M.Sc. in FACILITY AND ENVIRONMENT MANAGEMENT

M.Sc. RESEARCH REPORT

THE PRIVATE FINANCE INITIATIVE

POTENTIAL IMPLICATIONS FOR FACILITY MANAGEMENT

by

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Chapter 1

❖ Introduction

The Private Finance Initiative was introduced in 1992, by the then Chancellor of the Exchequer Norman Lamont. The principle objective of the PFI was to introduce private sector finance and skills more directly into the procurement of public sector facilities, infrastructure and services.[1]

Since its launch the PFI has been applied to an extremely wide range of public sector activities from the construction of roads, hospitals, prisons, schools and office buildings to the purchase of information systems and management consultancy services. It marks a step change in the principles of procurement within the public sector. The emphasis of the PFI is that the government is procuring a service and not the underlying asset.[2]

Whilst the introduction of PFI has been beset with difficulties in many areas of its application it is almost certain that it will have a profound impact upon the public procurement of assets and services. In addition it is predicted that the PFI and the development of its equivalent in the private sector is very likely to have far reaching implications for facility management. This research report will examine the PFI procurement concept and will speculate as to the potential implications for facility management. In this respect this study has three main objectives. These are described overleaf.

1.1 Key Objectives of the Study

1. To provide an overview of the principles and concepts of the PFI. The study will focus upon its application in the procurement of serviced government accommodation but will also examine procurement of facilities in other areas of public sector activity, where common issues exist.

2. *"..... Where the government has purchased assets to meet current needs they have not always been designed for future flexibility and government has not always been able to maintain them effectively throughout their lives. As a consequence, operating costs have often been higher than they need to be and assets have not developed to meet changing requirements"*

   (Extract from Private Finance Panel guidance document "PFI in Government Accommodation")[3]

   The second objective of this study is to examine the potential created under the PFI to develop approaches to facility briefing, design and management which more effectively address the long term issues of facility operation under the contemporary circumstances of continuous change.

3. The final objective is to speculate as to the broader implications that the concept of the PFI may have on the development of facility management.

1.2 Comment on Report Structure

A description of the nature of the study, the research methods adopted and the constraints to research is provided in the following Chapter 2. The main body of the report then follows, initially with an examination of the general issues and key concepts of the PFI in Chapter 3, analysis of the key criticisms of the approach is also offered in this chapter. Within this context the specific opportunities to develop innovative approaches to briefing and design are examined in Chapter 4. Chapter 5 is a case investigation of a PFI contract for the provision of serviced accommodation to the Inland Revenue in Manchester.

Chapter 6 offers speculation as to the possible impact that the Private Finance Initiative may have on Facility Management as a whole. Will the creation of joint ventures that finance, design, construct and operate spread beyond the public sector and become the means by which facilities are procured in the wider property market?

Chapter 7 provides a conclusion to the report by summarising the main findings. It specifically examines the attitudes of a number of industry experts engaged in a variety of roles within the PFI process.

1.3 Background to the Study

Much has been written about the rapid and continuous change that organisations have become subject to in recent years. The impact of this phenomenon is experienced by public sector organisations in much the same way as it is by commercial organisations operating in the private sector. The continuing pressure on public spending and the increasing exposure of government departments to market forces indicate that this rate of change is unlikely to diminish. In many ways the introduction of the Private Finance Initiative itself is symptomatic of these forces of change.

Running in parallel to the rate of change at the organisational level, is the consequent change in demand that these organisations have for the facilities and services that support their operation. The need to create facilities and provide support services that are responsive to the changing requirements of the organisation has as a consequence become an issue, which receives the attention of academics, facility managers and designers alike[4, 5]. This has led to criticism of traditional approaches to facility briefing and design which over emphasise the immediate functional requirements of the client body and end user. Approaches that attempt to establish contingencies by which the unknown future requirements of the occupier may be handled, are seldom considered. [4]

Official government documentation suggest that one of the benefits of the PFI procurement approach is that assets and services will be created and delivered in a way which retain the flexibility to respond to changing client requirements. [3] The degree to which the PFI can deliver this benefit together with the other stated objectives of the approach has been a matter of debate. This debate is examined and speculation as to possible future developments is offered.

References

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Chapter 2

❖ Method of Approach

2.1 Nature of Study

The nature of this study can best be described as a targeted investigation, [1] which aims to answer the three key questions, outlined below. It will describe the PFI procurement process, contemporary problems of continuous change and the context within which innovation in facility briefing, design and management may occur under the Private Finance Initiative to address these issues. It is supplemented with speculative assessment of what future developments may be expected and the implications that these may have on facility management.

Given that the concept of the PFI is relatively new with few contracts having been signed and still fewer at the post occupancy phase, this can be described as a hypothetical study. [1] The lack of hard data available has led to the adoption of methods of investigation that are best described as soft or semi-formal approaches. These methods have been aimed principally at examining the opinion of experts engaged in PFI projects.

2.2 The Key Questions

The key questions that this report attempts to find answers to:

- What are the fundamental principles of the PFI and can it be expected that the approach will deliver the benefits outlined by Government guidance on the subject?

- What new approaches may potentially be adopted in the fields of facility briefing, design and management, that expressly recognise the uncertainty of the future needs of the client body and end user?

- What, if any will be the impact of the PFI and related arrangements upon facility management as a professional discipline and will new facility management organisational structures develop as a consequence?

2.3 Research Methodology

Three basic methods of research have been adopted:

- Literature Review
- Interviews of experts
- A single case investigation

These methods of research have been selected because it is believed that they offer the most realistic method of studying a complex but as yet undeveloped subject, given the normal resource constraints that a humble M.Sc. student is subject to.

Literature Review

The impact of the PFI and the level of interest that the subject has generated can be measured in some part by the large body of literature available. This research report has to a large extent been based upon the analysis of secondary data through a literature review and examination.

Of particular importance has been the review and analysis of government guidance on the PFI, published principally by the Private Finance Panel. This has been useful in establishing the official view of the perceived benefits of the PFI approach over traditional, public sector approaches to the procurement of capital assets and services.

Expert opinion from a wide range of perspectives has been reported in many professional journals and the national press, this creates a picture of the general attitude of key practitioners towards the PFI. The analysis of these reports has been used to establish the key criticisms and an understanding of the common problems encountered to date.

The literature review has been supported by a citation analysis which has been undertaken to identify the key areas of concern as indicated by the relative coverage of categories of article, published in the professional and national press.

Interview of Experts

A number of interviews with experts who can claim direct experience or specialist knowledge of the PFI have been undertaken. The interviewees being selected from across a range of roles so as to gauge the opinion of key individuals working at the various stages of the PFI procurement process.

Those experts interviewed were:

- A representative of a Public Sector Client.
- An adviser to a Public Sector Client.
- A member of a Private Sector Consortium.
- A design consultant to a Private Sector Operator.
- A leading facility management practitioner with extensive PFI experience.

The aim of the interviews was firstly to gain an understanding of the key issues faced by those individuals engaged in the practical application of the PFI. The second objective was to establish the experts view as to whether the benefits of the PFI, as expressed in official government guidance material, could be realised in practice. The interviews were also focussed to assess the degree to which new approaches in facility briefing, design and management were likely to be adopted by both the public and private sectors. To what extent were these approaches likely to result in innovative design and service solutions that specifically addressed the long-term issues associated with the management of the built facility?

A short structured questionnaire supplemented the interviews in order that the variation in attitudes of these experts could be effectively summarised and compared.

In addition to these formal interviews a number of telephone interviews were also undertaken in order to gauge expert opinion on issues of specific interest.

Case Investigation

The final method of research adopted, has been to examine the processes, methods and attitudes of those involved in the actual development of a PFI project, by conducting an exploratory case investigation. The adoption of case investigation techniques has been limited to a single project, as at the time of research, this was the only such example of a signed PFI contract for the supply of serviced office accommodation. However in order to gain an insight into the various approaches adopted by both public and private sectors, case material has been used from other projects from across a range of sectors.

2.4 Constraints to Research

Apart from the normal constraint of time and financial cost other constraints to the research have been experienced. Of these constraints the restrictions on access to information, imposed at the time of writing, has had the most serious effect. Confidentiality clauses used in all PFI contracts are seen as the major cause of this limitation. Whilst it was anticipated at the inception of this research that the financial detail of contracts would not be freely available, confidentiality clauses have in some cases prevented access to briefing and contract documents which has to some degree hampered the study. The effect of these clauses has drawn comment from interested bodies such as the CBI which, recognising that such clauses act as barrier to the development of expertise and 'best practice' in the PFI, have called for a relaxation in their use. [2]

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Chapter 3

❖ The Private Finance Initiative: Key Concepts

3.1 Introduction

Since 1979, government has introduced a number of initiatives to draw the private sector into areas of economic activity, which had previously been undertaken by the public sector [1]. Privatisation, market testing and compulsory competitive tendering being prominent examples [2]. The PFI represents a further step in this direction and is concerned primarily with the purchase of assets and services required to support the activities of the public sector.

Increasingly it is being used as the means by which hospitals schools, prisons and government offices are being procured. In the past, the private sector has been employed in the design and construction of such facilities. However under the PFI things are somewhat different, the private sector 'operator' (as the developer is now referred to) [1] is required to bear responsibility for the whole life cycle of the asset, integrating the risks of operation with the risks of design and construction. PFI contracts are usually referred to as Design Build Finance and Operate (DBFO) contracts [3].

In PFI terminology, the public sector client becomes a purchaser of services rather than a purchaser of an asset [1]. In return the operator is not paid 'up front' for the capital costs of the facility but receives a stream of income from the public sector, theoretically based upon the usage, performance and availability of the 'service' over the period of the contract, which will be typically around 20-25 years [3]. The underlying philosophy behind this idea being that government departments are not fundamentally expert in the finance, delivery and operation of a capital asset and no direct benefits accrue from the ownership of these assets, the benefits arise from the purpose for which these assets are used [1].

By harnessing private sector skills throughout the life of the asset from development to operation, it is expected that the public sector will receive a more efficient and effective service than would have traditionally been the case and as a consequence obtain better value for money [4]. However the delivery savings brought about by increased efficiency, better design and improved service provision, must outweigh the higher cost of private finance compared with public finance, which would normally be used to fund the purchase of capital assets [5].

"An important by product of the PFI is that it redirects government spending away from the capital expenditure and largely fixed costs involved in conventional procurement and operation towards current expenditure on running costs." [4]

The procurement approach can potentially be applied to any government project, which involves large amounts of capital expenditure and where a significant operating content exists [6]. However certain projects will be deemed as being more amenable to the use of the PFI than others. Table 1 summarises characteristics of projects that are likely to be favourable and unfavourable to the use of the PFI.

FAVOURABLE	UNFAVOURABLE
Scope for additional/ alternative uses	Limited additional alternative uses
Output driven	Asset rather than service driven
Scope for innovation in design	Design solution fixed
Substantial operating content	Minimal operating content
Surplus assets intrinsic to transaction	Any surplus assets wholly separable
Long contract term	Short contract term
Committed public sector management support	Lack of high level public sector management support
Political sensitivities manageable	High political sensitivity (e.g. clinical services in the NHS
Risks primarily commercial in nature	Risks mainly political/regulatory
Substantial projects (though mega deals have their own difficulties)	Small projects

Table 1 – Favourable v Unfavourable PFI projects [6]

The two main benefits that the public sector may expect to derive from the adoption of the PFI can:

a) Better Value for Money

b) Reduction in exposure to risk

Indeed it is necessary to demonstrate that these benefits are delivered in order to justify the adoption of the procurement route [2].

3.2 The Payment Mechanism

The traditional way of paying for the construction and operation of a capital asset i.e. by means of an initial capital outlay followed by annual revenue expenditure in the operation of a facility, is replaced under the PFI. The use of the facility is paid for by means of a 'unitary charge' paid at regular intervals throughout the life of the contract [7]. The private sector will include in its calculation of the unitary charge, an element of each of the following: facility capital costs, service provision, value of risk transfer and required profit.

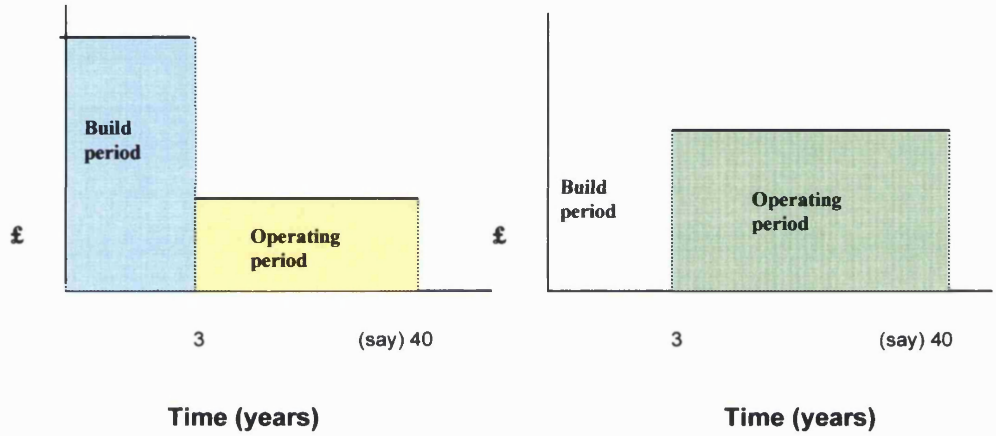


Figure 1 – Comparison of Conventional v PFI - capital asset payment models

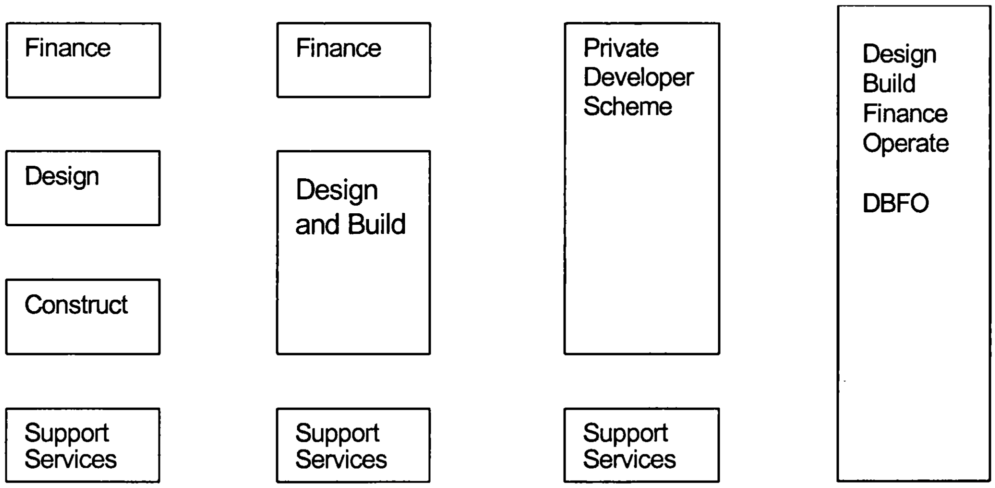
3.3 The PFI in Government Accommodation

In some sectors such as health and prisons, DBFO contracts "represents a radical new approach in the way these facilities have been procured. However in the case of office accommodation the public sector has already been used to tapping private finance through the procurement of Private Developer Schemes or by acquiring leases in commercial office market." Figure 2 illustrates four procurement models available to the public sector.

