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UNECE International PPP

Centre of Excellence

REPORT

FEASIBILITY OF USING PPPs FOR THE RENOVATION OF THE PALAIS DES NATIONS

*prepared by the UNECE Secretariat**

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**The report was prepared by the secretariat under the auspices of the Bureau of the UNECE Team of Specialists on PPPs (TOS PPP) and its co-Chairpersons, with the technical support of an ad hoc expert task force consisting of TOS PPP members.*

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BACKGROUND AND PURPOSE

i. The United Nations building in Geneva - the Palais des Nations - is in a dire state of disrepair and urgently needs funding for its renovation. Many Member States are facing severe economic problems and are reluctant to provide funding even for such a magnificent and historical building as the Palais des Nations. Given the parlous economic situation, in which many donor countries to the UN find themselves, the General Assembly took the step of asking the Secretary-General to explore innovative financial mechanisms, including public private partnership (PPP), to see whether such alternative funding mechanisms could be used in undertaking this urgent task of renovation, while achieving optimal value for money.

ii. PPP is an alternative financing source and method which uses private sector capacity and resources in order to deliver public sector infrastructure and services according to defined functional specifications and performance objective. Beyond developing the infrastructure (design and build) and providing finance, private sector companies can also operate and maintain the public facility.

iii. The UNECE Team of Specialists on Public-Private Partnerships (TOS PPP) was asked to advise the United Nations Office at Geneva (UNOG) on PPP options for the renovation of the Palais. TOS PPP has long standing expertise in the UN system on PPP and has provided UNOG with studies and organised two PPP seminars devoted to the topic, as well as a visit to London to see, at first-hand, two fully operational renovation projects that have been done through PPPs. The UNECE Secretariat, working under the UNECE TOS PPP, has prepared this report based on its expertise and on the work undertaken for UNOG in the last few months. It also contains findings from a study undertaken by Toyo University in Japan[1].

iv. The report consists of the following sections:

- 'Pros' and 'Cons' of adopting a PPP model
- Exploring the most suitable PPP model for the Palais des Nations
- Is it feasible to employ PPP in the Palais des Nations?
- How the risks in such a project might be allocated and mitigated
- Conclusions and recommendations

[1] A study was conducted under the auspices of the UNECE TOS PPP that was based on research visits to Geneva in April 2013.

EXECUTIVE SUMMARY

Background

The Team of Specialists on Public-Private Partnerships (TOS PPP) of the United Nations Economic Commission for Europe (UNECE), because of its expertise in PPPs, its independence as an intergovernmental UN body and its global spread covering both developed and developing countries, has been asked to provide the United Nations Office at Geneva (UNOG) with advice on whether to use a PPP model for the renovation of the Palais des Nations (PdN) in Geneva. It provides the following report and recommendations, including several that have been taken from a study which has been undertaken in parallel under its auspices, by Toyo University, Tokyo, Japan. The latter is also made available to UNOG by the UNECE TOS PPP.

'Pros' and 'cons' of using a PPP

The report begins by analysing a number of case studies of PPPs in the building sector – including the case of the Capital Master Plan of the renovation of United Nations Headquarters in New York - from which it sets out a number of factors that favour selecting a PPP model for the renovation rather than pursuing a traditional procurement approach:

- Faster project completion, reduced delays and cost overruns.
- Whole ‘life’ costing in the PPP that optimizes the design and quality of the construction in order to minimize the maintenance and life cycle investment costs, thus lowering the overall cost over the lifetime of the asset.
- Provides for transformational change moving from the “build and walk away, neglect, renovate” model of public asset management, to a focus on added value.

On the other side of the balance are the following:

- Every PPP involves allocation of risks between the partners and UNOG will pay market price for transferring those risks to the private sector.
- UNOG representatives must have specialised personnel (or be able to acquire the required skills).

Exploring the most suitable PPP model for the Palais des Nations

Having examined some of the advantages and disadvantages of PPPs, the report then identifies the most suitable model of PPP for the PdN. The model proposed is a ‘Design, Build, Finance, Maintain’ (DBFM) model[2] for the renovation. Typically, a private sector consortium forms a special company called a ‘special purpose vehicle’ (SPV) to design, build, finance and maintain the asset for a contracted period (usually 20 or 30 years). The consortium is usually made up of a building specialist, a maintenance company, lender(s) and, if applicable, specialized service providers.

