



# ASSET

## PARTNERSHIPS FOR CHANGE (OR SCALING THE MOUNTAIN)



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## INTRODUCTION

Throughout the General Election campaign we heard a lot about the deficit and deficit reduction, and about this black hole in government finances. After the events of early May 2010 we now need to focus on solutions. Holes and deficits are not the language of ambition; no one ever said that their life's dream was to climb out of a hole. But people do aspire to climb mountains, so my key theme in this paper is how to scale the mountain that is in front of us. And more specifically what is the role of partnership working in helping us make that climb.

As property professionals, the challenge for us all is how do we: -

- TRANSFORM public services,
- DELIVER efficiencies and
- KEEP regeneration and development projects moving.

This is a sizeable challenge, of Mount Everest proportions. We may not all reach the summit, but we need to start moving, step-by-step up the mountain.

## Agenda

I intend to explore how we climb this mountain through partnership working involving both the public and private sectors. I will consider in more detail the following topics.

- The scale of the challenge; we face a period of major change in public service delivery. We need to face up to that challenge.
- Available equipment; I will review some of the toolkit available and consider whether we have the equipment we need, whether it is fit for purpose and what new equipment is needed.
- Developing partnerships; what should the role of public private partnerships be, and
- What have existing partnerships delivered?
- What have they NOT delivered?

- Do we need new types of partnerships with different ambitions?
- What will new partnerships look like?
- What legal structures will be appropriate?
- And successful partnerships rely on the creation of value to enable the private sector to make a profit. How to create value to make partnerships work.
- Keys to success; what is essential if we are to deliver?

## The Scale of the Challenge

The General Election campaign was something of a phoney war particularly around the scale of the deficit problem, where funding cuts will need to be made and around the implications for public services deemed to be of lower order of priority. Further details will begin to emerge over the next few weeks especially in the Emergency Budget probably due in July. Meanwhile there are lots of different numbers out there, which illustrate the problems that the new government is dealing with.

For example John McCready, Head of the Property Unit at the Shareholder Executive, quoted these in one of his first public interviews. They are striking as the problem is rarely presented so starkly.

"In 2008-09, public expenditure was £622 billion. Tax revenues were £498 billion."

This is like a household with a monthly income of £4000, adding £1000 to its credit card debt each month.

And see this second set of numbers is from the Institute of Fiscal Studies and actually come from the time of the 2009 Budget. But the 2010 figures were not materially different.

THE SCALE OF THE CHALLENGE  

Table 4.1: TME, current spending and investment spending.

	Average annual percentage real increase		
	Total managed expenditure	Current expenditure	Public sector net investment
Labour, plans 2011-12 to 2013-14	-0.0	0.7	-17.5
Labour, spending reviews to date: 1998-00 to 2010-11	4.2	3.9	13.6
Labour, inherited Conservative plans 1997-98 to 1998-99	0.0	-0.1	3.0
Conservatives 1979-80 to 1996-97	1.5	1.7	-5.0



These numbers show the historic nature of the problem. The revenue figures look more palatable than the capital. Over the last decade, revenue expenditure grew by 3.9% per annum in real terms. For the next spending review, Labour was talking of growth of just 0.7% per annum, but this includes debt repayment, increasing benefit payments and so on. Thus revenue support for frontline services will dramatically reduce.

However the picture is much bleaker for capital. Labour was planning to reduce capital spending by 17.5% per annum in real terms over the next spending review period whereas in the previous decade it had grown by 13.6% per annum. To push the mountain analogy, capital spend is about to plunge into a crevasse. Clearly, we will get a new set of numbers in the new Budget.

The Institute for Fiscal Studies (IFS) produced a report just before the Election saying that none of the parties was being honest about the scale of spending cuts required. These next few slides are taken from their report.



The IFS forecasts that departmental spending will have to reduce by between 11 and 15% over the next 4 years. With a Conservative led government, I assume that we will lean towards 15%. This is equivalent to between £43 and £59 billion. Again we can expect it to be towards the upper end.

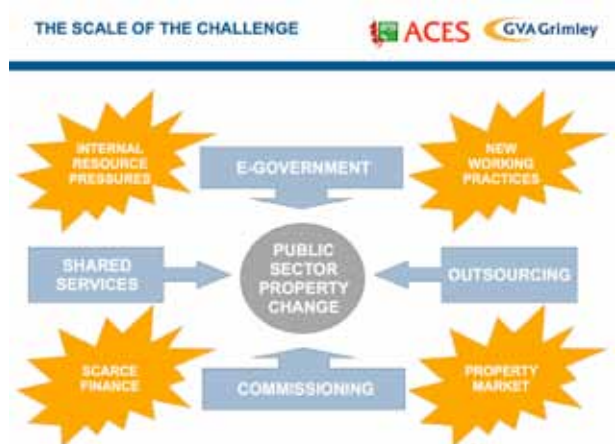


This shows how expenditure has run ahead of the tax take over recent years. The striking thing to me is the steepness of the decline in expenditure forecast. Again, it is historically unprecedented. And as the IFS said, the rate of decline is not really about which party is in government.