The PFI is therefore said to represent an evolution in the way office accommodation is procured, the key features of this evolution are [3]:

- "A move away from institutional FRI leases by transferring the responsibility for facility operation to the facility owner" [3].
- "A more critical assessment of the nature of the public sectors requirements rather than on specific building solutions" [3].
- "A greater recognition of the uncertainty surrounding the governments future accommodation needs" [3].

Figure 2 – The Four Generic Procurement Models



The means by which the full benefits of the PFI are thought to be delivered may now be considered in detail.

3.4 Value for Money

Best value for money is defined in the guidance notes as the optimum combination of whole life costs and benefits [2]. Enhanced value for money is said to be delivered in the following ways:

3.4.1 Better Allocation of Risk [2]

The PFI is said to deliver benefits by transferring risks to those best able to manage them. Whilst a simple concept when expressed in this way the achievement of what the PFP guidelines refer to as optimal risk transfer has often been a particularly difficult issue to solve in early PFI contracts. The public sector will pay a premium where it seeks to transfer risks that the private sector considers it is unable to manage. It is recognised that the optimum level of risk transfer will vary from project to project.

3.4.2 Better Incentives to Perform [2]

Incentives are created for the private sector to manage the design, construction and operation of the facility in a more efficient manner. For example the public sector will only initiate payment of the unitary charge when a satisfactory service is made available, delays incurred during the design and construction phase of the project will for example result in delay of the first payment of the unitary charge. In addition the continued payment of the unitary charge [7] will depend upon the operational performance criteria being met by the service provider throughout the length of the contract.

3.4.3 More efficient and better quality service provision

The public sector will tap the full range of private sector management skills and expertise throughout the length of the contract. Better management it is argued will lead to higher quality, more innovative and efficient service solutions, which will more effectively meet the demands of the client over time. [4]

3.4.4 Integration of service needs with design

By integrating the design and operation of the facility under one contract it is believed that a greater synergy will occur between the two phases of the contract [4]. It is proposed that this will incentivise the operator to place a greater emphasis upon whole life costs at the design phase [2]. In addition design solutions will be sought that more visibly address the issues surrounding the facility's long term management.

3.4.5 Opportunities to generate additional revenues by sale to third parties

The PFI is also said to create the incentive and the opportunity for the private sector to maximise its return from a capital asset by allowing it to supply accommodation to a wider range of customers [9]. For example under circumstances where excess capacity within a serviced office facility exists or becomes available, the Operator will typically have the right to let the space and services to other public or the private sector occupiers. This opportunity is essential if the private sector is to accept the risk of a fall in public sector client's demand for space.

3.5 Risk Transfer

As described in the previous section, the transfer of certain risks to the private sector is seen as a function of enhanced value for money. However reducing the public sector's exposure to risk is also seen as an end in itself [1] and needs to be demonstrated in order to justify the adoption of a PFI alternative in preference to conventional procurement routes [9]. Figures 3 and 4 show the different degrees of risk transfer anticipated under traditional and PFI arrangements respectively.

In serviced office accommodation contracts the principle categories of risk that the guidance notes have identified as being fully or partially transferable are as follows: [9]

- Planning risk
- Design Risk
- Construction Risk

- Decant Risk
- Occupancy risk
- Disposal risk
- Operating (Availability and Performance) Risk
- Regulatory Risk
- Residual Value Risk

The basic definition and means by which these risks are transferred are briefly summarised below

3.5.1 Planning Risk [9]

This is the risk associated with obtaining planning consent on refurbishment or new build projects i.e. the risk of having planning consent refused or the delays incurred in receiving this. Where the public sector client has not identified a specific site and has left the private sector to propose suitable locations, the planning risks include those associated with obtaining both outline and/or full planning consent.

Alternatively the public sector will select and/or acquire an appropriate site and bear the risk of applying for outline planning consent, but will transfer the risks of obtaining detailed planning consent.

3.5.2 Design Risk [3]

Whilst the public sector bears the risk of defining its requirements accurately in its 'User Brief', the private sector assumes all design risks in meeting this output specification and will be required to demonstrate that the facility meets 'fitness for purpose' criteria [10]. The operator will also be liable for any increase in operating cost attributed to defective design and will be liable for a reduction in the 'unitary charge' payable should the building fail to meet the client's satisfactory performance criteria at any stage in the contract term [9].

3.5.3 Construction Risk

This is clearly a fundamental risk that is transferred to the private sector and would be the case under traditional procurement routes. The guidance notes argue however that the PFI places an additional burden upon the operator to deliver the building on time, as no income will flow until the point at which the facility is made available for service [2]. The author observes that such pressures do exist in the conventional commercial office market.

3.5.4 Decant Risks

One of the additional benefits that the PFI is seen as having over traditional procurement routes is that it enables extension in the scope of the contract [11]. Transferring responsibility for the relocation from existing accommodation to the new facility is one such example [3]. This category of risk can also include the transfer of liabilities associated with the client's existing accommodation to the PFI operator. Where this risk is transferred, any delays incurred during relocation will result in delay in the payment of the unitary charge [5].

3.5.5 Occupancy (Demand) Risk

Flexibility to respond to changing demand for accommodation can be achieved through the transfer of occupancy risk to the Operator. This is an area of considerable controversy particularly where attempts have been made to transfer such demand risks in locations where the private sector does not believe a ready market exists to take up the excess supply of accommodation.

The guidelines warn against the use of 100% break clauses, as there may be a tendency for the private sector to amortise all capital costs up to the point of the break [9] leading to a high unitary charge. In reality the use of partial break clauses exercisable at a stipulated point in the contract have been adopted, for example a 20% reduction in occupation at two thirds contract term. The public sector occupier may also hold the option to assign space to other occupiers [5].

It is noted that these provisions resemble break clauses found in traditional FRI leases and in some cases may even offer less flexibility. Notwithstanding these observations where such risks are transferred an emphasis is placed upon the operator to consider matters relating to the subdivision and adaptability potential of the facility at the design phase.

3.5.6 Disposal Risk

These are defined as the risks involved in disposing of or redeveloping surplus property that has been transferred as part of the PFI deal [3]. These properties may represent a liability to be discharged at least cost e.g. dilapidations on leased property or an opportunity to maximise value through redevelopment [3]. By offering these investment opportunities to the private sector it is argued that the expected returns will in some part be harnessed by the public sector through enhanced 'value for money' of the deal as a whole.

3.5.7 Operating Risk

The transfer of the operating risks is central to the philosophy of the PFI and represents a determined move away from tradition FRI leases [3]. By making the private sector responsible for the operation of the facility and delivery of support services, it is argued that a greater emphasis will be placed upon whole life costs and the manageability of the facility in use [1]. An incentive will be created for the operator to address these issues at the design phase and will therefore seek innovative solutions as a means of managing the long-term risks [2].

3.5.8 Residual Value Risk

The Client is not expected to hold any stake in the ownership of the facility which will generally not revert to the public sector at the end of the contract period. Residual value risk will therefore pass to the private sector operator i.e. the risk that the residual value of the facility falls below that anticipated at the start of the contract. It is suggested that this creates the incentive for the private sector to maximise the residual value through prudent design and management. It will additionally encourage the operator to invest in the asset throughout the contract.

Category of Risk	*Risk Allocation by percentage*	
	Public	*Private*
Planning Risks	100%	0%
Design Risks	30%	70%
Construction Risks	20%	80%
Decant risk	100%	0%
Disposal risk	100%	0%
Occupancy Risk	100%	0%
Operating (Availability and Performance) Risks	80%	20%
Residual Value Risk	100%	

Figure 3 – Risk Transfer Under Traditional Contract [11]

(Assumed in house facility management with outsourced facility support services in maintenance and cleaning)

Category of Risk	*Risk Allocation by percentage*	
	Public	*Private*
Planning Risks	10%	90%
Design Risks	10%	90%
Construction Risks	10%	90%
Decant risk	10%	90%
Disposal risk	10%	90%
Occupancy Risk	50%	50%
Operating (Availability and Performance) Risks	10%	90%
Residual Value Risk	0%	100%

Figure 4 - Risk transfer in typical PFI contract[11]

3.6 Other Benefits

3.6.1 Off Balance Sheet Finance

"The PFI redirects spending away from the capital expenditure and largely fixed costs involved in government procurement and operation towards current expenditure on running costs"[2]. This principle has a potentially important effect when considering the treatment of the PFI in relation to public spending accounting procedures; it offers the opportunity for Government to essentially obtain 'off balance sheet' finance. Such 'off balance sheet' finance will not appear in the Government's public spending and borrowing figures as would be the case if it were procuring capital assets using traditional methods.

This also distinguishes PFI contracts from traditional property leases, which are considered in accounting practice to essentially amount to borrowing, these are defined by the governing accounting standard SSAP 21 as 'finance' leases[12]. All future lease payments are capitalised 'on balance sheet' and will be reported in the company's financial statement in the year the contract is entered into. [13], or in the case of the public sector in public expenditure accounts.

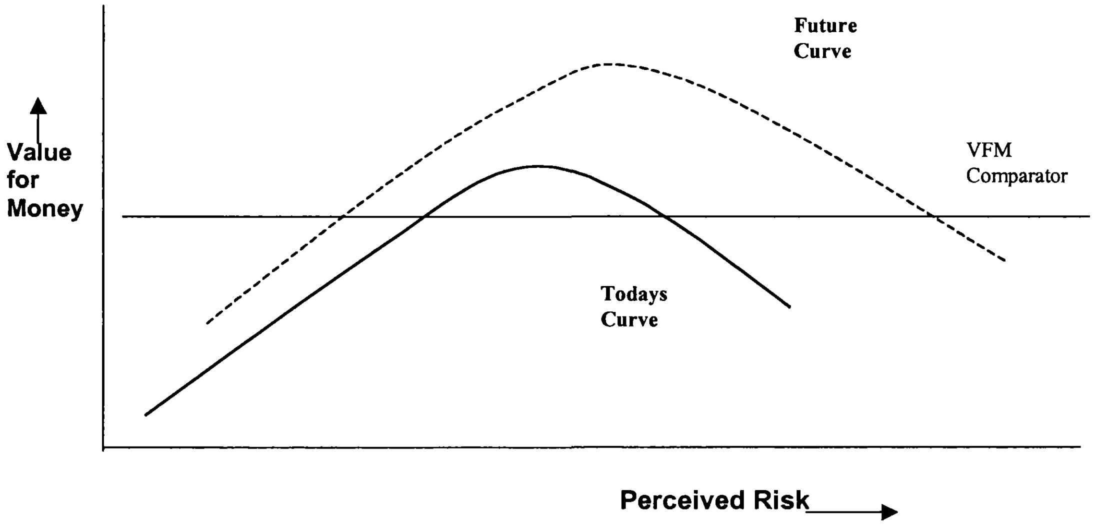
In contrast it has generally been assumed that PFI contracts will be regarded as 'operating' leases and under the principles of the accounting standard will be regarded as 'off balance sheet' finance. There are however a number of conditions that need to be met in order for PFI deals to be treated in this way. The accounting standard FRS5 defines the rules by which an operating lease is to be differentiated from a finance lease. Whilst some quantitative guidance is given, in essence FRS5 requires that a significant transfer of risk occurs, to the extent that the public sector becomes a purchaser of a service rather than the purchaser of a capital asset. [2] This whilst being apparently mundane, is of critical importance when examining the PFI. The PFI guidance notes emphasise the importance of achieving sufficient risk transfer for the procurement to be placed off balance sheet, arguing that in some way this has an impact upon value for money.

Criticism has been levelled in some quarters that the PFI is being misused and that the short-term benefit that the Government accrues from obtaining 'off balance sheet' finance has become the overriding motivation and that all other objectives are subordinate. As a consequence the critics argue that the taxpayer is receiving a poor deal from the PFI, value for money is not being delivered and huge revenue commitments are being stored up for the future. [6]

The Potential Conflict of Risk Transfer and Value For Money.

Best value for money relies upon the principle of achieving what is referred to in the guidance notes as optimal risk transfer i.e. risk is transferred to those best able to manage them. The theory behind this concept is described by Coopers and Lybrand as follows "value for money will rise so long as the private sector is taking on risk with which it is familiar and which it is better able to manage than its public sector counterparts. Beyond this point value for money will begin to fall as the private sector is asked to take on risks which it feels unable to control, whilst these risks may be accepted they will be priced at a level which represents poor value for money". Figure 5 is a notional illustration of this concept. [6]

Figure 5 - Value for Money v risk Transfer Graph



Critics of the PFI to date suggest that the public sector has attempted to transfer excessive risk to the private sector and has as a consequence received poor value for money. Because of the vagaries of the accounting standards previously described, this effect has been exacerbated in the drive to obtain 'off balance' sheet finance. [16]

3.6.2 Better Government Planning

It has been argued that the PFI gives the Government scope to improve its planning. It creates greater certainty of the Governments forward spending commitments and reduces the short term "political and fiscal" risks which have in the past been subject to significant annual variations, undermining long term investment in public sector infrastructure and services. [7]

3.7 Evaluation of Value for Money

In order for approval to be given to proceed with procurement it is necessary for the public sector client to demonstrate that a PFI option will deliver better value for money than would be the case under a traditionally procured project. This is typically achieved by establishing the relative value of a PFI scheme against a hypothetical conventionally procured alternative known as the 'public sector comparator'. [16] The public sector comparator is usually calculated by estimating the aggregate costs of finance, design, construction and operation, expected under traditional forms of procurement. [2]

The assessment however relies in some part on the valuation of external benefits such as the value of receiving higher quality service and the value of risk transfer. The evaluation of these benefits whilst being valid can be open to large elements of subjective judgement. [16] Treasury guidance would also appear to encourage subjectivity in favour of PFI projects by advising that “Allowance must be made for the likelihood that outturns (in traditional public sector procurement) are usually higher than actual estimates. [2]

The introduction of subjectivity has led some to imply that there is scope and pressure for public sector bodies to engineer a favourable evaluation of the PFI bid, in order that their project is delivered. [16]

3.8 Specification by Output

One of the key principles of the PFI is that client‘s service requirements should be expressed in the form of outputs and that detailed design guidance is to be avoided. The philosophy behind this approach is that it allows the private sector maximum scope to propose innovative design and service solutions, leading to better design and more innovative service delivery. [17] The drafting of output specifications, like many other aspects of the PFI is a difficult exercise in practice and much comment has been made as to the merits of this approach. In practice, a careful balance has to be made in setting the level of detail in the brief; bidders require a clear indication of client requirements whilst clients are under pressure not to stifle innovation.

