



# ASSET

## NEW PARTNERSHIP MODELS

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Since joining PUK he has supported a variety of transactions including the refurbishment of the Government Office at Great George Street, MOD accommodation rationalisation projects such as MoDEL and project PRIME and in the transport sector is providing support to Crossrail.

Alan has led PUK's involvement in a number of wider market PPP projects such as One North East's property limited partnership and other regeneration-led initiatives and has worked with English Partnerships and Communities and Local Government in the developing the concept of local asset backed vehicles for regeneration.

Before joining PUK Alan was an Associate Director with Insignia Richard Ellis where he led the technical advisory team for the public sector for the Inland Revenue and HM Customs & Excise STEPS property PPP and also provided advice on a number of private sector property outsourcing transactions.

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# NEW PARTNERSHIP MODELS

## DRIVERS FOR CHANGE

### POLICY

Central government policy is a major driver with papers such as the OGC's high performing property initiatives, the Local Government White Paper, and papers from the National Audit Office on the use of innovative structures. These are having impacts across the board and the outputs are greater collaboration across the public sector estate, driving efficiencies, consolidation across geographical areas and political boundaries, a focus on improved public service delivery and better structures to promote urban regeneration.

### LAND AND PROPERTY

Before dealing with the new structures it is important to examine the difference between property in operational use and surplus property. The key driver for operational property, the occupied estate, is cost reduction. At the same time it is important to deliver value for money, fitness for purpose, lower construction or refurbishment costs for new facilities using whatever techniques we can, managing and mitigating the cost in use of those facilities and using residual value to reduce costs and to set up structures to reduce unitary payment in PFI and in partnership type structures.

The key driver for surplus buildings or land is to maximise value. There are common fundamentals. These are maximising receipts and where there is development potential making sure that we mature the planning status and do not dispose of the asset prematurely. There are drivers at a policy level to get rid of surplus assets and this may pressurise some authorities to dispose of assets at a point where they have not yet reached their greatest value as it may not have been possible to mature the planning status due to lack of resources or skills internally to enable us to take this process forward.

Maximising the value of surplus property is also driven by the way that we crystallise capital values, the way we invest in infrastructure to drive up value and the approach we may take to claw back of future land value enhancement. But crystallising value at a point in time does not necessarily

take into account the regenerative effects and it is often difficult to lock into those future regenerative effects and future land values over time. Often that benefit goes to the developers and the funders of those projects.

## DEAL STRUCTURES

There are a number of fairly straightforward approaches in current use. There is:

- Straight acquisition/disposal driven predominantly by current public sector policy;
- Traditional leasing models including leaseback, securitisations and other forms of finance or operating leases, but all essentially different models of leasing;
- Private Finance Initiative (PFI);
- Overarching delivery programmes that can incorporate PFI or mix PFI and traditional forms of procurement or utilise the LIFT Initiative or "Building schools for the future";
- Partnerships - We have been doing partnerships for a long time with English Partnerships (EP) and others such as regional development agencies (RDAs), urban regeneration companies (URCs) and development corporations. We know a lot about this. But there are new forms and approaches using both contractual relationships and corporate structures such as limited partnership structures and other forms of vehicle that provide a better platform for risk transfer or improved risk/reward balance between the public and the private sectors.

The important factor is to analyse whether your objective concerns the operational estate and driving efficiency or whether your requirement is to find a better way to dispose of surplus assets. The key factor is to understand your requirement, to understand what controls and governance arrangements you want in place and then to follow up with robust appraisal of those requirements; the appropriate structure should then emerge. Beware of solutions looking for problems.

### THE FUTURE FOR PFI

Government remains committed to PFI; HM Treasury published the paper "PFI: strengthening long-term partnerships" in March 2006. This clarifies the Government's commitment to this method. But PFI still remains as only 10% of public sector expenditure. Traditional forms of procurement are used to facilitate most public estate capital investment.

# PUBLIC SERVICE DELIVERY PROGRAMMES

There are two main initiatives, “Partnerships for Health”, and “Building schools for the future”. These are providing an envelope to take forward in a more efficient manner a programme of procurement and public service delivery. These initiatives provide a clear policy context to work with. These structures were put in place with the specific object of delivering established policy objectives and in terms of output they have created a more efficient market including increased market capacity, reduced procurement costs and timescales, that drive out of greater long term value and improved service quality. The initiatives have helped the development a better information base nationwide and importantly, particularly with Building schools for the future, the programme is not restricted to PFI projects, other forms of procurement can be used within that programme structure.