As a supplement it is also proposed that alongside the DBFM is created a separate real estate project that will make use of the PdN real property to raise revenues for the renovation. Together this makes a type of ‘hybrid’ PPP scheme. If the expected revenues from the real estate project (using the prime real estate inside the PdN for example an hotel and accommodation for UN staff and delegations) can be used in meeting the costs or at least a substantial percentage of the renovation costs, a 'win- win' situation for all stakeholders could indeed be envisaged.

[2] Within the term ‘Maintain’ it is also understood that certain elements of operations, such as cleaning and catering, could be transferred to the private entity.

The clear advantage of a DBFM for UNOG is that the latter will no longer have to endure the challenges of raising funding for maintenance. This can then allow it to focus on the strategic aspects of the management and implementation of the PdN project. The DBFM is moreover attractive because of its comprehensive nature, dealing with all aspects in the project and offers a ‘sustainable ‘solution to the PdN, provided, of course it is feasible to do a PPP in the unique circumstances of the PdN.

Feasibility to employ PPP in the Palais des Nations

With respect to its feasibility, from a legal point of view, there are several important issues from both the UN’s side and from a prospective private partner. These concern *inter alia* the UN’s immunities and privileges and whether UNOG can use negotiation in a prospective PPP procurement which is a standard way of obtaining significant benefits from the market. There is, it appears, however already considerable experience of the UN working with the private sector. Based on such precedent experience, a PPP can thus be considered feasible. Checking, however, with representatives from the Office for Legal Affairs will be required (and the holding of a seminar on these aspects in New York could be proposed for this task).

With regard to the actual feasibility and whether there is a business case for doing a PPP, the report makes a preliminary analysis based on the use of a five case framework (financial, strategic, etc.) that is used in preliminary assessments for all PPPs in some countries. There are mainly positive assessments arising from the analysis of each of the cases. However, over the question of the management capability of UNOG to undertake all the requirements for doing a PPP, consideration will need to be given to this aspect. In addition, a more detailed analysis will need to be conducted to determine conclusively whether there is an economic case for PPP.

How the risks in such a project might be apportioned

PPPs are about the identification and allocation of risks between the parties. PPP provides a considerable benefit in that the operational and project execution risk is transferred totally to the private sector leaving the public side on a win–win situation. However, risk transfer comes at a cost as the private sector will only provide the ‘service’ to the public sector at a price. Most PPPs are successful if there is a balanced sharing between the two partners, not where the public entity attempts to transfer all the risks to the private sector. The reality is that PPP is a negotiation; the risks are thereafter allocated and placed into the contract between the two entities.

Conclusions and recommendations

The report recommends to UNOG that the next step is for the General Assembly to authorise a feasibility study to be carried out by the United Nations, thereby providing the necessary data by which the Member States can determine whether the PPP option provides better value for money than the traditional form of procurement.

The initial challenge for UNOG is that bringing the idea into reality will require new capacity, UNOG also because of the tremendous goodwill of its Member States can rely on top level expertise on PPP from the governments from both developed and developing countries, who are also members of the UNECE International PPP Centre of Excellence. In terms of the steps for the development of PPP inside the PdN, the following three additional recommendations are made:

(i) An event may be held in New York to discuss PPP options and whether they are compatible with UN rules and regulations;

(ii) A component of the feasibility study, i.e. a Public Sector Comparator (PSC) could be carried out under the auspices of the UNECE TOS PPP; and

(iii) Studies and materials collected for providing advice to UNOG should be made available to Member States interested in using PPP models for renovation of their public buildings.

SECTION 1
'PROS' AND 'CONS' OF
ADOPTING A PPP MODEL

1.1. PPP is often considered as an innovative model. Yet, this mechanism in fact has been around for many years. Many developed countries have significant PPP programmes that are successfully transforming their infrastructures and delivering public services (e.g. schools, hospitals, roads, ports and so on). PPP has become mainstream[3]. To take just one example, Canada now requires that any infrastructure project that is valued at CAN$100 million or above, and seeking federal funding, must be screened for its PPP, or its P3-ability (in Canadian parlance)[4]. Developed countries, like Canada, employ PPP for reasons of Value for Money, rather than adopting the traditional form of procurement.