Confusion has led to a myriad of different approaches being adopted by public sector clients, where some have sought to apply the principles of specifying by output others pursuing tried and tested approaches of detailed input based specification, hybrids also exist. As a consequence expert opinion varies considerably, some calling for more detailed user briefs[15], others asking for a reduction in the level of detail to allow scope for innovation. [18]

In cases where output specifications have been drafted in accordance with the PFP guidance notes, clients have complained that the task of evaluating the opposing bids has been difficult because “we are not comparing like for like”. [19]

3.9 The Procurement Process

PFI projects will in almost all circumstances be subject to EC procurement rules. Subject to complex rules there are three alternative procurement procedures that are potentially available to the public sector client under European Union law. These are

- The Open Procedure- all interested parties can tender
- The Restricted Procedure – selected parties only invited to tender
- The Negotiated Procedure – purchaser may negotiate the terms of the contract with those selected by it.

It is generally accepted that the negotiated procedure will be adopted for PFI projects as this allows the procuring body scope to negotiate the terms of the contract in detail with tenderers. This is said to allow maximum scope for tenderers to propose innovative technical and service solution. [9]

Figure 6 illustrates the generic stages in the procurement process under the Negotiated Procedure. A basic description of each stage of the process is described below: [20]

Stage 1 - Preparation for Procurement

Following approval by the project sponsor of an outline business case, the client body will undertake pre procurement planning of the project. This stage involves the appointment of advisers, planning the output specification/user brief and developing a contractual framework (this will include consideration of the desired contract duration, risk allocation and payment mechanism).

Stage 2 - OJEC Advertisement

The procurement process is initiated by the client body placing an advertisement in the Official Journal of the European Community (OJEC Notice). This provides a broad invitation to potential suppliers, outlining the size and nature of the opportunity.

Stage 3 - Prequalification

All parties having responded to the OJEC notice are provided with further information as to the details of the project in the form of an Information Pack and are invited to respond to a questionnaire. This questionnaire is aimed at assessing the suitability of the organisation to tender, in terms of technical competence and financial strength. From the evaluation of these questionnaire a shortlist of bidders is drawn up. Where a significant level of interest is expressed it is sometimes considered appropriate to adopt a two stage approach in the selection of a shortlist.

Stage 4 - Shortlist

The shortlisted bidders will be expected to demonstrate specific competence to undertake the project, a willingness to accept the risks which the client intends to allocate to the private sector and the means by which they propose to finance the project. The public sector client will sometimes request some details as to the technical approach that will be adopted by the bidders.

Stage 5 - Invitation to Negotiate

Following selection of the shortlisted bidders, an Invitation to Negotiate is prepared and sent to tenderers. This document forms the basis upon which tenderers will provide worked up and costed design and operational solutions and will typically contain:

- The user brief/ output specification which details the clients requirements
- The proposed allocation of risk

After submission of tender, a period of negotiation takes place, At the end of these negotiations, tenderers will submit their 'best and final' offer.

Stage 6 - Selection of preferred bidder

Having evaluated each of the negotiated bids 'a preferred bidder' is selected. At this stage the detail of the design and service solution is developed further and a period of final negotiation takes place. Prior to contract award, the public sector client must demonstrate that the preferred bidder's proposals meet the required value for money and risk transfer criteria when measured against a public sector comparator.

Stage 7 - Contract Award

The contract is signed and an award notice is place in the Official Journal

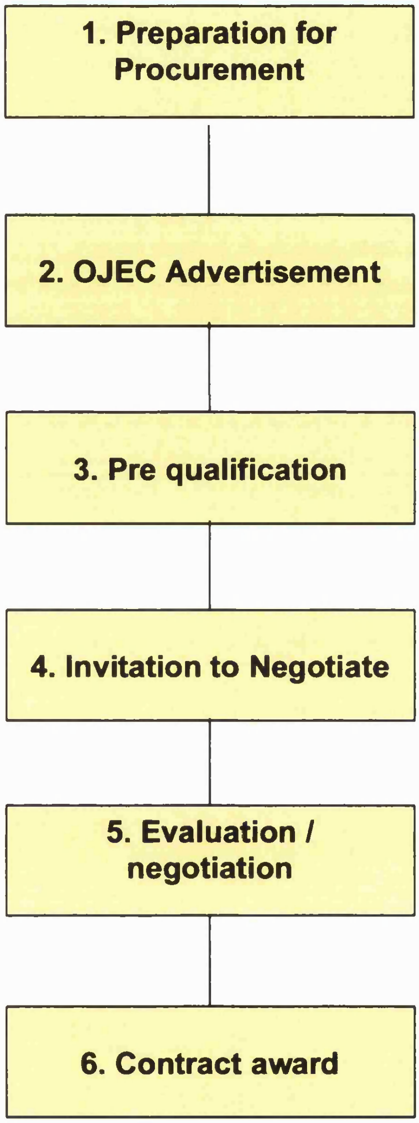


Figure 6 – Generic Stages of the PFI Procurement Process[20]

3.10 The Main Criticisms of the application of the PFI to date

Implementation of the PFI has been highly controversial and criticisms have been widely expressed. A number of recent changes in PFI policy have been introduced by the current Labour Government in order to address some of the concerns of industry. Furthermore accounting regulatory bodies have acted to clarify the rules of accounting that are to be applied to PFI projects.

There is recognition that the PFI is inherently complex[16], however, doubts have been raised as to firstly whether the public sector is appropriately equipped to manage the process effectively[20] and secondly, and most fundamentally, whether the PFI can ever deliver the twin objectives of achieving better value for money and significant risk transfer. [14]

The main arguments of those most critical of the principles and application of the PFI are examined below:

3.10.1 The high cost of bidding

As previously described the process of bidding for PFI projects typically follows the EC procurement guidelines for negotiated projects (the basic stages of this process are as illustrated in Figure 6). The complexities of this multiple stage process and the extent of detail that shortlisted bidders are often required to provide in their proposals, have placed significant financial burdens on bidders. It has been observed that in a large number of cases to date, following selection of the preferred bidder further extensive work has been required to add to or amend proposals, only for the project to be cancelled because it has failed the affordability test[20]. The result of these combined effects is that the costs involved in bidding for PFI projects have been very high when compared with traditional procurement approaches.

In addition to the high direct cost to bidders, the process has also been characterised by lengthy delays[14]. The costs incurred by the public sector as a consequence of these delays has not been established, but will arguably be significant

Figure 7 illustrates the comparison of PFI tendering costs against the costs of bidding for traditionally procured contracts. On average tendering costs are ten times what would have been expected using traditional routes[21]. For projects with a value in excess of £100 million, costs are nineteen times greater. [21] Furthermore in contrast to other procurement routes, tender costs are an increasing function of project costs. [21] This feature of early PFI projects has been cited as a major deterrent to potential bidders who may otherwise have considered entering the bidding process. [4]

Public sector clients have been criticised for exacerbating these problems by adopting excessively bureaucratic procedures during the process. The overall capability of some public sector clients to manage this new and inherently complex process has also been called into question. Inconsistency in the approach adopted by departments is also apparent. [20]

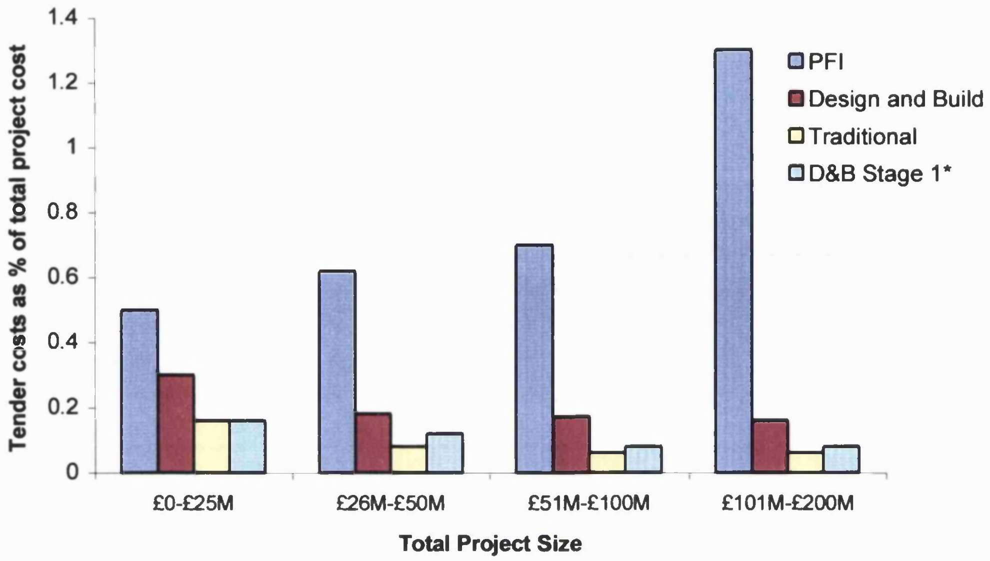


Figure 7 – Relative Tender Costs[21]

Sources: BEC Survey and Constructing the Team (Sir Michael Latham)

3.10.2 Excessively ambitious Risk Transfer

A second frequently cited criticism made by private sector bidders is that procuring bodies are attempting to transfer risks that are considered to be beyond the control of the prospective PFI operator. [15] PFI guidance stipulates the principle that risks should be borne by those best able to manage them. The effect of excessive risk transfer to the private sector may be twofold:

- Some of the risks that the public sector will attempt to transfer may be considered to be 'unbankable' i.e. a risk that the inherently 'risk averse' funders will not be prepared to lend against. At the very least this leads to lengthy delays in securing finance for a project and can sometimes lead to the entire project being shelved.

- A PFI bidder who may decide to accept risks that are considered to be beyond its ability to manage will as a consequence price these risks cautiously.[6] The outcome will often be projects, which ultimately prove to be unaffordable as a result of the high cost of risk transfer.

3.10.3 The PFI applied to unsuitable projects

An additional criticism is that a large number of projects have been launched which were fundamentally not 'amenable' to PFI treatment. In 1994, it was announced that the Treasury would not approve capital projects unless private finance options had been explored.[2] This policy seemingly exacerbated the possibility that public sector clients would pursue the PFI option as a paper exercise only for it to fail at one of the stages in the procurement process. [15] The result being much wasted effort on the part of both public sector clients and private sector bidders. The Bates Review described below, introduced measures which were intended to prevent the possibility of unsuitable projects being launched.

3.10.4 The PFI is used purely as means of achieving 'off balance sheet' public spending

Some critics have argued that the PFI will rarely deliver the benefits that Government has proposed and that the initiative is simply being used as a creative method of obtaining 'off balance sheet' financing. In the absence of any real means of monitoring the expenditure implications of the PFI, this results in the real public borrowing and expenditure implications of PFI projects being hidden from the view of the taxpayer[15]. These critics further question the logic of the public sector essentially raising finance through the private sector when it could otherwise borrow at lower rates. [22]

Cynics may find cause for their arguments in Treasury guidance which clearly directs the public sector procurer towards achieving a level of risk transfer that allows the project to satisfy the definition of an 'operating lease'[9] which and will consequently be treated as 'off balance' sheet finance.

3.11 The Bates Review

In November 1997, the Bates Review which had been commissioned by the new Labour government earlier in that year, attempted to make changes to PFI policy. These changes sought to address some of the criticisms, described above. Of particular importance was the introduction of a new rule that meant that thorough testing of potential PFI projects must be carried out by departmental Private Finance Units to assess the suitability of the projects before the procurement process was
initiated. [22] Following departmental testing, the project proposals would then be checked by the newly formed Treasury Taskforce to assess suitability, before the PFI process could officially be launched.

The Bates Review also recommended the establishment of a project database in the hope that this will lead to a standardised approach by all government departments. [22]

3.12 Clarification of Accounting Rules by the Accounting Standards Board

Another important recent development is the clarification of accounting standards by the Accounting Standards Board, which has attempted to further define the extent of risk transfer that must necessarily occur in order for projects such as PFI serviced accommodation deals, to be counted as 'off balance sheet' finance. [23] The perceived effect of these rule changes is apparently that greater 'residual value' risk transfer will be required than had previously been the case. It has however been argued that the greater transfer of risk will put up the price of some PFI projects. This will once again call into question whether, in a number of cases, the PFI will be able deliver 'value for money' when compared with traditionally a procurement alternative.

It has been concluded that many of the hospital and prison contracts, signed before September 1998, would now have to be treated as government capital spending and as such would count towards government debt. If this ruling was applied retrospectively the impact on the PSBR has been estimated at £10.5 bn. [23]

At the time of writing, the overall effect of this ruling remains a matter of some debate. It is speculated that this will however lead to more appropriate, albeit less extensive use of the PFI. Only when the clear benefit of the use of the PFI is demonstrated will it be used. The ruling can be expected to partially defuse the argument that the PFI is solely being used as a creative form of accounting.

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Chapter 4

❖ The opportunities for innovation in facility briefing, design and management

4.1 Introduction

This chapter examines the possibility that the Private Finance Initiative and its equivalent in the private sector will stimulate innovation in facility briefing, design and management. It offers speculative analysis as to the implications that the transfer of the long-term risks associated with the operation and use of a facility will have in these areas.

Harnessing innovation is one of the key objectives of the procurement approach and many of the principles and processes adopted are designed to allow maximum scope for this.

Innovation may be expected to be stimulated on both the supply (operator) and demand (client) sides and will be necessary if the full benefits of the PFI are to be realised.

The chapter will attempt to examine the following questions:

- In the practical application of the PFI approach what incentives exist for the private sector operator to develop new approaches to facility briefing, design and management, which more effectively address the issues of facility and service obsolescence?

- Under the PFI what are the potential opportunities to develop design and operational briefing arrangements that incorporate strategic approaches as a means of facing the uncertainty of future client demands?

- Does evidence exist to suggest that innovative approaches of tackling the uncertainty of future demands are evolving? May we expect to see current approaches develop as experience of the PFI grows?