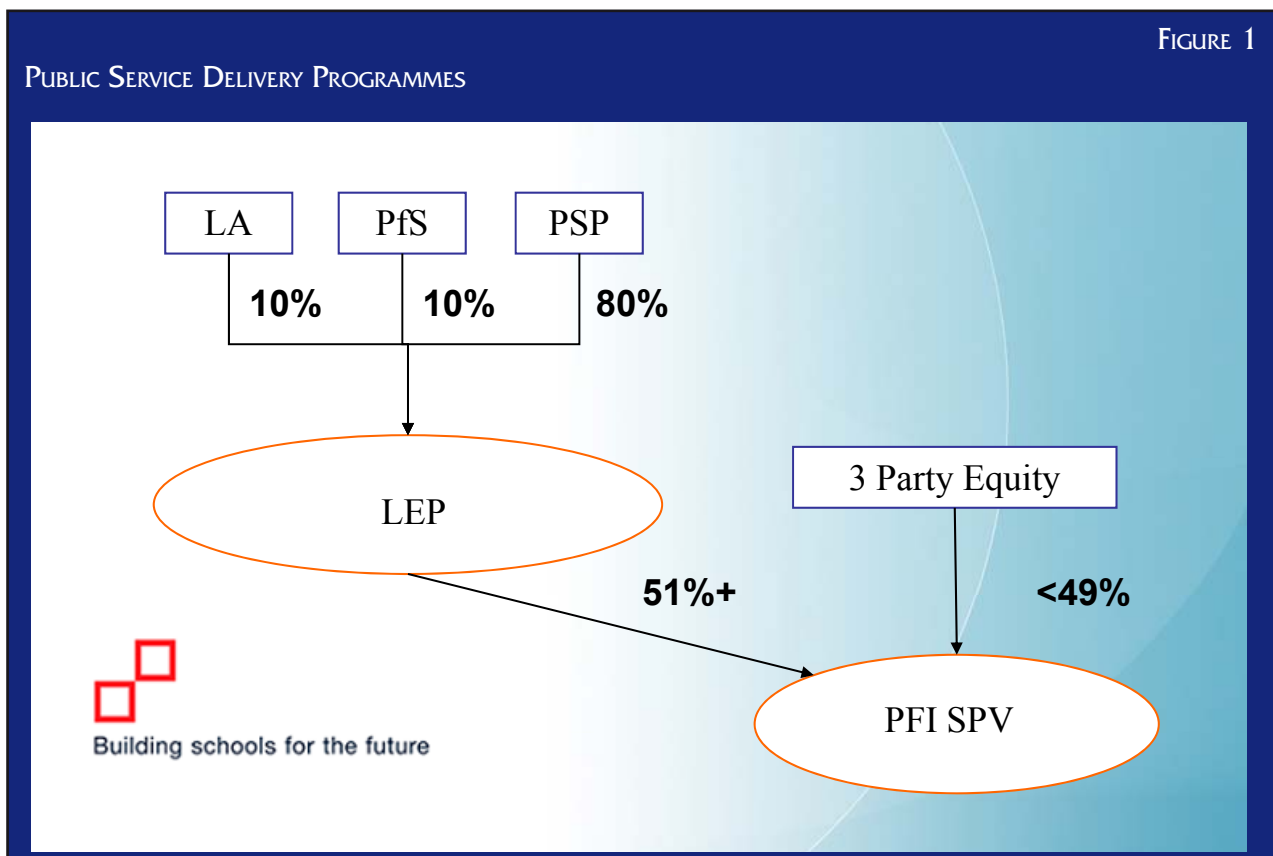
Figure 1 is a representation of local education partnerships encouraged by Building schools for the future. This shows the joint venture arrangement involving the local authority, Partnerships for Schools (PfS) and the private sector provider (PSP). Each party invests in the local implementing vehicle as suggested in the Building schools for the future structure arrangements. Thus a strategic joint venture, referred to as the “Local Education Partnership” then invests in the individual project vehicle using third party equity. That could be a traditional form of PFI using the standard form of contract or could include

other forms of procurement. This structuring approach is similar to LIFT.