1.2. Many developing countries (India, Mexico, Brazil, the Philippines, etc.) also have significant PPP programmes. These have emerged over the last decade. Unlike developed countries, these countries often lack the public sector alternative, and the PPP model has been selected because of a lack of financial, managerial and technological capacity in their countries. Common to both groups of countries though is a general dissatisfaction with the performance of the state as an exclusive deliverer of public services.

1.3. As it concerns PPP in building construction and renovation, there is also a considerable number of public buildings which were built and/or renovated through use of the PPP model:

- HM Treasury (UK) (completed in 2002);
- The Ministry of Defence (UK) (completed in 2004);
- Alberta Schools Alternative Procurement III (Canada) (expected to be completed in 2014);
- Ministry of Finance (The Netherlands) (completed in 2008);
- Union Station, Washington, DC (U.S.) (completed in 1988);
- Cantonal Civic Center Burgdorf (Switzerland) (completed in 2012);
- Ministry of Defence (France) (expected to be completed in 2015);
- Four Tuscan Hospitals PPP (Italy) (expected to be completed in 2013);
- Halton Building Schools for the Future (UK) (expected to be completed in 2013);
- Humber River Regional Hospital (Canada) (expected to be completed in 2015);
- Paris Court of Justice (France) (expected to be completed in mid 2017).
- National Institute for Sport and Performance (France) (expected to be completed in 2014)

1.4. These projects cover a number of years and countries and accordingly several key lessons have emerged, which show that while PPPs can provide some significant benefits (Pros), there are some risks (Cons) that can arise with PPPs.

PROS

PROS: Delivery within budget and on time

There is a tendency for renovation and new building accommodation projects procured through traditional procurement to suffer mild, critical, or even severe budget and time overruns. Indeed, as seen in *Box 1*, the bigger the project, the more likely for these undesirable eventualities to take place. A case in point is the Capital Master Plan project, i.e. the renovation

[3] PPPs still however represents a small proportion of government expenditure on infrastructure in the leading PPP countries.
[4] A project deemed as P3-able must go ahead as a P3 for federal funding to be provided.

of the United Nations Headquarters (UNHQ) complex. Done through a traditional procurement, the project has suffered from considerable budget overruns and delays. Indeed, if the Palais des Nations follows the traditional procurement route and repeats this same pattern, then the cost of the renovation in 2018 will not be CHF 618 million[5], but could conceivably be almost 3 times that amount, in the order of almost CHF 1.8 billion (see Box 2).

1.5.

Box 1. Recent traditionally procured projects with substantial cost and time overruns

The Berlin-Brandenburg Airport (BER). Approved in 2006 with cost estimates of around €2 billion, with a planned opening date of October 2011, the project has been delayed four times, and in the end, the airport is estimated to cost at least €4.3 billion. Meanwhile, companies like Air Berlin, Germany's second biggest airline, are suing for lost revenues.

Hamburg's Elbphilharmonie Concert Hall. A new symphony hall for €241 million was agreed in 2007 and planned to open in 2010. At the end of 2012 the new price tag had risen to €575 million with a projected opening date in 2017.

Jubilee Line Extension, London Underground. The project was two years late and £1.4 billion over budget. According to the report prepared by Arup, the public sector Jubilee Line Extension Project team did not have strong enough management needed for the project.

Source: SPIEGEL ONLINE 2013, and PWC report on 'Delivering the PPP promise: A review of PPP issues and activity'

1.6. A renovation employing a PPP approach would be an ideal way to avoid this problem arising in UNOG. Every project mentioned in the above list of PPP renovations (see 1.3) was successfully delivered on time and within budget, including major renovations done in large government buildings, such as the HM Treasury and the Ministry of Defence Buildings in London. Virtually all available studies point in the same direction (*see Box 3*). One of the principal factors which explains this divergence in performance between the PPP and traditionally procured projects is that payments in PPPs are aligned to the delivery of project objectives, success receives a reward, whereas failure to meet objectives lead to severe penalties.