4.2 Potential implications of risk transfer

As we have seen a key principle of the PFI is that by transferring the long term risks of a facility and its occupation to those engaged in the financing, design and construction, an incentive will exist for the owner / operator to address these risks at the pre-occupancy phase of the project. [1]

The PFI guidance notes use the enhanced consideration of "whole life costs in use"[2] as one example in which these long-term risks may be more effectively managed. It is however proposed that the long-term risks associated with a built facility go far beyond simply the single financial issue of whole life costs.

Some other long term post occupancy considerations that can be expected to be of concern to those with an interest in the built facility be that, the owner, client, occupier or facility manager, are the issues of:

- Whole life utility value
- Future development value
- Whole life manageability

It has been proposed that a failure to recognise the significance of these concepts from the outset of the development cycle, has been largely to blame for the under performance of a large proportion of the commercial property stock. The ultimate outcome being high levels of financial, physical or functional obsolescence. [3].

In the contemporary circumstances of continuous and rapid change it is expected that the risk of obsolescence will be of primary concern to those who bear this risk. Under the PFI where the emphasis is upon the transfer of the long term risks associated with the built facility to the financier, designer, constructor and operator of a facility, the post occupancy implications of the pre occupancy decisions may lie with those who most acutely influence them. This represents a step change from the traditional supply side features of the UK property market, which has traditionally allowed the property investor to minimise its exposure to long term operating risks, typically through lengthy full repair and insuring leases. It is therefore pertinent to investigate the incentive and the opportunities that the PFI operator has, to seek innovative ways of evaluating and managing the risk of facility obsolescence or under performance.

Furthermore it has been estimated that the normal shelf life of a service contract is generally 3 years. [4] Under the PFI, the client is essentially procuring a long-term agreement for the delivery of facility support services, for anything up to 30 years. The concept of service obsolescence risk and the means by which this is evaluated and managed is therefore also of concern.

4.2.1 Examination of the incentives to adopt strategic approaches to facility design and briefing

It is suggested that within the procurement concept lies a number of potential incentives for the public sector client and the PFI operator to adopt innovative approaches to facility briefing, design and management that more effectively address the uncertainty of future demands. These incentives are not necessarily exclusive to the PFI, but may be exacerbated through the application of the approach.

4.2.1.1 The transfer of risks associated with changes in occupier demands

Where the operator accepts the risk of a change in occupier demand it is speculated that it will adopt alternative approaches, to seek ways to address the uncertainty of future requirements

Changes in occupier demands may be either

a) **Quantitative**; where the demand for the quantity of space occupied changes These occupancy demand risks are transferred to the operator through flexible tenure arrangements such as the inclusion of break clauses or partial break clauses which allow total or partial abandonment of a facility, exercisable at regular intervals. Increasing degrees of risk transfer in this respect may be expected to incentivise the adoption of briefing and design approaches that emphasise the flexibility and functional adaptability of a facility to accommodate subdivision, extension or change of use.

It is clear that such tenurial flexibility may be offered through more traditional leasehold tenures, however the PFI is likely exacerbate the emphasis on spatial flexibility and functional adaptability where the client has special use or locational requirements.

b) **Qualitative**; where changes occur in the end user or client organisation's requirements in relation to the functional aspects of the built facility. In cases where the PFI operator can be persuaded to accept and manage this risk it can be expected that approaches will be adopted that optimise facility flexibility and manageability, with the emphasis being placed on maximising the whole life utility value of the facility.

c) **Business Support**; where changes occur in the client's requirement for operational support services that it receives. In procuring and delivering the full range of facility management and business support services through long term agreements, both the client and operator respectively, will necessarily be required to adopt robust approaches to ensure that such services continue to 'add value' to the client's core business processes through time.

4.2.2 The encouragement of mixed use developments

PFI guidance suggests that the public sector should encourage the operator to maximise third party revenue from PFI developments, [2] with the expectation that the public sector client may benefit from the increased revenue generated, through a reduction in the unitary charge that will be payable to the PFI Operator. It is speculated that this is likely in many cases to consequently encourage mixed-use developments. Over time it can be expected that the relative demand for each use type within such mixed use development will change. The ability of a facility to respond to these changing demand differentials will place a further emphasis upon building adaptability.

4.3 Strategic Briefing

(This section is based upon The Strategic Brief an article written by Professor Bev Nutt and published in Facilities Vol 11, No. 9, 1993 – Ref 5*)*

Professor Nutt proposes the concept of strategic facility briefing as a means by which the uncertainty of future demands may be more positively handled. This chapter starts from the premise that the application of strategic briefing may be particularly apt in PFI type projects. It is therefore worthwhile to briefly examine the key elements of the concept.

It is suggested that traditional methods of design briefing, whilst being of value in articulating the short term needs of the end user and the corporate requirements of the client organisation, fail to address the issues associated with inevitable demand side changes that will become evident in the medium or long term. The development of new working practices, shifts in corporate strategy and the impact of new technology can be expected to be important drivers of such change. In the face of these unpredictable developments the means by which a facility will be utilised in anything but the immediate future is subject to high levels of uncertainty. The failure of built facilities (supply side) to respond to these demand side changes has been cited as a contributory factor to the high levels of functional, technological and financial obsolescence apparent in much of the existing commercial building stock of the UK. Nutt proposes two approaches by which such uncertainties may be combated:

- The adoption of strategic approaches to design that recognise the uncertain medium and long term requirements of first or subsequent generation users of the facility. This approach will systematically address and promote the issues of facility manageability and responsiveness to accommodate the changing functional requirements of the end user.

- The development of robust post occupancy operational briefs that lead to the delivery of a responsive and accountable management service over time.

These approaches will be integrated into the six stages of the property and facility decision cycle as proposed by the Construction Industry Standing Conference[6] illustrated in Figure 8. In the context of the Strategic Brief, Nutt breaks this cycle down into three basic stages of briefing.

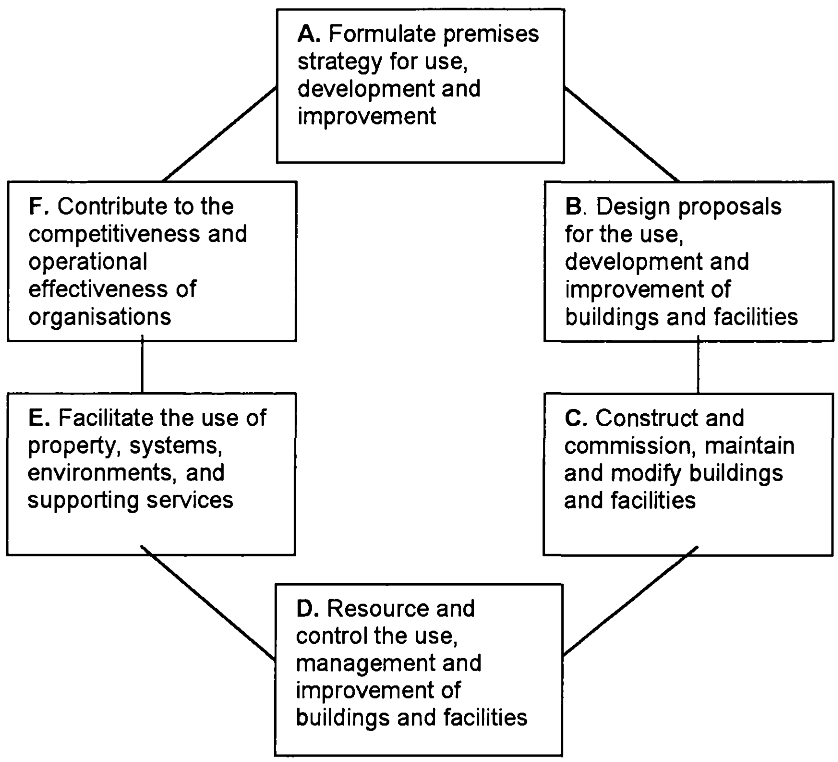

Figure 8 – The Facility Decision Cycle[6]

- The first stage F-A relates to the Organisational /Development brief which describes the overall corporate requirements, corporate objectives and property strategy of the client organisation.

- The second stage B-C concerns the design and construction briefs for both new build and major adaptation of existing buildings

- The third stage D-E concerns the operational facility management briefing and describes the requirements for general operational management and maintenance of the built facility and the briefing arrangements for periodic alteration and modification of the facility.

The strategic briefing approach will be applied to all stages in this cycle and the philosophy will be expected to flow from the inception of the organisational brief through to the design and management stages of the cycle. The desired outcome being the creation of robust facilities that are responsive to the changing functional requirements of the user and which are managed in a way which realises the full utility value of the facility through time.

Nutt concludes that a set of dynamic performance measures should be established to enable analysis of the relationship between the supply side (physical attributes of the built facility) and the demand side (the set of organisational requirements) and their positive and negative influences over one another.

4.4 Opportunities for the application of strategic approaches to PFI Projects

It is proposed that the development of the long term relationship established between the client and the designer and operator at the pre design stage of a PFI project offers a significant opportunity for the concept of strategic briefing to be fully integrated into the facility decision cycle as applied to the PFI project. Management philosophies may be adopted and measurement systems created that support the continuity of the approach at least throughout the project life cycle from design to operation.

Figure 9 illustrates the potential PFI project decision cycle, an adaptation of the dynamic briefing cycle illustrated in the previous section. The nature of each stage of this cycle is examined and the opportunities to incorporate strategic approaches to briefing and design are investigated below:

4.4.1 Client side briefing

Under the principles of the PFI, the facility decision cycle is initiated by the development of the Client's user brief. This will in part describe the strategic corporate objectives of the client organisation, its property strategy and a statement as to how the PFI project relates to these objectives. [7] This document articulates the organisational brief and additionally creates the framework upon which the strategic design and operational briefing arrangements will be based.

The user brief will provide in output terms an illustration of its accommodation and service needs and how these should relate to its core business processes.

In the spirit of specifying by output the consideration of the precise spatial, technological and service approaches that will satisfy these need over time is delegated to the PFI operator.

4.4.2 Operator Side Design Briefing

The second stage of this cycle will be that of design brief development which will be undertaken by the operator's team, comprising property development, project management and facility management professionals expert in project briefing arrangements. The operator will adopt a phased approach to brief development and with an understanding of the clients support service requirements will encourage principles of facility design that ensure that the built facility promotes efficient service delivery.

Bearing the risks, or at least a share of the risks, in a change in the functional demands of the client, the overall manageability of the facility will be emphasised. The affects of constraints imposed by the facility will be felt by both the client and operator, albeit in different ways.

Throughout the development of design concept proposals, facility robustness analyses will be undertaken to assess the adaptability potential of the scheme as it develops. During this process, modifications in approach will be made where opportunities to enhance adaptability are identified. Through its understanding of the inherent adaptability potential of the facility, the operator will be able to accept a greater degree of occupancy demand risk from the outset.

4.4.3 Detailed design

The third stage is that of detailed design. In transferring the main risks of operation and maintenance to the operator, it can be expected that strenuous attempts will be made to optimise the whole life costs in use of the built facility. Here, approaches will be adopted that evaluate and manage operational risks associated with the technological characteristics of the built facility. The adoption of value engineering approaches will therefore be further emphasised. Bearing the energy utilisation risk the operator will seek to ensure that the building is inherently efficient in this respect.

4.4.4 Operational Phase

The fourth phase in the cycle is that of the post occupancy operational stage and relates to the facility management provision and operational delivery of support services. It is proposed that this creates the potential for the promotion of strategic approaches by both the client and operator sides. The PFI places an emphasis upon the use by the client of a range of operational service performance measures by which the quality of the operational service provision is determined. The operator's income is to a degree linked to the performance of the built facility and support service provision.

The potential exists that the client side will wish to develop a dynamic performance measurement system, which accurately maps the mismatch between the features of supply and demand through time. It is suggested that these measures will be designed to establish the increasing or decreasing constraints imposed upon the organisation by the built facility and to reflect the degree to which operational facilities management and facilities support service provision are being adapted to meet these changing requirements. The adoption of these dynamic performance measures will trigger the review of functional and service requirements and will be an important element of the operational briefing framework that had been established at the pre occupancy phase.

The Operator will be encouraged to develop the operational brief on a continuous basis throughout the operational phase of the project. Motivated by a system of 'risk and reward', in keeping with the principles of the PFI, the operator will seek to ensure that facility management and support service delivery is constantly under review, and modifications made to suit the changing client demands. Furthermore through continuous monitoring of the constraints imposed upon the organisation by the built facility, as indicated by the dynamic performance measures, the operator will seek to realise the full utility value of the facility, making periodic reconfiguration to suit changing functional requirements. Where structural shifts in demand occur, the operator will tap the inherent adaptability of the facility that enables an appropriate change of use to meet the new demands of the market.

