

Decentralisation Implementation Group

Report

to

Minister for Finance

Decentralised office accommodation

Procurement methodology

and

Financial assessment

19 November 2004

Procurement methodology

1.1 In our report of 31 March 2004 we suggested the adoption of a Public Private Partnership (PPP) approach in procuring office accommodation in the decentralised locations, with a preference for a Design, Build, Finance and Maintain (DBMF) approach.

1.2 The OPW has since been advised by the National Development Finance Agency (NDFA) that potential PPP projects need to exceed a certain minimum value in order to generate an economically viable proposition for private sector investment. Relatively few single construction projects within the decentralisation programme would exceed this minimum value.

1.3 We have considered the scope for bundling several projects together and offering them *en bloc* to the market. The OPW advice is that this approach would give rise to serious practical difficulties in managing the projects and should not be adopted.

1.4 Defining the maintenance provisions for a DBMF contract involves anticipating eventualities that may occur over a twenty-year period. As a result, it can take time to develop the required contract documentation and assess its acceptability to the market. As stated in our March report, experience of this approach in property procurement is limited.

1.5 Ultimately, the suitability of the DBMF approach will have to be determined by testing the market for a number of the larger projects and evaluating the bids received relative to the Public Sector Benchmark (PSB)¹.

1.6 In the case of smaller projects and in the light of the advice received, the OPW now recommends that a Design Build (DB) approach be pursued in most cases. This approach should help to advance projects to tender stage at a faster pace because the contract documentation would not be as complex as for DBMF. At the same time, it would allow the OPW to test whether the use of warranty provisions for particular components of the building provides a possible alternative to a comprehensive maintenance contract.

1.7 Two projects have already advanced beyond the stage where a DB approach could be considered. OPW has developed a scheme, to tender stage, for rationalising civil service office accommodation in Sligo town which would involve providing an extension to the Government Offices in that town. Planning permission has already been obtained for the provision of accommodation for the Irish Prison Service in Longford.

1.8 In the case of Trim (the OPW's headquarters building), the OPW suggests that its in-house design capacity should be used to produce a cost-efficient sustainable building based largely on open plan design. OPW wishes to showcase the advantages of a modern office layout where senior staff share an open plan area as well as meeting and conference facilities with other staff. It believes that such an approach is not only cost-effective but can also offer an enhanced

¹ In line with our recommendation, the OPW has developed, with the assistance of the NDFA, a generic PSB. This is a comprehensive risk-adjusted costing of the project, over its whole life, using conventional procurement. It provides a comparator against which to measure the value for money of PPP.

working environment for staff. This could provide a template and exemplar for civil service office accommodation in the future.

1.9 There may be other locations where the DB tender approach would not be suitable, e.g. where an existing building is being acquired, where the OPW can enter into a satisfactory agreement with a developer or where the project is so small that it would not attract sufficient private sector interest. In such cases, a fit-out or traditional procurement would be required.

1.10 In general, however, we believe that a twin-track approach should be adopted at this stage for the procurement of office accommodation in the other locations. For those locations which involve accommodation for at least 300 staff, we recommend that the DBMF approach continue to be pursued subject to it demonstrating value for money relative to the PSB in each case. For the remaining locations, we recommend that a DB approach be adopted. This parallel approach should:

- (i) give the market (construction industry, developers, property professionals and financial institutions) an opportunity to demonstrate that it can provide the required office accommodation on a value for money basis; but
- (ii) at the same time, provide assurance about early progress on implementation of the programme; and
- (iii) allow each approach to be compared with, and evaluated relative to, the other.

1.11 We will review this overall strategy in the light of experience with the market during the first phase of implementation of the programme.

1.12 Under the DB approach the finance could be provided by the Exchequer, the NDFA or the private sector. As indicated in our March report, the private sector normally faces somewhat higher financing costs than the State and private sector financing might, therefore, increase the cost to the State of procuring the new office accommodation. However, the impact of different forms of financing on the General Government Balance also has to be considered. It may be that financing by the NDFA and/or the private sector would be seen as appropriate in order to avoid crowding out other important capital investment programmes and projects. The appropriate mix of Exchequer, NDFA and private finance is an issue that needs to be considered by the OPW, with the advice of the NDFA and the Department of Finance.

Financial assessment

2.1 Our terms of reference require us to address the office infrastructure aspects of the decentralisation programme on a basis which ensures that property being acquired at regional level is matched over time in cost terms by disposal of property currently held in the Dublin region, whether held on lease or otherwise.

2.2 At our request, the OPW prepared a decentralisation property finance study which evaluated the likely costs of procuring sites and accommodation in the regions and compared these with the financial benefits of moving out of property in Dublin.

2.3 This study was based on the earlier assumption that all the new accommodation would be procured on a DBMF basis on OPW-acquired sites, with ownership of the accommodation reverting to the OPW after a twenty year period. Estimates of the annual payments (unitary charges) that would arise under such an approach were calculated. These calculations are highly commercially sensitive - if they were made public the market would know in advance what price the OPW expected to pay for the new accommodation and could structure tenders accordingly.