# PROPERTY PARTNERSHIPS

## MoDEL

This is a Ministry of Defence (MoD) form of contract for the MoD project. The principles of this are simple and although this does not directly relate to local authority estates it is a format worth studying. The MoD entered into a contract with VSM Estates, this is Vinci plc and St. Modwen. The essence of the deal was to manage and finance a programme of new investment (about £150 million) in the core site at Northolt. The key driver for this project was to allow the MoD relocate 900 personnel from six other sites and to manage the disposal of the surplus land over a 5 to 6 year period. The problem was that this was not a core project for the MoD hence the MoD Defence Estates did not have the money to deliver it. The benefit of this partnership structure was that it contained all the financing in a completely self-financing model, i.e. the PSP funded the initial investment and provided further resources to achieve planning permissions on the six surplus sites and install infrastructure prior to disposal on the open market in return for disposal receipts based on a minimum value of £230 million. The contract includes some carefully drafted arrangements to ensure that the MoD achieve full value



from the disposal of its surplus estates. Whilst there is always a trade off between value and the point at which you crystallise that value this contract has moved beyond the traditional clawback and overage mechanisms of most disposal agreements. It includes a sophisticated profit share arrangement with a high degree of visibility. But the base line is that the development partnership VSM is underwriting the minimum land values for those disposals and investing its own resources in developing the surplus assets and managing the of investment and applying at its own risk equity into the infrastructure investment for the surplus sites to leverage the value of them.

The structure here incorporates the following key commercial principles:

- The underwritten land value (ULV) was sufficient to cover the investment at Northolt;
- Sales receipts above ULV are shared between VSM and MoD;
- VSM's equity returns earned from the sale of surplus land are above the ULV;
- Sites transferred on day 1 provide VSM with sufficient interest in the assets to raise finance;
- VSM must subcontract any additional works required beyond the original specification using public procurement;
- VSM cannot undertake direct development.

The following are some further key principles that you might apply to make this kind of contractual model work elsewhere:

- A robust estate rationalisation plan is needed;
- You need to be able to define what it is you want, what is your requirement, for investment in new facilities (this means a capital requirement up front);
- There has to be focus on a core facility allowing peripheral locations to become surplus over time;
- Properties concerned are ideally within a single ownership and predominantly freehold or valuable leasehold.

Putting together this kind of structure across different districts or local authorities could be difficult. It is already a complex structure and introducing additional complexities could be difficult. If there is a complex integration or programming requirement again the expertise that an external partner can bring could be helpful and risk can be transferred to that partner through equity involvement.

## ONE NORTHEAST

One NorthEast, a successful regional development agency, had accumulated £100 million worth of industrial assets in the north east but the concept was being pushed as Treasury policy that such assets were not part of their core requirement, they were surplus, and so had to be got rid of. However as the assets were providing a good return to One

NorthEast and there was still some development potential the RDA began to consider how to dispose of those assets AND to unlock any remaining development value.

The £100 million worth of surplus assets comprised 1,700 properties. The RDA entered into partnership with UK Land Estates with the twin objectives of retaining ONE's interest in the assets and delivering enhanced returns.

Figure 2 shows the overall structure with One NorthEast transferring its surplus assets into the limited partnership vehicle. There was a £75 million redeemable loan note so the retained equity in the structure was £25 million. So One North East with £100m worth of assets transfers them into a limited partnership vehicle. The private sector partner made a £25 million loan to the PPP Limited Partnership to match the equity put in by One NorthEast. The vehicle created thus had £50 million worth of equity that can be geared up with debt. This immediately increases the ability to do more with the estate, to invest, acquire additional assets, develop and to grow the fund. So for