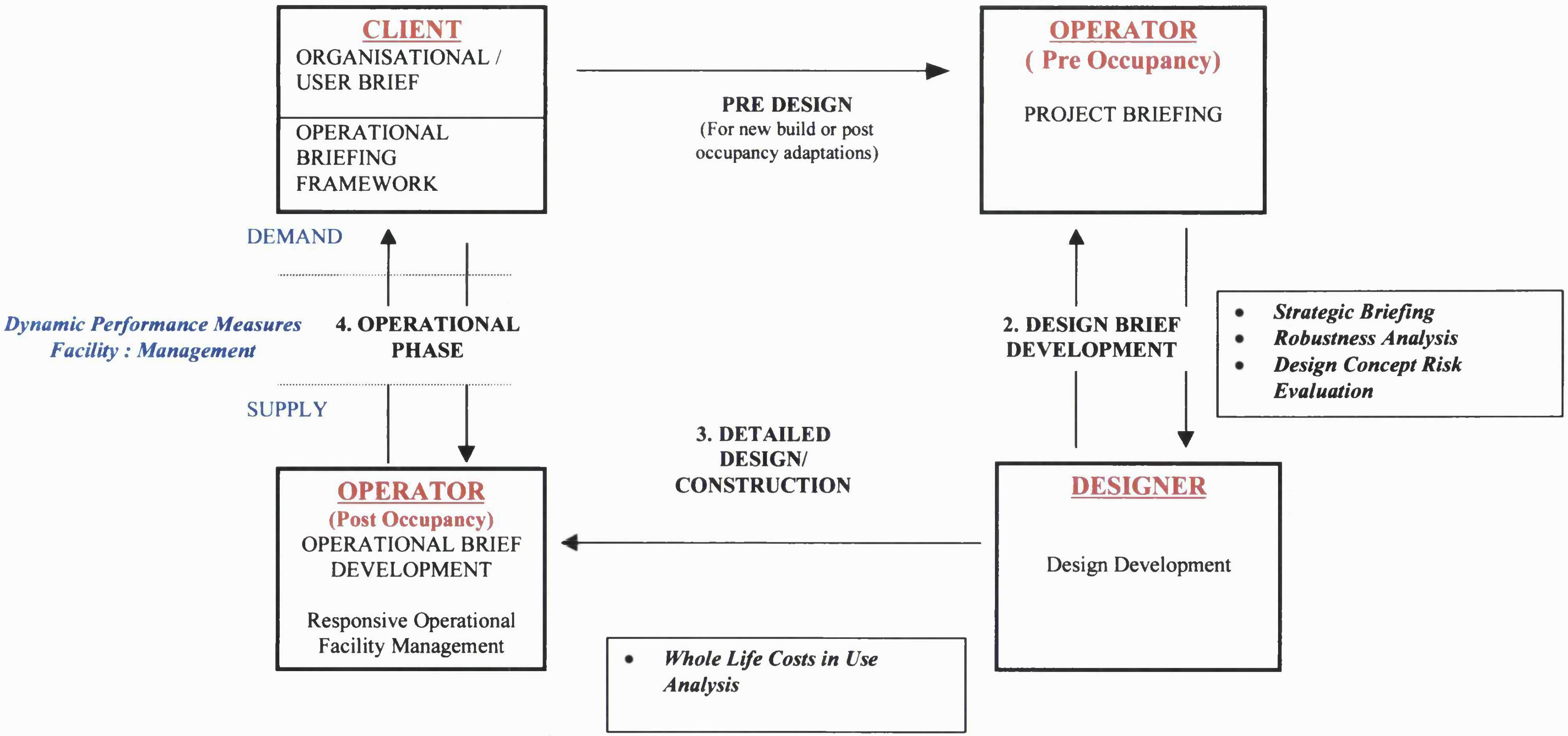

Figure 9 – The PFI Project Cycle

4.5 Emerging evidence of innovation in facility briefing and design

The possibilities described in the previous section should be seen as the theoretical opportunities presented by the PFI to address some of the defects observed in current briefing and design arrangements. In the context of the PFI, in its current state of development, it has to be stated that the substantive transfer of the "risk of a change in client's requirements", remains an ambitious proposition and one which has been largely untested. At best the immediate future offers the possibility that such risks will in some way be shared. It is however proposed that as the PFI is further refined and clients express an increasing need for flexibility in the supply of accommodation, the possibility of this degree of risk transfer may be further investigated by both sides.

It is observed that the real incentive for the private sector to adopt new ways of ensuring the responsiveness of facilities and services remains vague. There is however anecdotal evidence that the long term nature of PFI contracts has highlighted the need to explicitly address the prospect of change. Approaches to briefing that sought to ensure that the adaptability potential of two residential PFI projects was fully explored, are examples of client side initiatives.

A second example of the development of a structured approach to the evaluation of long term risks, is the adoption of robustness analysis techniques by a prospective PFI operator, proposing the supply of serviced education facilities to a local authority. This analysis was used to evaluate the "locational" and "physical building" risks associated with the development and as a means of investigating the future development potential of the site. In addition it specifically evaluated the flexibility and adaptability potential of the proposed scheme in terms of the designer's "space", "fabric" and "services" proposals.

Isolated examples such as these, cannot be regarded as an indication of a clear trend that the PFI promotes innovative approaches to the evaluation and management of the "obsolescence" risks associated with the development of facilities. They can however be viewed as a initial point from which further investigation may be conducted to establish whether such approaches are evolving as a consequence of the procurement approach.

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Chapter 5

❖ Case Investigation – Inland Revenue, Regional HQ, Manchester

5.1 Introduction

This case investigation has been undertaken in order to explore the principles and processes adopted in the practical application of the Private Finance Initiative. The study examines the procurement of the Regional Headquarters of the Inland Revenue in Manchester and has been based upon interviews of a representative of the client and the design consultant employed by the PFI Operator. These interviews have been supplemented by analysis of relevant briefing and contract documentation that was available.

The case study specifically examines the project strategy adopted by the client body and how this fitted into the wider estate strategy being pursued by the Inland Revenue. The procurement process is examined together with an analysis of the client's approach towards the production of its User Brief and how this brief was developed by the private sector bidder. The extent to which operating and occupancy demand risks have been transferred to the PFI Operator and the nature of the Operators organisational structure are finally investigated.

5.2 The Client's Strategy

At the time that the project agreement was signed in 1997, the new Manchester Regional Headquarters of the Inland Revenue represented the only new build PFI serviced office accommodation contract signed up to that date. The project had been procured as part of a long-term strategy adopted by the Inland Revenue to ultimately reduce the size of its estate. It was intended that the operations of the six tax offices in the Manchester area would be consolidated within this new facility. The intended project strategy was that through the PFI contract, a new fully serviced facility would be provided to accommodate 1,950 staff [1]. The Inland Revenue's freehold and leasehold interests in the six existing offices would be transferred to the successful PFI Operator.

Whilst the Inland Revenue was committed to remaining within the Manchester area, a specific site had not been selected and as such it was for the PFI bidders to propose a suitable location for the new facility. The risks associated with the acquisition of the site and the planning risks associated with its development were therefore transferred to the private sector. In order to allow the private sector an opportunity to propose as wide a range of options as possible, a new build approach was not stipulated.

5.3 The Procurement Process

Following submission of an outline business case and the creation of a project team by the Inland Revenue, a contract notice was placed in the Official Journal of the European Community. At the suggestion of the Private Finance Panel and the Inland Revenue's commercial consultants, the Inland Revenue advertised that the Negotiated Procedure would be adopted under EC procurement law. This was thought to offer tenderers the opportunity to present innovative design and service approaches and allowed some flexibility when negotiating issues concerning the allocation of risk.

Following the placement of the OJEC advert, an information memorandum was issued to 23 organisations who had expressed an interest in the project. The organisations expressing interest were varied in type, although as has been the experience of PFI projects to date the significant majority were led by construction based companies; 16 coming from this sector, a further six were property developers and one came from the facility management sector.

These organisations were required to complete a pre qualification questionnaire. Following evaluation of the responses to this, the Inland Revenue drew up a 'long list' of eight organisations who were asked to make presentations that would describe the nature and experience of their organisation and the approaches that each would adopt in developing their proposals. On the basis of these presentations a shortlist of three was selected to enter into negotiation with the Inland Revenue, all three being property development companies.

At this point the client prepared its User Brief which was distributed to all shortlisted bidders. It was on the basis of this document that these bidders would prepare tender proposals. In September 1996 the preferred bidder, London and Regional Properties was selected whereupon six months of negotiation followed, before the contract was finally signed. Construction commenced almost immediately afterwards and the operational phase began in May 1998.

An illustration of the PFI procurement programme for this project is given in Figure 11.

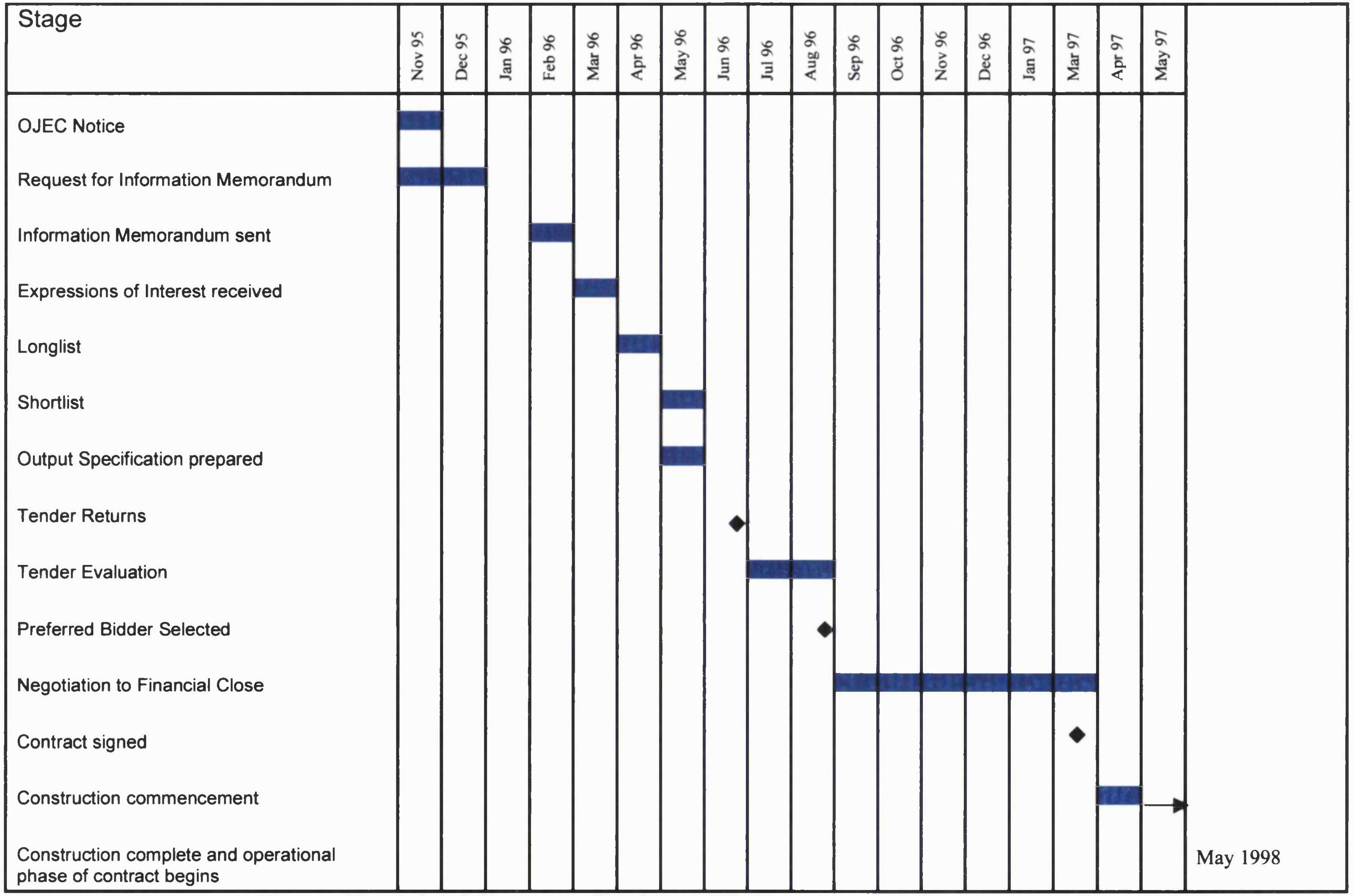

Figure 10 – Inland Revenue, Regional HQ, Manchester – Procurement Programme

5.3 The Briefing Arrangements

In conjunction with its team of advisors, which included specialist PFI and property consultants, legal and financial consultants and an adviser from the Private Finance Panel, the client developed its User Brief. This document was produced in the month immediately after the selection of the three shortlisted bidders.

The User Brief could be regarded as a "classic" PFI 'output specification', [2] i.e. developed in accordance with Private Finance Panel guidelines to allow the greatest scope for innovation. This approach had the effect of transferring a greater share of design risk to the service provider, than would normally have been the case.

During the interview of the public sector client, questions were raised as to the effectiveness of the output specification philosophy, which he claimed made the comparison of bids in terms of "relative value for money" a "matter of conjecture" and "open to interpretation". [2]

The User Brief included:

- An outline of the Inland Revenue's business and property strategy.
- A schedule of existing properties.
- An indication in output terms of its accommodation and technical requirements.
- Facilities Management requirements.
- Legal requirements.

5.3.1 The Development of the User Brief by the Private Sector Operator

It became clear during an interview with the operators design consultant that any attempt by the PFI operator to develop this brief in any meaningful way had not occurred, the User Brief was the only written briefing document available throughout the development of the design. [3] Traditional design management approaches had been adopted from that point. The design consultant acting for the service provider did however suggest that this form of client briefing had achieved its end, in enabling him significantly greater scope for innovation than would have been the case under traditional briefing arrangements, particularly those generally adopted by public sector clients. [3]

5.4 Consideration of Risk Transfer

Table 2 illustrates the risk transfer matrix developed at the tender evaluation stage. It illustrates the comparison of two of the bidders PFI proposals, in terms of risk transfer relative to the risks generally transferred under a traditionally procured contract.

Of particular interest to this study was the extent to which the long-term risks associated with the use and management of the facility had been transferred to the operator, in particular those of the occupancy demand risks and operating risks.

5.4.1 Occupancy risks

It is known that an option exists within the contract for the Inland Revenue to reduce its occupation of the facility by 20% at a two-thirds contract term. This provision in conjunction with the client's stated requirement that the facility be designed to allow multiple tenancy arrangement, created some incentive for the Operator to design a facility which offered potential for subdivision. It was however observed that the occupancy demand flexibility offered by this contract was less than that offered in many traditional leases.

5.4.2 Operating risks

Contrary to the indication of the risk transfer matrix, it is known that the PFI Operator bears the principle operating risks associated with the maintenance of the facility throughout the contract period. The operator will be responsible for providing the operational facility management service and a number support services including cleaning and catering. As would be expected, the Operator's performance in this regard would be evaluated against a set of performance measures and deductions in the unitary charge would be made by the client, if agreed service standards were not achieved.

It became apparent in interviewing the public sector client that a number of support services had been excluded from the project agreement, these included information systems management, security guarding and telephonist services

Another notable exclusion to the transfer of operating risks included those associated with the cost of utilities, which were withdrawn from the contract at the negotiation phase of procurement. These were omitted on account of the view that energy costs were "beyond the ability of the Operator to manage". [2]

5.4.3 Risks of changes in Client Requirements

It was noted that the risks associated with changing client requirements, either in the form of its functional requirements of the built facility or the means by which facility services are provided, remain predominantly with the Inland Revenue. Where for example it became an operational requirement to undertake changes to the internal layout, alterations to the structure, fabric and services would be paid for by means of a full cost lump sum payment. Some transfer of risk was however imposed through the provision that any management costs incurred to implement such modifications would be borne by the service provider. This is not an unusual arrangement in terms of the PFI deals being developed currently, but may to some extent undermine the assertions of the Private Finance Panel that the PFI is more likely to lead to design and service arrangements that are more responsive to the changing requirements of the client.