Box 2. Renovation of UN New York through traditional procurement

Discussion on the renovation of the UNHQ started in 1998, which was initially designed as a six-year project. The budget in 2004 was estimated in the region of USD 964 million. In 2007 the General Assembly approved a budget of USD 1,876.7 million for the project. It is expected that the total cost will now be around USD 2.15 billion. The project suffered from considerable cost overruns. In its resolution the General Assembly, for example, states that it '*notes with deep concern the drastic increase in the cost overrun of the project*'.

Source: Capital Master Plan, http://www.un.org/wcm/content/site/cmp/

Box 3. PPP versus traditional procurement in Australia

"PPPs demonstrate clearly superior cost efficiency over traditional procurement, which can range from 30.8% when measured from project inception, to 11.4% when measured from contractual commitment to the final outcome. On a contracted $4.9 billion of PPP projects the net cost overrun was only $58 million—not statistically different from zero. For $4.5 billion of traditional procurement projects, the net cost overrun amounted to $673 million".

Source: Comparative performance of PPPs and traditional procurement in Australia, Construction Management and Economics, Vol. 28, Issue 4, 2010

[5] Strategic Heritage Plan of the United Nations Office at Geneva. Report of the Secretary-General. Sixty-sixth session. Item 143 of the provisional agenda. Proposed programme budget for the biennium 2012-2013. Distr.: 8 August 2011.

PROS: "Whole Life" Costing

1.7. Any project needing to be undertaken in the current financial climate must prove that the path it is proposing provides Member States with the best value for their money. The UN is in no way different. Can a PPP to renovate the Palais be proved to be best value for the funds expended?

1.8. Because the cost of the private sector borrowing from capital markets is more expensive than public borrowing backed by sovereign guarantees, some parties believe that PPPs are more expensive than traditional procurement. But if one takes the *whole life* cost of the project into account, a different conclusion emerges. This life cycle approach will optimize the design and quality of the construction in order to minimize the maintenance and life cycle investment costs, thus lowering the overall cost over the lifetime of the asset. Over the whole project life, PPP frequently provides the best value, even though the initial financing costs may be higher.

PROS: Innovation

1.9. The Palais des Nations is a building that is in great need of modernization. The building was constructed in a different era and the work space needs to be transformed to make it more efficient, cost effective and "fit for purpose" as a facility for the UN. In most of the projects cited above, PPP introduced modern techniques in facility management, such as open planning and the concept of 'work stations' and allowed creativity to deliver innovative high quality services to the end-users. Applied to the UN, this would allow the building not only to become more energy efficient, but also to create more working space for UN staff, and to enable those working outside the Palais to be re-accommodated within the renovated building thereby achieving significant reductions in rental/lease expenses, reduced travel time for meetings, and increased efficiency.

PROS: Transformational change

1.10. Delivering the project as a PPP could considerably alter the aims, scope and form of the Strategic Heritage Plan (SHP), from a renovation to an ambitious and transformative project. These transformations based on the above mentioned case studies could include:

- the commercialization of unused or underused land and real estate assets;
- a clearer focus on the provision of services to users;
- a cultural change away from the "build and walk away, neglect, renovate" model of public asset management, to a model that maintains the building over its lifetime;
- a cultural change where strategic decisions are made considering *whole life* costs, not just construction costs and removing many perverse incentives in the use and management of the building (*see Box 4*).

Box 4. Maintenance and life cycle and initial capital cost

The construction cost of a government accommodation project such as SHP is typically 1/30th of the asset's entire life time costs and therefore any investment decision by Member States regarding SHP should clearly focus on delivering a cost effective solution that focuses on the major cause of cost, (maintenance and lifecycle) and not become wrongly focussed on the initial capital cost, which is a relatively insignificant amount, in comparison with the *whole life* costs of the asset. Traditional procurement cannot deliver a *whole life* solution.

Source: Leo McKenna, co-Chairperson, TOS PPP

PROS: Increasing the capacity of UNOG

1.11. UNOG has very limited staff resources. Under the DBFM (Design, Build, Finance and Maintain model discussed in Section 2 below) arrangements a project team would be created to work alongside the existing management under UNOG and thereby create more capacity to successfully deliver the project and maintain the asset.

1.12. Furthermore, PPP facilitates workload reduction. The DBFM approach, for example, provides a single point of contact and responsibility for the Procuring Authority, which enables timely and efficient decision-making, benefiting the overall project schedule and which focuses the role of the Procuring Authority on its core task, namely overseeing the implementation of the project plan. In this way the Procuring Authority can focus on defining and tracking the targets to be achieved, leaving it up to the private sector operator to determine the resources and innovations to be employed.

