play
	PRIME expansion	●					
Furniture	PRIME					●	LST has to supply all furniture to the Department free of charge
	PRIME expansion					●	
Force Majeure	PRIME			●			No Change
	PRIME expansion			●			
Change of Law	PRIME				●		No Change
	PRIME expansion				●		
Compliance with Health and Safety requirements	PRIME					●	LST is required to bring the buildings up to standards required by Health and Safety regulations within 2 years of the start of the contract
	PRIME expansion					●	
Default by LST	PRIME					●	
	PRIME expansion					●	
Default by the Department	PRIME	●					
	PRIME expansion	●					
Data Accuracy	PRIME			●			(Some specifics with DWP). LST will have recourse against surveyors under direct warranty. LST to undertake its own due diligence and satisfy itself
	PRIME expansion					●	