RISKS	Public Sector Comparator	PFI OPTION 1	PFI OPTION 2	COMMENTS
Detailed Planning Permission	Retain	Transfer	Transfer	Risk of refusal / redesign / delay in receiving planning permission. Impact on construction costs/programme. Risk transferred in Options 1 & 2
Design	Retain	Transfer	Transfer	Design problems construction stage. Impact on costs and programme. Risks transferred in Options 1 & 3
Construction Cost overruns	Retain	Transfer	Transfer	Costs overruns from increased cost of building materials, poor estimating, unforeseen additional work, poor project management. Risk transferred in Options 1 & 2
Construction Delay	Retain	Transfer	Transfer	Delays from unforeseen work, technical problems, poor project management. Impact on NOS savings. Risks transferred in Options 1 & 2
Occupancy	Retain	Reduce Exposure	Retain	Risk of filling surplus space in Option 2. Risk transferred in Option 1. Risk of building becoming surplus to requirements. No risk transfer in options 1 or 2 as tied in for 15 years
Operating Risk	Retain	Retain	Transfer	Risk of escalating running costs. Increased operating costs due to poor design. No transfer of risk in Option 1. Fully transferred in Option 2.
Future Major Maintenance	Retain	Reduce Exposure	Transfer	Risk of unforeseen major maintenance. No risk transfer in Option 2 but exposure reduced in Option 1 as new building. Fully transferred in Option 2.
Residual Value Risk	Retain	Transfer	Transfer	Risk of unrealisable residual value. Risk transferred in Option 1 & 2

Table 2 – Inland Revenue, Regional HQ, Manchester – PFI Risk Table

5.6 The Contractual and Organisational Structure

The selected operator, London and Regional Properties is a single property company not operating within a consortium. A special purpose company has been established through which the project has been financed and managed. It is understood that the design and construction of the facility has been procured traditionally under a 'turn-key' contract and that the operational facility management services have been sub contracted by the Operator along traditional lines.

Figure 11 illustrates the contractual relationships that are believed to exist.

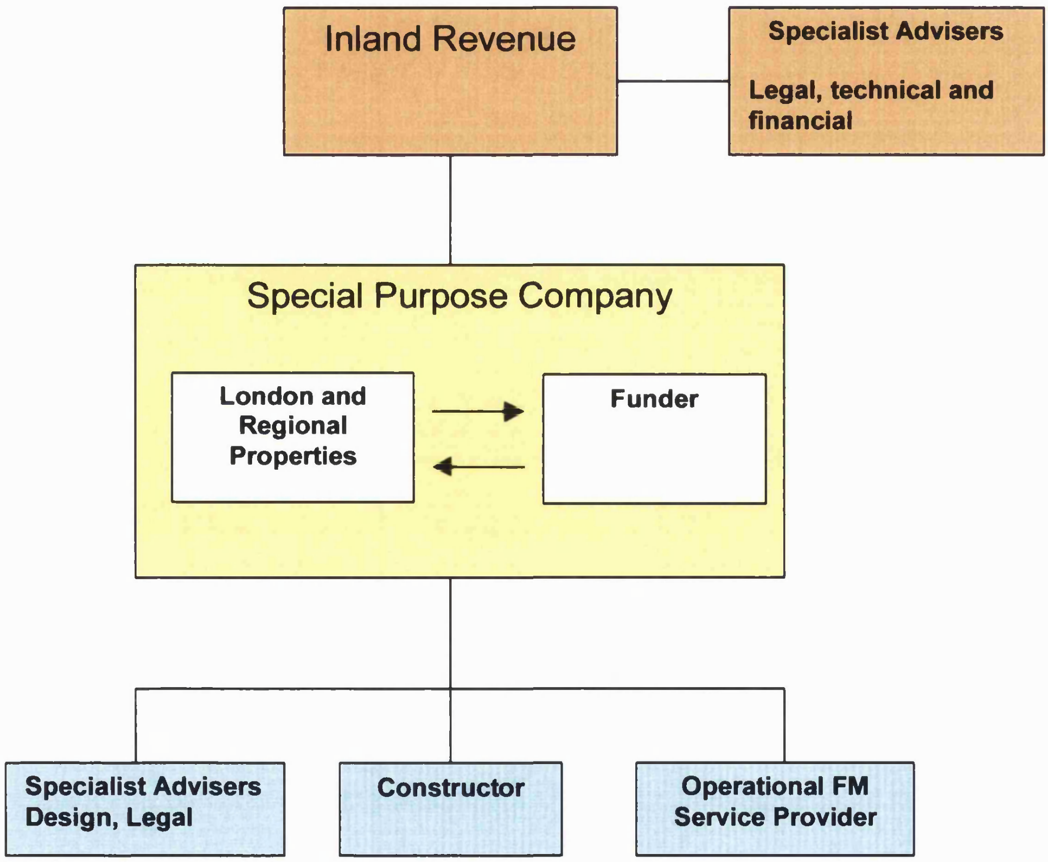

Fig 11– Inland Revenue, Regional HQ, Manchester – Project Structure

5.7 Comment

A single case investigation of this sort cannot necessarily be used as a reliable guide to the public and private sectors experience of the PFI to date, nor is it any indication of what the likely characteristics of future arrangements will be. Used in conjunction with a review of literature such a study is however of some value in examining the positive and negative aspects of the process, and as a means of judging whether the benefits of the approach proposed in Treasury Guidance documentation have been captured in a practical example.

What is apparent in the assessment of this example is that the extent of risk transfer that has been agreed is less than would be expected after perusal of PFI guidance documentation. The client body has been allowed only limited opportunity to reduce its occupancy 'take up' during the project period. A number of support services will not be delivered as part of the contract, most notably that of information systems management. In addition the costs associated with energy utilisation are on a direct 'pass through' basis. It is proposed that these omissions will limit the Operator's incentive to adopt innovative design approaches as a means of managing the long term operating and occupancy demand risks.

The briefing arrangements adopted by the Client organisation have followed PFI guidance on the subject and have in this case apparently been successful in allowing the designer greater freedoms to innovate. No attempt has been made by the Operator's team to develop a project brief, which whilst not necessarily being unexpected maybe indicative of the conservative level of risk transfer that has been made. There are therefore no signs of innovation made in the respect of briefing and brief development on the part of the Operator.

The Operator's own approach has largely followed that of conventional property development with construction and operational support services being procured by traditional means.

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Chapter 6

❖ The PFI and the Strategic Development of Facility Management

6.1 Introduction

In addition to a range of potential developments and innovations in FM practice, the PFI is expected to have a significant impact upon the development and type of organisation engaged in the delivery of facility management services. There are signs that other developments may be leading both the property industry and specifically facility management in a very similar direction. Key examples of such developments are: -

- developments akin to the PFI in the private sector,
- the changing methods of financing property and most importantly securitisation
- the contemporary strategies of commercial organisations that create the demand for property and associated facility management services. In particular concentration on core competencies

It is forecast that the move from long term leasehold tenures, characterised by minimal involvement of the owner in the operation and management of a facility, will give way to much greater tenurial flexibility, with more active involvement of the owner in the operation of facilities.

This chapter looks at the variety of organisations currently bidding for PFI contracts. In addition it examines some evidence of the growth of new organisations that are being created in order to specifically address the modern property and facility demands of both public and private sector organisations.

The Owner-Operator

The concept of the owner-operator company is examined in this chapter. These are defined as those organisations engaged in financing and/or supplying commercial property, who are also actively engaged in the operation of the facility, supplying and managing the range of facility services necessary to support the core processes of the occupier. Providers of serviced offices could be viewed as examples of owner operators.

6.2 The Structure of Supply Side Organisations currently engaged in the PFI Process

Analysis of organisational structures tends to suggest that, in simple terms, two types of organisations are currently engaged in bidding for PFI contracts. Namely these are [1]:

- The single company and
- The consortium

6.2.1 The Single Company

The simplest type of organisation bidding for PFI contracts is the single company. It has generally been observed that in the early years in the development of the supply side of the PFI market, construction companies have emphatically taken the lead. [2] These companies have been attracted by the large-scale capital projects that are being procured through the PFI and the relatively high margins that these organisations expect to generate when compared to their traditional market. [3]

A number of large construction companies have over the past number of years altered their resources disposition by introducing new expertise often characterised by the development of FM arms.[1] This has potentially equipped them with the range of skills required to see a project through its life cycle from design and construction to the operational phase. These multi-disciplinary but construction based companies have been key players in the development of the PFI supply side to date.

In practice where project finance has been used, the construction company would be expected to form a special purpose company (SPC) specifically for the PFI project for which it was bidding. [4] The other partner within the SPC probably being a funder able to inject substantial equity with which the project would be partially financed. [4]

Whilst some construction/operator companies have been technically equipped to deliver the full range of services required, the lack of financial capacity that these organisations possess will generally limit their ability to deliver numerous large PFI projects as a single company. [2] Even when supported in projects by a major financial backer, lead companies will still be expected to inject a significant amount of equity into a project.

For this reason it has been predicted that construction based companies are probably unable to fund more than 20% of the total PFI schemes planned, with only a small proportion of these schemes being delivered by a single multi-disciplinary construction based company. [2]

N.B Rather than the single company becoming directly engaged in the construction and operation of the facility it may seek to procure the operational facilities management services through a traditional service sub contract. In this case the sub contractor will not hold an equity share in the SPC, and market testing may result in its replacement at any stage of the operational phase of the project. The lead company would bear the operational risks but would seek through careful procurement to 'back out' much of the operational 'availability' and 'performance' risk to the operator sub contractor. [1]

6.2.2 The Consortium Approach

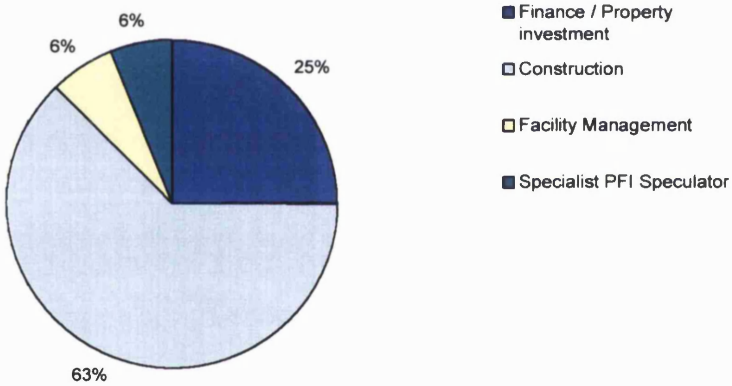
As a consequence of the complex risk profiles of most projects, bidders for PFI contracts will often take the form of a consortium. Consortia have been formed to not only create the necessary blend of technical skills required, but also as a means of securing a number of sources of equity funding and as a way of pooling the financial risks involved. [1] In PFI serviced accommodation projects, consortia typically comprise a constructor, an operator and a financier supported by a wide range of sector specific advisers which may include legal services, financial support and designers amongst others. [3]

These consortia typically form a special purpose company through which the project will be financed and managed. Only the key members, for example the financier and constructor, are likely to hold an equity share in the special purpose company. [3]

Facility management companies have become important members of such consortia, however despite being technically well placed to take the lead role in the SPC their current lack of financial strength appears to have largely prevented this from happening to date. [2]

Analysis of the make up of 41 consortia expressing interest in five PFI projects suggest that it is again construction companies who are predominantly taking the lead in such organisations (see below).

Figure 12 - Consortia Lead by Company Type



6.2.3 Current Criticism of the Consortium Approach

Despite the widespread adoption of the consortium approach, the current structure of these organisations has become the focus of criticism by some observers. Whilst property companies have taken a more active role in leading consortia in the past 18 months, the continued dominance of construction led consortia has been cited as an indication of a weakness in the supply side of the PFI market. [1] In spite of the development of facility management divisions, construction companies are principally concerned with the short term construction phase of the project, it is claimed. [1] Industry experts have suggested that in long term PFI contracts, (up to 25 years in many cases), it is the operating risks that constitute the most significant element of a project's risk profile. [5] It has therefore been further suggested that operators and specifically specialist facility management companies, expert in managing these long term operating risks are best placed to take the lead role in PFI projects. [3] As previously observed however these typically lack the ability to inject the levels of equity required to adopt this lead role.

Other commentators have therefore proposed that a new owner-operator supply side should be fostered that combines financial strength and operational management expertise to both finance the large and complex PFI projects and ably manage the long-term risks involved. [1]

The apparent instability of bidding consortia involved in the PFI process is another major criticism with the current arrangements. The pressures imposed on individual member companies by the high cost of bidding, has often meant that potentially viable consortia have been brought together to bid for one or at best a small number of projects only to break up before a major contract has been landed. [3] As a consequence the benefit derived by the consortium in developing experience of the PFI process in close working relationships is lost.

As dissatisfaction grows with current arrangements it is expected that new organisational structures will form to address these areas of weakness. Some speculation as to the form that these organisations might take and the role of facility management within these organisations is offered later in this chapter.

6.3 DSS PRIME (Private Sector Resource Initiative for Management of the Estate)

It is worth considering at this stage a further application of the PFI that can be expected to receive widespread use in the future. In 1997 through a project known as PRIME the PFI was used to transfer the ownership and operation of the existing estate of the Department of Social Security to the private sector. [6] This was a variation of the way in which the PFI had been used previously i.e. the new construction of serviced accommodation facilities etc.. [7] The philosophy behind PRIME is however consistent with one of the basic principles of the PFI - that is to enable government bodies to withdraw from the peripheral activities of developing, owning and managing property assets allowing them to concentrate on its core tasks.

Whilst PRIME was an extremely complex procurement exercise, in contrast to many 'conventional' PFI projects, it drew a successful conclusion in a relatively short timespan. Particular attention was reportedly paid by the client to ensure that the costs of bidding were kept to reasonable levels. Following pre-qualification, which brought the list of bidding consortia to twenty, a shortlist of six was created which was finally reduced to three. All three consortia comprised large teams made up of finance providers, facility management companies, property development and legal advisers. [7]

A consortium led by Goldman Sachs International and known as PPM were awarded the contract which saw the transfer of 700 long and short leaseholds and freeholds amounting to 1.7m m^2 of office space. PPM would now provide and operate serviced accommodation for 95,000 civil servants over a twenty year period. The contract would allow PPM to exploit the development potential of the estate to the mutual benefit of PPM and the DSS, who would share the proceeds of any development gain. Where necessary staff would transfer to suitable alternative accommodation. The contract allows the client the opportunity to reduce its total take up of space by 45% over the twenty year period. [6]

This PFI deal was as significant for facility management as it was for the structure of the property industry. Symonds Facilities Management the FM partner in the PPM consortium was expected to more than double its turnover as a direct consequence of the huge FM content of the deal. In addition Symonds have as a consequence become part of a major new organisation led by a principal international investment bank. [8]

The principle of DSS PRIME has already been accepted by other government departments and agencies such as the Inland Revenue who are already in the process of agreeing similar 'sale, leaseback and service' deal. Furthermore the idea is receiving the attention of private sector occupiers, such as ICL, who are currently negotiating an agreement along similar lines. It is anticipated that this trend will be continued with a large number of major organisations in both the public and private sectors disposing of their property assets and outsourcing the greater part of their property and facility management functions through such arrangements.