CONS

1.13. Of course, not all share the view that PPP can address all issues and problems that regularly occur in traditional public procurement. Accordingly the other side of the balance needs to be assessed in evaluating whether PPP is the right approach for the Palais des Nations.

CONS: Risk transfer to private party and higher costs

1.14. One criticism is that PPP transfers risks to the private entity, and the latter accepts these but charges an excessive premium to the public partner in the form of high availability payments. Risk transfer may in theory be a benefit to the public sector. However, in practice, risk cannot be transferred to private companies for nothing. Companies will always require payment to accept extra risks as private sector investor activity is based on the concept of “risk and return”; one should certainly not expect private sector investors and firms to assume a major risk without proper reward mechanisms. The more risk that is transferred to the private sector, the more cost will be charged to the public sector. Therefore, it is essential that the public sector specifies its needs clearly and fully and should ensure there is no “scope creep” during procurement.

CONS: PPP experience in UNOG/ Procuring Authority

1.15. The United Nations as an organization has never undertaken a procurement through a PPP, although UN agencies such as UNDP and UNECE regularly promote and/or facilitate Member States’ efforts to perform PPP procurements. These case studies (mentioned in 1.3. above) show that problems develop when the procuring authority has insufficient experience of PPP. Thus it may be unwise for UNOG to undertake such an important and a high visibility project on the renovation of the Palais des Nations, without employing the necessary skills, through UNECE TOS PPP.

Conclusion

1.16. Based on the above cases there are both pros and cons to UNOG employing PPP in the renovation of the Palais des Nations. On the plus side PPP can provide:

- Delivery within budget and on time;
- *Whole Life* project costing;
- Innovative and high quality solutions;
- Increased UNOG efficiency and capacity;
- Lower asset management costs; and
- Removal of problematic interface issues between separate build and maintenance contracts

On the other side of the balance – the CONs – the PPP option can be problematic because of the following:

- Appropriate risk apportionment and costs; and
- Lack of PPP experience of the Procuring Authority

SECTION 2
EXPLORING SUITABLE PPP OPTIONS FOR THE PALAIS

2.1. Having explored some of the ‘pros’ and ‘cons’ in adopting the PPP model, this section analyses the model that might be the most suitable in order to maximise the benefits and lower the risks associated with PPP. It also briefly reviews various models, suggests one model and then concludes with some of the requirements implementing such a model will place on UNOG:

- PPP models
- A DBFM and a project that uses UN’s real estate
- Tasks that will have to be performed

PPP Models

2.2. There are many different PPP models that have been successfully implemented and are operational in many countries. These include the following:

(i) Classical type PPP Model

The classical type accommodation models concentrate on keeping control of the project (time and budget) and delivering a service to the users. These models are widely used, and are generally referred to as DBFM, BOT etc. (a list of PPP models is presented in Annex 1). Both the public and the private sectors have a lot of experience with employing such models. When designed to international standards, they are a good option to secure financing and to encourage competition in the bidding process.

(ii) Sale and Lease back schemes

The next variant of the PPP combines again the strong points in the classical PPPs but with a financing arrangement that is more sophisticated. In these cases, the land and buildings are sold or leased to a private party and leased back. The amount of financing available with the sale/leaseback (or lease/leaseback, which may be more appropriate in this case) structure would depend on a detailed analysis of the costs involved (renovation, energy efficiency measures, etc.) plus any other capitalised expenses along the way (feasibility studies and other similar costs for example). The advantages are that the money raised can cover 100 per cent of the total cost of the project. The downside concerns the acceptability/perception that the UN is transferring (even temporary) ownership to another entity, e.g. a lessor. The scheme has worked successfully in US and in Spain.

(iii) PPP Models with revenue raising features

The models stated above can be combined with additional revenue income. This is referred to as *Third Party Income* (TPI). This is often done in government buildings, and most common are paid parking; housing other organisations; some retail and commercial activities like coffee outlets, restaurants; dry cleaner and so on. These latter models are familiar to everyone; such as in train stations or airports and within the PdN where the bank, travel and catering facilities and others are outsourced.