2.4 In any event, we are now recommending a different approach to procurement (i.e. a mixture of DBMF and DB). Accordingly, we have developed a financial model based on the work done by the OPW in preparing its study but using construction industry cost norms and making the assumption that the projects are Exchequer financed. The capital costs used in the model are also consistent with the PSB developed by the OPW with the assistance of the NDFEA. The model covers the entire decentralisation programme, i.e. civil service, State agencies and other parts of the public service. It estimates projected cash flow costs and savings over the period, and uses a discounted cash flow (DCF) method to calculate the break-even point, i.e. the year when the cumulative DCF becomes positive.²

Overall results

2.5 Appendix I sets out the assumptions used in the model. These contain commercially sensitive information and should not be made public. The overall results based on these assumptions are as follows:

- in the years 2006 to 2010 there is an increasingly negative cumulative cash flow as the site acquisition, construction and lease exit costs exceed the proceeds from the disposal of surplus owned property in Dublin and the rental savings;
- thereafter, the rental savings act to reduce, and eventually eliminate, the negative cumulative cash flow to the State;
- the break-even point is achieved in 2026, i.e. this is the year when the cumulative DCF becomes positive; and
- at the end of that period, the State also owns all the buildings in the decentralised locations and the annual rental savings would continue to accrue in perpetuity.

Sensitivity analysis and cost mitigation

2.6 As with any financial model, this assessment is sensitive to changes in the assumptions underpinning it. Some changes will be external to the programme, e.g. developments in the overall construction industry and the office accommodation market. Others would be internal to the programme, e.g. changes in timing or numbers. Appendix I illustrates the sensitivity of the projections in the model to various changes in assumptions

² The use of the DBMF approach for the larger projects would change the cash flow projections in the model (reducing the capital outgoings and introducing ongoing unitary payments). However, the DBMF approach will only be used where it represents better value for money than the alternative approach assumed in the model. It should not, therefore, invalidate the model's projected overall financial outcome.

Space requirements

2.7 The estimated construction costs are sensitive to the assumptions on space requirements per person. We recommend that the Government approve 20 square metres as the maximum space requirement per person, inclusive of all circulation and ancillary space. The current average is 21.7 metres but this includes many old buildings and non-purpose-built-offices. The corresponding net figure per person (excluding stairs, hallways etc.) should be about 13 to 15 square metres per person depending on building size.³ Modern office layouts can provide space and cost effective accommodation but also offer staff a much better working environment and, as indicated in paragraph 1.8, the OPW proposes to showcase the advantages of such layouts at its new headquarters in Trim.

2.8 We also recommend that the OPW be given the authority to determine the actual space requirements and specifications for each project, after consultation with the client organisation. If the client organisation is not prepared to accept the OPW's determinations in this regard, it would have the right to appeal to a special committee comprising a Secretary General from the Department of Finance, the Secretary General of the Department of the Environment, Heritage & Local Government and an independent outsider appointed by the Minister for Finance.

Property disposal

2.9 A desire to hold onto large amounts of owned property in Dublin for reasons other than its monetary value to the State would have a negative impact on the financial outcome. In addition, the estimated rental savings are sensitive to securing a match over a reasonable period between departments occupying regional property and vacating Dublin property. The relocation of Dublin staff to the new offices will take place on a phased basis in most cases, even where there is a full complement of new staff ready to decentralise. We have highlighted previously the particular issues that will arise in dealing with professional/technical staff and State agency employees. There is also the need to manage transfers of staff from existing offices outside Dublin in a way which respects the overall policy on public service numbers. Clearly, there will be some overlap period between new buildings becoming available and Dublin property being vacated. This overlap period will be longer in the case of some organisations and business units than in others. The financial model assumes an average two-year lag between property becoming available in the new locations and the disposal of equivalent space in Dublin.

2.10 It is important that the overall property procurement and disposal process be managed in an integrated way. There needs to be a 'decentralisation champion' to ensure compliance by departments with, among other things,

- (i) the release of space to allow OPW to take advantage of critical lease disposal dates
- (ii) agreement as required to interim moves to other buildings in Dublin to ensure efficient property utilisation and to capitalise on market opportunities to sell buildings, and
- (iii) acceptance of building sharing as necessary to allow property disposals (both for staff decentralising and those staying in Dublin).

³ By way of comparison, large U.K. organisations aim for 10 to 11 sq. metres gross per person nowadays: this involves hot-desking for some staff and other space utilisation strategies.

We recommend that this role be assigned to the OPW and that the committee to be established under paragraph 2.8 should be given the task of finding a resolution in cases where departments feel they cannot comply with OPW's determination in any particular case.

Lease exits

2.11 From a purely property management point of view, the longer OPW has to dispose of its leased space the lower the lease exit costs would be. These costs would also be reduced if, and to the extent that, the sequencing of moves could be driven by lease disposal and rationalisation opportunities. In reality, implementation of the programme cannot be driven entirely by property considerations. People and service delivery issues must also be taken fully into account.

2.12 The minimisation of lease exit costs needs to be actively managed. Paragraph 2.10 identifies a number of important issues in this regard. It is also likely that greater value would be obtained if more owned-property was sold and less forced disposal of leased property took place within a short timescale. This may require departments whose headquarters are not being decentralised to change accommodation. It should also be possible to sublet even relatively unattractive properties if they are offered to the market at sufficiently competitive prices. The projected cost for lease exits, including dilapidations, is a worst case scenario. The OPW should be required to achieve a very considerable reduction in this cost.

Conclusion

2.13 It will be essential to track developments in relation to actual property-related costs and savings as the programme is implemented. We have asked the OPW to put the required systems in place and to submit regular progress reports to us outlining (i) actual costs/savings at particular points in time and (ii) updated forecasts at each point of projected future costs/savings. This will enable us, in turn, to keep the Minister for Finance advised of developments, to identify any emerging divergences from the overall projected financial outcome and to recommend appropriate corrective action if required.