Clearly, events are now moving on politically. The General Election campaign discussions were vague about which services would be prioritised but it is clear to me that life will

be tough, even for priority services and very, very tough for those services deemed to be low priority. We will know more in July. Some organisations have already started to prepare for the problem by reducing staffing levels and by cutting jobs. Again, there are various numbers being thrown around.

The Chartered Institute of Personnel and Development (CIPD) has predicted a 10% cut over 5 years. This is equivalent to 500,000 public sector jobs. And there will have to be at least the same reduction in office property holdings, but with the demand for further efficiencies and changes in working practices, I would expect the reduction in office space to be significantly greater than 10%. And these are reductions that will generally be in addition to what you may have been planning anyway through your Asset Management Plans and Office Accommodation Strategies.



So much for services efficiencies and efficiencies from managing property better. There are also expectations about what we deliver. I think it is now accepted that in the relatively good times of the last decade, not enough was done to transform public services and address some of the structural problems. Now the challenge is that structural change is an imperative but the context is very difficult. We will need to change service delivery and to change it radically and, for example, the public sector will stop doing some things. We will also see, as set out in the diagram, an acceleration of the E Government agenda, an acceleration of the outsourcing of significant parts of public service delivery as public sector bodies increasingly become commissioners of services rather than deliverers. And we will see an acceleration in the trend for different public sector bodies to work more closely together, with more joint operation, more sharing of services and more sharing of property.

The implications of these service changes for public sector property are immense and the challenge is so much greater because change needs to be delivered in a very, very hostile environment. For example

- Property teams and resources will themselves be under pressure
- Staff will be asked to work differently and in new ways
- Finance will be difficult, revenue will be a problem, capital will very scarce.

- Property markets are at best sluggish and are likely to remain so for a few years.

Therefore the challenge for ACES members is that you need to

- Facilitate service change
- Create and maintain fit for purpose buildings, to meet statutory and health and safety requirements
- Deliver property efficiencies
- AND you need to sustain regeneration and development activity to meet wider Council objectives.

And you will need to do all of this with no money.

And there are some interesting contradictions. These extensive service delivery changes and new ways of working will simply not be deliverable in current accommodation. The public sector will need to invest in property to achieve change and deliver efficiencies. We need to INVEST to SAVE.

## Available Equipment

I now want to consider the equipment that we have at our disposal to climb the mountain. There was a blizzard of announcements and initiatives before the Election all around public sector efficiencies and saving money from property assets. For example

- Tim Laurence, Head the property asset management profession in government, of OGC, launched PAMCAM, its Property Asset Management Capability Assessment Model.
- John McCready, Head of the Property Unit at the Shareholder Executive, with a remit to develop the government's response to the challenges, has started to raise the prospect of property vehicles as part of the equipment needed going forward.
- DCLG launched Total Place – a whole area approach to public services – that was evolving as a key plank of the Labour government's policy; we need to wait and see how it is taken forward.
- The Smith Report, by Ian R. Smith, on the subject of transforming where and how government works ie about more civil service relocations.
- HM Treasury has talked about developing regional property strategies; these could look at the central government estate in the regions, the quango estates and the local estates.

Much of this is worthy material but to me does not feel to be very joined up; at least not yet. There are lots of new ideas and initiatives but not much of it is tried and tested. I am not sure that we know what is missing. Perhaps pilots for Total Place, Total Assets and Total Capital will help, if these initiatives are to continue. We need more clarity but time is short and the pressure to deliver cashable savings will come very quickly, especially now we have a £6 billion savings target for this year.

## The Role of Partnerships

One of the slogans of the General Election campaign was “we are all in this together”. I think that there is another coalition to be formed, a coalition of interests between the public and private sectors. We have a private development and investment industry that is struggling to create viable projects but which sees particular value in public sector tenants. We have a public sector faced with the many problems as already outlined. There are many common interests if the public and private sectors can come together and find solutions for the public sector efficiency agenda.

Under this heading I intend to examine

- The case for partnering
- Current approaches
- New approaches to partnerships
- Creating value
- Partnership structures including potential property vehicles

## The Case for Partnering

Partnerships are important as the challenge is simply too great for any solo climbing; the public sector cannot deliver on its own. We need to use all of the resources and expertise from across both public and private sectors; we need to access the best talent.