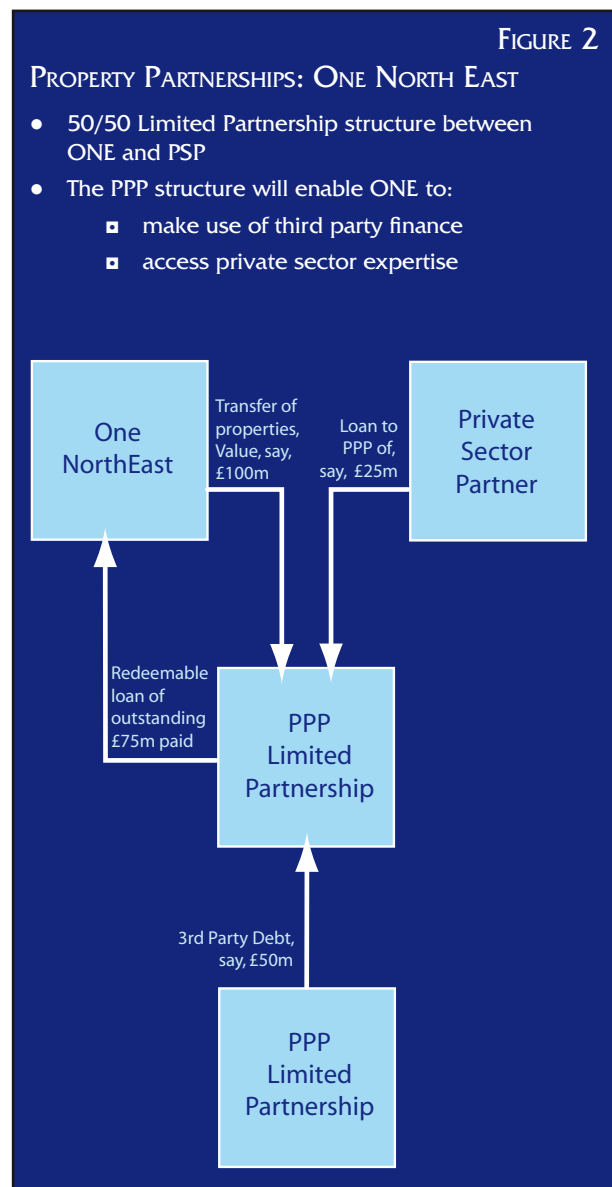


FIGURE 3

PROPERTY PARTNERSHIPS:  
OTHER EXAMPLES?

One NorthEast instead of receiving a once and for all receipt it still retain part of that value as a partner in this corporate vehicle. A number of the RDAs have already replicated this model.

## LOCAL ASSET-BACKED VEHICLES

There are many other forms of partnership structures that could also be researched and replicated. The CLG guidance on city development corporations contains a reference to similar structures to the One NorthEast example. These are called Local Asset-Backed Vehicles, LABVs, suitable for local authorities

with assets who want to make them work harder. Some local authorities suggest they are very good at maximising the value of their assets, others will see that they could do better and there may be structures that would help them with private sector participation and additional private sector funding to leverage the value of those assets. The LABV approach (See Figure 5) is where local authority assets can be put into a structure, again matched with external finance and private sector expertise, to promote either additional regeneration or other forms of property development. As an example, an input of public assets of £90 million and cash of £10 million into the LABV is matched with equity from the private sector to enable the LABV to fund additional land assembly, provide infrastructure, public realm and specific individual development projects. There are no completed deals using this format yet but a number are currently being explored.

FIGURE 4

## LABV POTENTIAL PILOT OPPORTUNITIES

- Northumberland/Newcastle
- Sunderland
- Leeds
- Bradford
- Sheffield
- Hull
- Birmingham
- Salford
- Manchester
- Carlisle

## SOME CONCLUSIONS

In conclusion these are some thoughts on things to look out for if you are thinking of setting up these

kind of structures or doing any kind of partnership deal.

- **Be realistic.**  
is there really the potential for assets/land receipts to contribute to core delivery or major capital investment programme?
- **Be aware of the limitations of “Market Value” and the valuation approach**  
The valuation process looks at the value of an asset at a static point in time. It does not always take into account the future growth of that asset, the true benefits of regeneration and land value uplift that goes with that. So the use of market value in these frameworks and structures has to be viewed with a degree of caution.
- **There must be proper appraisal of risks, and a realistic allowance for private sector returns.**

