

**ACCOMMODATION SERVICES FOR
THE DEPARTMENT FOR WORK AND PENSIONS**

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

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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.