To deliver the required changes we need investment in public sector property. But the public sector will not have any funds and so the public sector desperately needs private investment. And there are investors out there who are searching for good projects in which to put their money. They generally see the public sector as a good bet. But remember everyone is going to be cautious so that it is even more important than ever that we use partnership working to share risks effectively.

## Current Partnerships

There are many examples of partnerships that have been formed over recent years but I am not sure that any have yet shown they can deliver to the efficiency agenda that we now face. There are three common types.

- Service delivery partnerships; for example Liverpool 2020. These are really about service outsourcing. The theory is that outsourcing to the private sector delivers better value for money, but value for money invariably means reducing costs.
- Development or Regeneration Partnerships; a local example would be the Speke Garston Development Company. These partnerships are about delivering physical regeneration to meet economic and community objectives, but are not especially focused on rationalising property assets. Local Asset Backed Vehicles (LABV) would fall into this category. This form of partnership is just about keeping development on track in a difficult market and might be able to play a wider role around efficiencies.

- And there are those partnerships that deliver and then manage new public sector property buildings. This would include the whole range of PFI projects initiatives such as LIFT and BSF.

These partnerships are about cost savings, service change, and leveraging in private expertise and funding. But on reflection, I wonder whether they have often worked against both value for money and efficiency agendas. That is certainly a criticism of PFI and I am hearing more and more negativity about the cost of LIFT projects. Consequently none of the current partnership models really feels adequate to meet the challenge that we now face. If partnerships are to be part of our equipment, they need to deliver more.

## New Approaches to Partnering

The challenge now is to take partnership working to the next level. I think this is essential if we are to deliver the change that is now required. We need partnerships that can

- Meet the challenge of service change
- Meet the challenge to deliver property investment
- And meet the challenge of delivering property efficiencies.

These new partnering methods need to be broadly based but a number of questions will arise.

- How are public sector property assets best used to support these new partnerships?
- Do long-standing public sector attitudes to owning assets need to change?
- How will success be measured?
- And related to measuring success; how will the private sector be rewarded? For example, how is the private sector to be incentivised to reduce service costs year on year? How is the private sector incentivised to manage a property portfolio when the aim is to reduce the size of the portfolio and the costs of managing it year on year?

## Creating Value

Partnerships will only work if the private sector can make a profit. So partnerships must create value. Only then will the private sector engage in a proactive, meaningful and long term way. Currently this is challenging, but there are some positives to consider.

The covenant strength of the public sector does have real value and needs to be fully exploited. The private sector has never been more interested in investing in buildings leased by the public sector.

The value of prime accommodation has actually held up very well. This could create some ironies because the success of partnerships may depend on the public sector making the case to move into well located, grade A, BREEAM excellent buildings, despite general funding constraints. Critically, value needs to be looked at over the long or longer term. My suspicion is that in many current partnerships, the private sector is looking for a relatively short-term exit. This needs to

change but it might need the private sector and their funders to re-visit their current business models.

And finally, the public sector will need to provide incentives to encourage new approaches to partnership working. I believe that central government will need to play a key role and will have to provide funding for the changes that are needed. Also central government will have to be active partners.

Clearly, local authorities need to consider how they use their property assets. This means looking at your most valuable assets not just the rump of your property portfolios. Your value as a tenant is going to be a key driver of value creation.

## Legal Structures

I think that it is no coincidence that in March 2010 the Treasury re-issued guidance about the role of joint ventures between the public and private sectors. They must be expecting greater use of JV approaches. The guidance is comprehensive and considers all of the issues involved in setting up Joint Venture Companies. It is not an exciting read but a document that you should be looking at. It focuses on the three main options for Joint Venture companies:

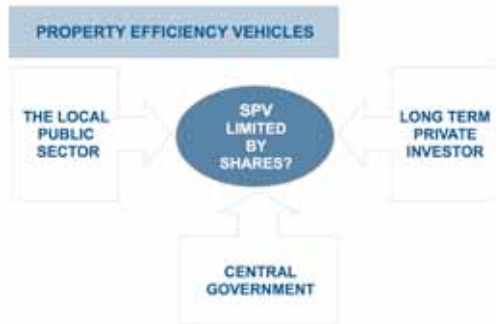
- Companies limited by shares
- Limited partnerships
- Limited liability partnerships

I will not go into the full details of each, as that needs to be left to the lawyers. However the guidance discusses how to choose the right option for you and the pros and cons of each approach.

The Treasury Guidance, Joint Ventures, will confirm that creating a JV can be a long process and much effort is needed even before the JV partner comes on board. The guidance identifies a five-stage process.

- Initial planning
- Looking at options
- Creating the business case
- Selecting the actual partner
- The on-going management of the JV to make it successful

In my experience, the management stage is often neglected but Joint Ventures do not run themselves. Selection of the partner will probably involve a Competitive Dialogue process. If you have been through it you will know that Competitive Dialogue can be a complex, bureaucratic and resource intensive process in its own right. We need to get better at creating these vehicles, share best practice and expertise. And we need to do it quickly.