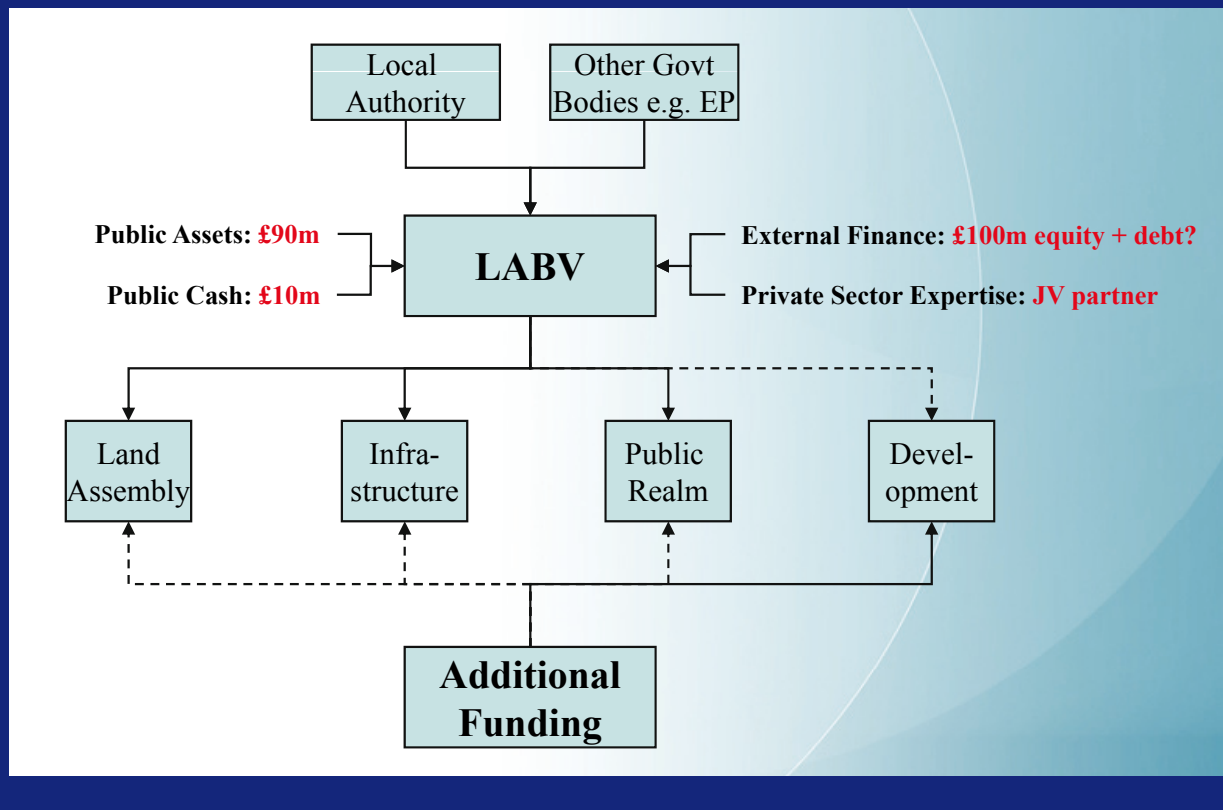
Private sector investors do need to make returns on equity. If it is relatively secure they will be looking for returns of 20% on their equity investment. Now you can read that as a bad thing or a good thing but if that equity or drive for equity growth is benefiting the structure in terms of providing additional incentive to accelerate or maximise returns then that is a good thing providing that the public sector is locked into that share appropriately.

- **Risk adjustment tends to depress value.**

One of the difficulties in setting up these structures is the depressing value of risk analysis. For example in setting up MoDEL, the underwritten land values, the market valuation approach and the risk approach taken by bidders significantly underplayed the real market value of those assets to the extent that about six months to twelve months after we signed the deal, asset values had significantly increased - but not really as there was now a different risk perspective being applied to the way in which the joint venture looked at the assets.

FIGURE 5

## PROPERTY PARTNERSHIPS: LOCAL ASSET-BACKED VEHICLES (LABVs)



- **Recognise uncertainty.**

It is difficult to guarantee either the timing or level of disposal receipts, particularly when subject to the vagaries of planning and political issues.

- **Think about classification, capital control and accounting issues**

Is it a private sector delivery vehicle or a public sector delivery vehicle? Treasury paranoia about breaching the golden capital control rules will always be an issue. Are we creating arm's length vehicles that will just go out and create lots of debt that finds its way back on to the public sector balance sheet?

- **Issues of EU procurement and state aid principles always need to be taken into account.**

Be aware of them and that good legal and financial advisers will help you work through.

I return to where I started. The key is to identify your requirement and match structures to that.

Beware of solutions looking for problems.

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# NOTES

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