6.4 Prospects for the Future

The failings of traditional methods of financing property have been well documented, however the delivery of property through the continued expansion of the market in serviced accommodation is one sign that significant change in the structure of the property market is occurring. The rate of change can be expected to accelerate in the coming years. The application of the PFI represents only one, albeit significant, aspect of this change.

In its report “Private Skills in Public Service – tuning the PFI” the CBI speculated that the development of an owner operator supply side was of particular importance if the PFI was to deliver all the benefits that this new form of procurement potentially promised. [1] Once established these owner operator companies can be expected to respond to the demand side changes of the wider UK property market.

Two organisational models around which a new owner operator supply side will possibly develop are:

- A new form of development management consortium
- The multi-disciplinary management company

6.4.1 Development Management Consortium

Oliver Jones speculates that a new form of development management consortia may evolve out of consortia currently bidding for PFI projects. [8] These consortia which will be backed by progressive finance providers will have as members, companies with proven project management and facility management capabilities. Emphasis will be placed upon the procurement and management expertise that these member organisations possess; they will however not become engaged in the actual delivery of the service. Instead, the consortia will essentially broker the deals with the private and public sector client. [3] Backed by a funder capable of providing significant equity financing (usually up to 50%), the consortia would carry the mainstream project risk in their concessions but would pass on the conventional construction and operational risks to the constructor and operational service providers through traditional sub contracts. This approach would negate the requirement to include the constructor and operational service providers as part of the consortium. [3]

The expertise required to manage the significant long term operating risks will emphasise the importance of the facility management partner, which would be expected to take a leading role in these organisations. Having initially played a part in establishing the project and operational briefs the facility management partner would be responsible for procuring the facility support services and would retain a long term role in measuring the performance of the facility and the associated support service providers.

6.4.2 The Multi-Disciplinary Management Company

There is already evidence that a new form of multi disciplinary management company organisational model is being developed specifically to deliver PFI type deals to the public and private sectors. These would be considered to be genuine owner operators.

Companies of this sort would act in much the same way as the Development Management Consortium described above and would be backed or owned by major providers of finance. They would however benefit from the long-term stability created by retaining the key financial, project and facilities management expertise within a single organisation.

Facility Management professionals within these organisations would again be responsible for developing project and operational briefs, procuring and managing facility management support service contracts and monitoring the performance of the built facility and associated support services. It is within these owner-operator organisations that the development of innovative approaches in facility management practice can be expected to most likely occur.

As the experience of such organisations grows, they can be expected to adopt positive approaches to the acceptance of operating and occupancy demand risks[1] generally found to be lacking in the often 'risk averse' approach adopted by bidding consortia to date.

The recent acquisition of Turner and Townsend Facilities Management by Servus Holdings Limited, a wholly owned subsidiary of Nomura International plc, is one indication that owner operator companies of the type described are beginning to form. Prior to this acquisition Nomura had led a consortium known as Opus which had been a shortlisted bidder for the DSS PRIME initiative previously described. It was considered that Opus failed to land this deal partially on account of a weakness in the facility management expertise that it possessed. [9] As a direct consequence of its experience in bidding for PRIME, Nomura formed Servus, a vehicle which would combine the financial strength and the management expertise through which public and private sector organisations could engage in PFI type projects. Servus will be particularly equipped to engage with large organisations in sale, leaseback and service deals along the lines adopted in PRIME.

At the time of writing US Investment Bank Donaldson, Lufkin and Jenrette are currently engaged in negotiations to acquire Ferguson Bucknall Austin the facility management arm of the Bucknall Group, to form a new company known as Citex to perform a similar role as that of Servus. This deal is being brokered by Oliver Jones, former MD of Symonds Facility Management who has been quoted in the Property Week as saying "there is a huge market gap for a well funded professionally, managed company that can deal with financing property and outsourcing". [10]

Securitisation

It is further anticipated that these new owner operator companies will not only foster innovation in facility management practice but that they will also seek modern approaches in the way that property is financed. Since the early 1980's pension funds exposure to property, traditionally the largest investors in property, has fallen from 17% to 5% of total assets. [11] The inherent problem of illiquidity, a characteristic of direct property investments, coupled with the lower than expected returns yielded by these investments, has been largely blamed for this trend. In recent years the principle of property investment securitisation has been increasingly trumpeted as a means by which the problems of illiquidity will be overcome and investment in property revitalised. [11] It can be expected that new companies such as Servus will seek ways to securitise the property portfolios that it acquires or develops. These new owner operator organisations will seek to securitise these property portfolios, either by creating individual operating companies which will be floated through the traditional equity markets or through new securitisation vehicles such as Real Estate

Investment Trusts (REITs). It is further proposed that the general move towards securitisation may in itself act as another catalyst in the growth of an owner operator supply side. These developments will be expected to add to the opportunities opening up to progressive facility management organisations who will be used as a means of 'adding value' to these investments. [12] Competing more directly with the equity markets, securitisation vehicles such as REIT's will exhibit similar investment characteristics and will in turn be a required by investors to yield similar returns as equities. One means by which those companies, involved in managing these investment vehicles, will seek to generate increased income from its assets will be by adding the delivery of a full range of high quality facility management, business support services and information systems management, with the supply of accommodation. In line with the principles of the PFI, the overriding aim will be the delivery of high quality services rather than simply the provision of office space.

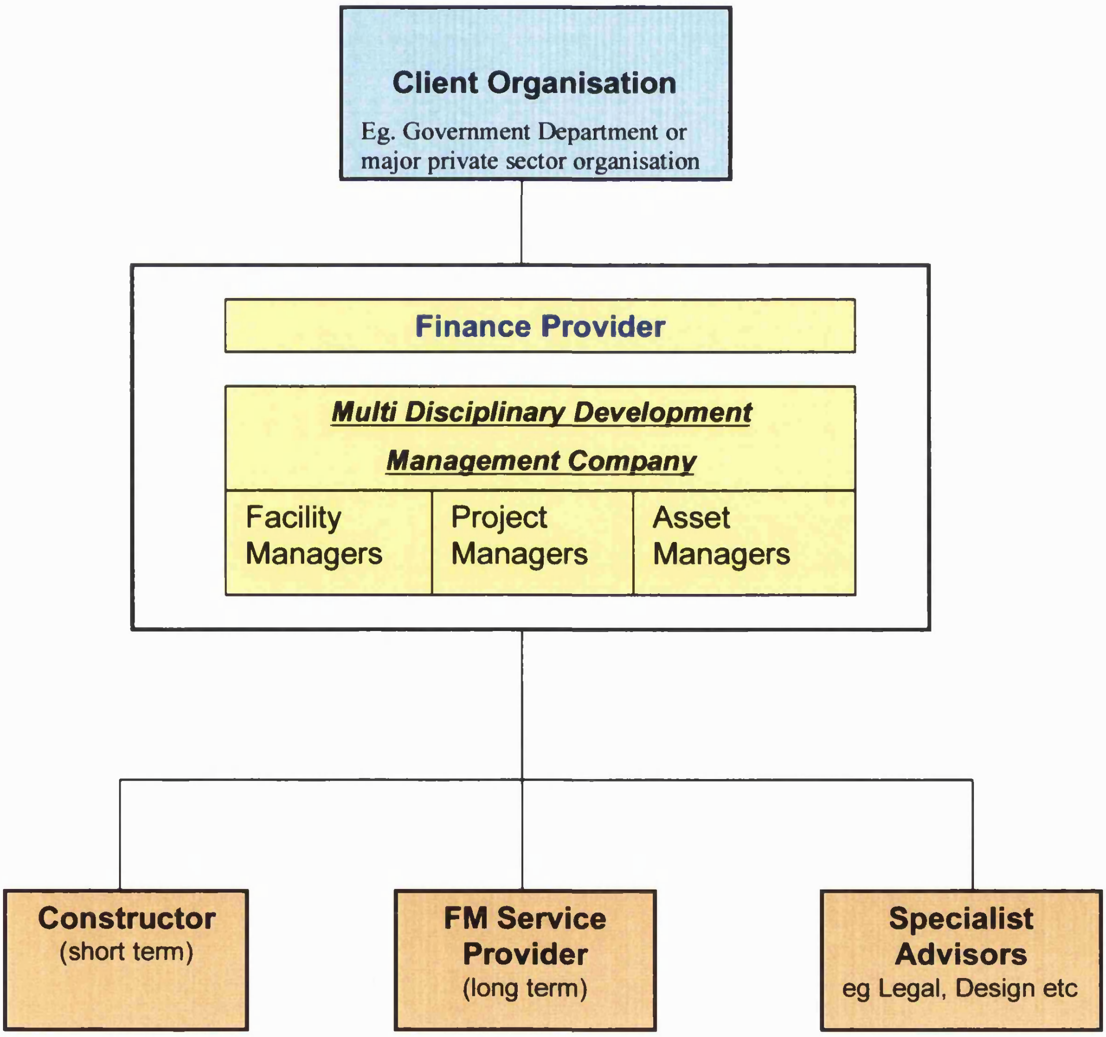


Figure13 Multi-Disciplinary Development Company - Organisation and contractual structure

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Chapter 7

❖ Discussion and Conclusions

7.1 Introduction

In the context of writing a research report about the Private Finance Initiative, the dynamic characteristics of this new procurement approach presents an interesting but nonetheless challenging task. In researching this subject much has been made of reviewing the mass of guidance literature and published comment which appear on HMSO bookshelves, in the journals of the property and construction industries, as well as in the pink pages of the national press.

This chapter however presents some of the primary research data that has been gathered in the research for this report. Because the PFI is a relatively new concept, only a handful of projects having reached the operational phase much more remaining a twinkle in the eye of many civil servants throughout the UK, it was considered appropriate to leave the examination of the primary research data to this late stage of the report. This is not to devalue such methods of research but the emphasis of a speculative study, such as this, has to be on the articulation of the theoretical future possibilities rather than on current thoughts and practices. This chapter concludes with a summing up of the author's own observations and opinions.

A citation analysis of 106 articles, taken from professional journals and broadsheet newspapers has been undertaken to establish the key areas of current concern as articulated through this literature. In this respect, this element of research was designed to examine in more detail some of the issues identified in Chapter 3.

In addition, interviews were undertaken to elicit the attitudes of industry experts. Their opinions have been summarised using a questionnaire, structured to summarise the main points that the interview was attempting to enquire into. Of most interest was to gain an appreciation as to the impact that the PFI was expected to have on facility management both in terms of the development of FM practice and the evolution of new structures of organisation engaged in the delivery of operational FM services or FM consultancy.

7.2 Early experiences of the Private Finance Initiative

Since the introduction of the Private Finance Initiative in 1992, it has become the principle means by which central government departments and associated agencies have sought to regenerate the national infrastructure and develop new public facilities. The PFI is being pursued as the means by which a diverse range of projects can be delivered; from the construction of roads and rail projects through to the development and operation of new prisons and hospitals.[1] The use of the PFI has additionally been extended to the means by which the outsourcing of entire property portfolios of government departments has been undertaken[2]. It can be argued that the PFI has really been used as a means by which organisational change within government departments has been accelerated. It extends the notion of 'core competencies' which allows public sector clients to withdraw from the peripheral activities of facilities management, property development and ownership, and asset management.[3]

The introduction of the PFI has however been a complex process with both the supply and demand sides of the PFI market, struggling to understand the implications of the transfer and acceptance of new risks. In particular how to evaluate, price and manage these new risks.

The twin objectives that the public sector is seeking to achieve through the PFI have often been found to be in conflict[4], i.e.:

- The transfer of both short term (design and construction) and long term (operating) risks

- The achievement of enhanced value for money.

Criticism has been levelled at public sector clients for attempting overly ambitious risk transfer[4]. Risk which the private sector have often considered to be either beyond its control or beyond its experience of managing. The supply side has therefore priced these risks accordingly, often culminating in "unaffordable schemes which are either delayed for modification or totally shelved as a consequence".[5] The experience gaining exercise has however largely been funded by the private sector, bidding consortia finding that tendering costs are on average ten times that that would be expected under traditional procurement routes.

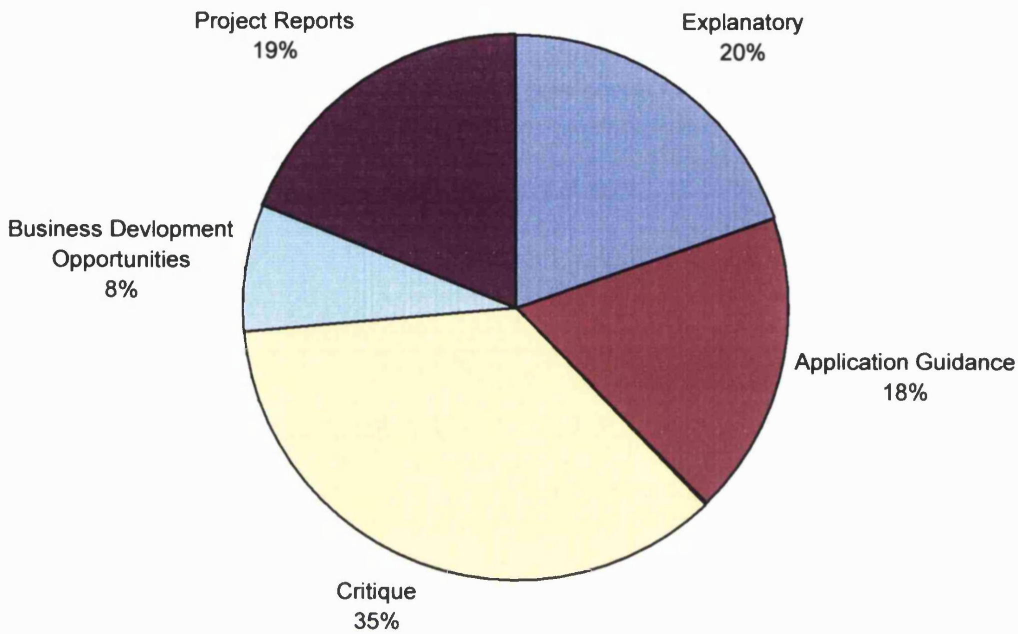
The present government has however reaffirmed its commitment to the principle of the PFI by commissioning a number of review committees, most importantly the Bates Committee, which has proposed and implemented new rules by which the PFI is to be managed. The intention being to streamline the procurement process, which it is hoped will reduce total bidding costs. Furthermore the findings of the Accounting Standards Board has clarified the accounting rules that apply and the possibility that certain types of PFI projects will in the future be counted as 'off balance' sheet spending now seems remote.[6]

7.2.1 Citation Analysis – Identifying the key areas of concern

Chapter Three discussed the fundamental concepts of the PFI and examined the key criticisms of the application of the PFI to date. To establish a quantitative measure of the key areas of concern a citation analysis was undertaken of 106 articles relating to the PFI. The articles were drawn from a range of property and construction journals principally Building, Property Week and the Estates Gazette. In addition articles were examined from national newspapers such as The Times and The Financial Times. Five categories of article were identified, these were:

Explanatory Articles	Articles explaining the principles of the PFI, Government policy or legal issues.
Application Guidance	Articles that provided guidance on the application of the PFI either generally or in specific service sectors.
Critiques	Articles offering critical comment of the PFI.
Business Development Opportunities	Articles that provided speculative analysis of the opportunities provided by the PFI for specific business types or professional groupings.
Project Reports	Reports on the progress of various PFI projects.