I mentioned above the potential role of property vehicles as part of the equipment available. We wait to hear more from the new government but I expect that these will need to be mixed in nature and operate at different geographic levels, national, regional and local. We need to be careful not to make them too complex and extensive.

There is a contradiction. We need them to be in place soon but they will take time to set up.

These vehicles cannot just be about property. They have to have delivering efficiencies at the core of their mission. I would call them efficiency vehicles or at least property efficiency vehicles. They will need critical mass, so the local partner would ideally be more than just a single local authority. More than one local authority may need to come together. Or local authorities may need to link with PCTs, the Police and others. This will create a further set of challenges in being able to work effectively across organisations.

Private sector partners will need to take a long-term view and need to be more ambitious. Success is not just about winning a building contract or simply delivering the same services as before just more cheaply. The private sector needs to take a lead role in delivering efficiencies and will need to be rewarded for achieving efficiencies. As mentioned already I also believe that central government will have to play a direct role involving, amongst other things, cash to support partnership business cases. Central government money will be critical to the Invest to Save agenda.

We have LIFT projects and Local Education Partnerships where central government is a shareholder. So we have a model. But Central Government needs to become more proactive in new partnerships and needs to be flexible in how it provides financial support responding to individual business plans.

## Case Study, Calderdale and Huddersfield NHS Foundation Trust

I want to share a limited example with you. This is a practical approach that could be delivered relatively quickly. It could be a route for others to follow. This Trust is currently seeking

to establish a Joint Venture Company with the private sector. Its overall aim is to provide a more efficient estate which better supports service delivery.

The Trust owns two major assets largely surplus to requirements. These assets will be put into the JV. Private sector partner will match the value of the assets, as it is a 50:50 Joint Venture.

ST LUKES HOSPITAL



ACRE MILL



The first surplus to requirements asset is St Luke's Hospital site. This area is 23 acres, there is potential for mixed use, perhaps mainly residential with some local shopping provision. It is a valuable site but less so in current market. The JV will hold the land and develop it out or sell on as appropriate and as market conditions dictate. The uplift in value over time can be captured within the JV Company.

The Acre Mill site has an area of 8 acres and is situated opposite the Huddersfield Royal Infirmary site. Acre Mill including a Listed building. The JV will take a long lease of the site. The JV will refurbish the listed building as office accommodation and this will be leased by the Trust. The new space will accommodate office uses from the Huddersfield Royal Infirmary across the road. The space freed up at the main hospital site will help with the re-modelling and improvement of clinical accommodation.

## The Benefits

This is one live example of how partnership working is being developed to use property assets in a creative way to support property rationalisation, efficiency and service improvement.

The benefits for the Trust are that it can take a long-term view on value. There would be a reduced receipt if the Trust had to sell in short term. The partnership structure also gives the Trust financial flexibility. It can decide how and when to take a return. The approach also brings in new private money. This is important, as the Trust literally has no money to support property disposals or site redevelopment.

The whole approach is aimed to help the rationalisation and efficiency process. The company structure aims to give flexibility. The JV can expand and develop its role over time and support the wider health economy in Kirklees and Calderdale.

## The Keys to Success

I have discussed the need for partnership, given the challenges faced. And how partnership working needs to evolve but what will make partnerships work? What are the success factors?

There can be no room for silo mentalities, ie narrow thinking. A joined up approach within organisations and between service areas is needed. We especially need a joined up approach between finance functions and property functions and a joined up approach between different professions. And of course we need a joined up approach between public and private sectors. Each party will need a better understanding of the needs of the other.

Secondly we need to develop better strategic visions for both service delivery and for property. We need quality long-term thinking.

We need strong and robust business cases. I think that we lost sight of the importance of the business case when money was relatively generous. In a challenging funding world, we will need to prioritise and the quality of the business case should be the key driver in choosing priorities.

We need pro-active partnerships that create value and need to accept the challenge of change.

## Conclusions

Even if we are starting to edge forward we clearly do not have all of the answers, yet.

Remember that partnerships

- May not be right for everyone.
- They are an historic challenge
- We need pioneers
- We need more ambition
- Government will have to do more to move the process along, despite everything else on their agenda.

And critically for ACES members, and public sector colleagues, it is essential that public sector property professionals take a central role.

Finally I think that the biggest challenge remains that of bringing service needs and property strategies together.

If I have one fear, it is that the service managers will deliver their changes and climb their mountain. And finance managers will deliver their changes and climb their own mountain. And property managers will deliver their changes and climb their mountain. But each party will actually have climbed a different mountain.

John Keyes  
Director, DTZ

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