Figure 14 - Citation Analysis



The largest single category of articles were those which are best described as critiques. This may be interpreted as a measure of the lack of confidence that industry has had in the application of the PFI process to date. Further breakdown of this category suggest that 85% of the criticisms centre around the four main criticisms identified in Chapter 3, these are:

- The high costs of bidding.
- Excessively ambitious risk transfer.
- The PFI is being applied to unsuitable projects.
- The PFI is being used purely as a means of achieving 'off balance' sheet spending.

Of particular concern to industry was the apparent tendency of government to use the PFI as a means of achieving 'off balance sheet' spending with the accusation that it is merely a convenient form of creative accounting. The PFI guidance notes were clear to steer the public sector towards a position where sufficient risk transfer occurs in order that the project could be defined as an "operating lease" and would therefore not hit the public sector borrowing requirement.

In spite of the difficulties, there was widespread opinion amongst industry experts that the PFI will survive as the principle means by which the government will procure capital assets and services in the future. Of equal importance was the conclusion that the private sector will continue to believe that investment in roads, government offices, prisons and hospitals, was worthwhile where they could foresee higher margins through the acceptance and management of greater risk.

If a further literature review and citation analysis was undertaken in the coming years, an altogether more positive attitude to the PFI may be revealed. Following the recommendations of the Bates Review, government departments will have to be more selective in their use of the PFI and Treasury testing can be expected to eliminate projects that are inappropriate, or likely to prove unaffordable, before the procurement process can be initiated. This will reduce the amount of abortive tendering undertaken by bidders. As experience of the procurement process is gained by both the supply and demand sides, the high costs of tendering associated with PFI projects, can be expected to fall. It must be expected however that the inherently complex process will always lead to relatively high tendering costs.

7.3 Developments in FM practice

Chapter 4 examined the theoretical possibilities that through the transfer of the long term operational and occupancy risks of the built facility, the client and the operator would be encouraged to seek innovative approaches of combating the uncertainty of the future needs of the end user. This was examined specifically in relation to the concept of strategic briefing as proposed by Professor Bev Nutt.

The following possibilities were specifically identified

- Public sector clients will seek to procure facilities and services that will remain responsive to their changing requirements in the long term. This will lead to the development of a robust operational briefing framework at the inception of the contract. The PFI places a great emphasis on the continuous monitoring of the facility and support services required to support its business, the public sector will therefore also seek to create dynamic performance indicators that are able to reflect their changing requirements. Systems of risk and reward will be developed which incentivise responsive service delivery.

- The PFI operator will seek approaches to brief development that firstly ensure the immediate requirements of the end user are appropriately addressed but which also include a strategic approach to the evaluation and management of the long term risks to which the operator is exposed.

- The long term arrangements created between the supply and demand sides will bring those responsible for the design, construction and management of the facility more clearly into the operations of the occupier's business' leading to a greater understanding of clients requirements. It will be in the interest of both parties to seek continuous innovation and improvement in the supply of assets and services.

- The operator will be incentivised to continue to seek ways of improving the quality and scope of the services provided, in order to 'add value' to the clients operation and to maximise his return from the asset. Both the client and the operator will suffer the effects of any constraints imposed by the built facility.

- The design of the capital asset coincides with the creation of support service specifications. The integration of these will lead to a change in the philosophy of facility design which will see the facility as a means of delivering high quality support services. In the spirit of the PFI the emphasis will be on the delivery of a service rather than a capital asset. The facilities manager will therefore be drawn into the design process at an earlier stage than may otherwise have been the case, to ensure that issues of facility manageability are fully addressed.

7.3.1 Examining Client side briefing - Specification by Output

The PFI guidance suggest that public sector clients are to outline their facility and service needs by output rather than providing technical specifications. The theory being that this allows greater scope for designers to propose innovative design approaches than would normally be the case using traditional public sector briefing procedures. This has been a controversial element of PFI policy, some private sector bidding consortia blaming the indeterminacy of this approach for creating uncertainty of client requirements. This has been cited as a contributory factor in creating some of the lengthy delays experienced during the procurement process.

There was general agreement amongst experts that this approach differed significantly from the 'highly specified' approach traditionally adopted by the government departments, with the interesting exception of the PFI operator's design consultant who considered this to differ only slightly from traditional approaches. It was generally agreed that the specification by output philosophy reduced the constraints normally imposed upon designers to suggest new approaches.

7.3.2 Emerging evidence of the adoption of innovative approaches to briefing and design

The interviews also attempted to establish whether by transferring the long term operating risks to those engaged in the financing, design and construction of the built asset, enhanced consideration of the post occupancy issues of facility operation and management would be more rigourously considered at the pre occupancy phase of the project. An important aspect of this was whether the operator would be encouraged to adopt techniques that addressed the issues of long term changes in occupier requirements. PFI policy documents suggest that two of the forecast outcomes of the PFI approach were that:

- The Whole life costs in use of facilities would be more effectively considered and managed. [7]

- Facilities will be designed with the flexibility to respond to changing occupier requirements. [7]

There was generally wideheld belief that, under the PFI, whole life costs were considered more than would otherwise have been the case under traditional procurement routes. It was however the opinion of the public sector client that these considerations were only 'slightly enhanced' as life cycle cost analysis was already undertaken through the public sector's existing design strategy.

There was greater variation in opinion that facilities would be designed in a way which paid greater attention to the overall manageability of the facility. Although significantly the private sector operator claimed that such considerations were examined in detail during design development.

When fully questioned two of those most closely connected with facility management, expressed the view that in practice facility management organisations had to date not played as full a part in the development of PFI proposals as may have been expected. Whilst the FM partner was actively engaged in developing support service proposals there was no significant enhancement in the role of facility management during the design process. As a consequence it seemed unlikely, to these individuals, that facility manageability considerations would be enhanced by any significant measure. It was concluded that because consortia were currently struggling with the complexities of the procurement process they had typically resorted to traditional design management approaches and innovation in this respect was yet to be seen. The FM practitioner was however of the opinion that such developments could be expected in future as experience grows and become more "comfortable with the (PFI)".[5]

Finally the interviewees were questioned to investigate the strengths of the claim of the Private Finance Panel that the PFI will lead to the provision of facilities and services that will remain responsive to the changing needs of the user. The concept of flexibility was not fully defined in order to gauge as wide a range of responses as possible. The issues of tenurial, functional and service flexibility were however discussed with all interviewees. It was generally concluded that the PFI currently provides minimal opportunity or incentive to significantly emphasise these concepts. Only in circumstances where the risks of a change in user requirements were transferred to the private sector would a significant incentive be created in this respect. It was speculated that such risk transfer would generally be considered unacceptable to bidders, as these were likely to be viewed as being beyond the PFI Operator's ability to manage. Contract "Change mechanisms" were in place to deal with the issues of changes in functional or service requirements, these however essentially amounted to a controlled means of passing associated costs of such changes through to the public sector client.[5] There was some concern expressed that in some cases the PFI may indeed not offer sufficient scope for change. Of particular note was the limited tenurial flexibility offered by PFI contracts, in the example studied through the case investigation the agreement allowed reduction in occupancy of only 20% at the two third point of a twenty year contract.

A summary of the interviewee responses is provided in Table 3 - Structured Interviews – Questioning Response

	Questions 4-6 **When compared with traditional forms of procurement in the private sector:**	***Public Sector Client***		***Client Advisor***		***Private Sector Operator***		***Operator's Advisor***		***Facility Management Practitioner***	
4.	**Under the PFI the concept of occupancy and facility flexibility which recognises the uncertain future needs of the occupier is considered**	Now	Future	Now	Future	Now	Future	Now	Future	Now	Future
	a)significantly more										
	b)more			*	*						
	c)slightly more	*	*				*				*
	d)no more at all					*		*	*	*	
5.	**The issue of the building's manageability is considered:**	Now	Future	Now	Future	Now	Future	Now	Future	Now	Future
	a)significantly more			*	*						*
	b)more		*			*	*				
	c)slightly more	*						*	*	*	
	d)no more at all										
6.	**In reality design solutions are likely to be:**	Now	Future	Now	Future	Now	Future	Now	Future	Now	Future
	a)significantly different										
	b)different			*	*	*	*				
	c)slightly different	*	*					*	*	*	*
	d)no different at all										

Table 3b - Structured Interviews – Questioning Response

Questions 1-3 **When compared with traditional forms of procurement in the private sector:**		***Public Sector Client***		***Client Advisor***		***Private Sector Operator***		***Operator's Advisor***		***Facility Management Practitioner***	
1.	**The briefing arrangements adopted by public sector clients under the PFI are:**	Now	Future	Now	Future	Now	Future	Now	Future	Now	Future
	a) Significantly different	*	*	*	*	*	*				
	b) different								*	*	*
	c) Slightly different							*			
	d) no different at all										
2.	**The opportunity to propose innovative design solutions, under the PFI are::**	Now	Future	Now	Future	Now	Future	Now	Future	Now	Future
	a) significantly enhanced			*	*						
	b) enhanced							*	*	*	*
	c) slightly enhanced	*	*			*	*				
	d)not enhanced at all										
3.	**Under the PFI whole life costs are considered:**	Now	Future	Now	Future	Now	Future	Now	Future	Now	Future
	a)significantly more			*	*	*	*		*		*
	b)more							*		*	
	c)slightly more	*	*								
	d)no more at all										

Table 3a - Structured Interviews – Questioning Response

7.4 Conclusions

It seems likely that the PFI will remain the most prominent method by which Government will seek to procure capital assets and services. The actions of Government PFI review committees, most prominent being the Bates Review, and the work of the Accounting Standards Board to clarify accounting rules, will have a significant effect in rectifying the credibility crisis that the PFI has suffered from in its early years of application. The PFI will also continue to be used as a way in which government departments will outsource its entire property portfolios, of which the DSS PRIME initiative represents the precedent. The PFI reflects the public sector's move away from being owners and managers of capital assets towards becoming "intelligent purchasers of long-term services "[3]. It is also representative of a general move away from traditional forms of tenure of which the full repairing and insuring lease is the most obvious example.

In many respects, through the PFI, the public sector may be seen to be leading the way to a new means by which property and the associated support services will be procured in the future. The private sector can be expected to follow this lead by adopting approaches akin to the PFI. In fact the application of the approach may be more straightforward in the private sector where it is likely to be less encumbered by the "excessive bureaucracy" which has been a contributory factor in blighting the PFI to date. Business cases may also be easier to justify. There is already evidence that the sale, leaseback and service approach of DSS PRIME will find favour amongst commercial organisations who will continue to withdraw from peripheral activities of property ownership and management allowing these to focus on core competencies.

This research report proposed a number of potential innovations in facility management practice that may be expected to flow from the PFI. The possibility that innovations in briefing and design that explicitly recognise the uncertainty of future demands at the pre occupancy phase of a project was specifically examined. In this regard there was some doubt in the minds of experts questioned that that the PFI would deliver one of the benefits proposed in the PFI guidance namely that " facilities and services would be designed and managed so that they remained responsive to the changing needs of the user".[7] The difficulties in transferring the risk of a "change in occupier requirements" to the operator tended to limit its incentive to seek innovative ways of evaluating and managing these risks at the pre occupancy phase. Indeed there is some concern that the many aspects that comprise the concept of flexibility (be that functional tenurial or service flexibility) are not currently receiving enough attention of those engaged in the procurement and delivery of PFI projects.[5] Given the proposed lengths of PFI projects often up to 30 years, without a meaningful method by which change is satisfactorily allowed for PFI contracts may become a huge burden to public sector departments who will very likely experience the same rapid rates of change as organisations in the private sector.

Despite the concerns of experts there is some evidence that both clients and operators are adopting approaches that do expressly tackle the risks of obsolescence. Examples are the emphasis upon the adaptability potential of facilities, examined in two schemes for the provision residential accommodation. In another case a formalised facility robustness analysis was undertaken by a prospective PFI operator proposing the development of a college facility for a local education authority. Whilst these could be considered to be isolated examples of steps towards innovative approaches, as experience of the PFI concept grows and new organisational models develop, operators are expected to become increasingly able to accept additional risks and will seek new ways of evaluating and managing these. The idea of the strategic brief with its emphasis upon the development of a whole life strategy from briefing, design through to management seems particularly apt in the context of the PFI.

This report finally examined the impact that the PFI and the expansion of the market in serviced accommodation would have upon the development of facility management. Amongst the varied criticisms that have been levelled at the PFI is the weakness of the supply side,[8] it has been observed that the construction sector most prominent in leading PFI consortia to date, is perhaps inadequately equipped both financially and technically to deliver and manage a large number of projects.[9] It has been argued that increased emphasis should be placed on the operation element of PFI projects, of which facility management organisations are well placed to manage. These however generally lack the financial strength to inject sufficient equity finance or to accept the significant risks which accompany a 30 year project. To address this supply side weakness, it can be expected that a new breed of owner operator, specialist in the delivery of PFI type projects, will evolve. There is evidence that such developments are already being seen. Finance providers, such as investment banks are actively pursuing the opportunity to acquire organisations, most specifically facility management companies, that are equipped with the expertise required to effectively manage the operational phase of PFI projects. It is speculated that the growing recognition of the need for facility management expertise will enhance the opportunity for FM organisations and individual professionals to influence the delivery of property at the strategic level.

Historical deficiencies in the structure of the property market has led to the adoption of new financing techniques such as Real Estate Investment Trusts (REIT's) and the growth in demand for serviced accommodation generally. [10] It is speculated that these developments, combined with the evolution of the PFI, are expected to reinforce the continued emergence of facility management as an increasingly important feature of the UK property market.

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