A full analysis of all the available options, the ‘pros’ and ‘cons’ is found in Annex 1 prepared as a part of the Toyo University study.

A DBFM and a real estate project using UNOG's real property assets

2.3. The main task of the UNECE TOS PPP is to help UNOG with selecting the most suitable model of PPP for UNOG. Clearly, the experts saw:

(i) a building in dire disrepair: that is getting progressively worse, whose design and service was fitted for a different era - inefficient energy use, environmental concerns, lack of proper accommodation of disabled people inside the building etc.

(ii) a need for a project that does not 'cover over the cracks', but can transform the Palais into a building 'fit for purpose' for the 21st century.

(iii) Member States are by no means ready to, or in a position to, fund the renovation and contribute to the initial cost estimates and are anxious to avoid the cost overruns seen in the CMP in New York.

(iv) very poor facilities outside Geneva for housing delegates in short and long term stays to attend UN meetings[6] and the fact that existing land space at the PdN is an underutilised asset, because of the high demand, and has considerable income generating potential.

2.4. On this basis, the following PPP hybrid model is suggested:

- **DBFM PPP to renovate the Palais; and separately**
- **A real estate project that uses UN real estate assets to generate capital for the renovation**

DBFM

2.5. Under a DBFM model, the design, build, financing and management of the asset are delivered by a single private consortium. This is a comprehensive contract usually running for a period ranging from 20 to 50 years. The private sector has performance management incentives to undertake very high quality capital investments during the infrastructure construction phase, in order to prepare for the operations phase and to optimize it.

2.6. In terms of the financing of the project, this part of the project will be given to the consortium's Special Purpose Vehicle (SPV) company created to deliver and maintain the asset. UNOG would pay the SPV in the form of availability payments based on the performance of the maintenance and for the delivery of any services contained in the contract. The project would thus be financed using private capital (equity and debt) until the completion of the construction and the Procuring Authority would not directly take risk by investing money into the project before the construction phase has been satisfactorily completed.

Payment to the SPV

Under the above-mentioned contractual scheme, the Procuring Authority would commit to make periodic payments (the 'Unitary Payments', usually on a quarterly or semi-annual basis) to the SPV during the operation phase of the project. The Unitary Payments would allow the SPV to cover its operation, routine maintenance and heavy maintenance (lifecycle) costs, reimburse the senior funding over the duration of the contract (or a shorter period depending on structuring considerations and maximum tenors available on the financial markets at that time) and to remunerate the equity of the investors.

[6] In busy periods many have to be housed in Lausanne and Annecy.

2.7. This model is desirable for the following reasons:

- DBFM implies a *whole life* cost approach whereby the most efficient technical solutions will be provided through the whole life cycle in order to achieve the best design and the quality of the construction, thereby, minimising maintenance cost and bringing down to a lower overall level project costs;
- It covers all the stages of the project and benefits from synergies between the different phases;
- By giving incentives to the constructor who will be the operator as well, the constructor will have the best possible incentive to introduce the maximum efficiencies and innovations into the whole project; and
- UNOG will have a single point of contact and responsibility, which ensures better performance management and enables more efficient and timely decision making within the project.

Real Estate Project

2.8. Of course, the size of the unitary payments or availability payments will be important. Following the proposals made by the study of Toyo University, it is suggested to use the underutilized real estate assets to generate an income to bring these periodic payments to acceptable levels. These services would be for the exclusive benefit of the Member States, the UN and the UN specialised agencies and involve hotel accommodation, serviced apartments and some condominiums.

2.9. There are many details here not least the relationship between the renovation and the income streams generated by such real estate development, but until a proper Feasibility Study is done, it is advised that the two projects be kept <u>separate</u>. As to the figures and the amount of funding that could be raised to meet a still to be determined percentage share of the total renovation cost, for the moment, it can be said, the initial figures that are presented in the Toyo study look promising. The Feasibility Study will, of course, greatly refine these initial projections.

Tasks that will have to be performed

2.10. To implement these proposals UNOG's tasks and role will change. In the short term pre-PPP, UNOG will need to undertake the following:

- Feasibility study (and associated tasks);
- Risk identification and allocation (see Section 4); and
- Procurement.

A sequenced approach from feasibility to contractual close is elicited in Box 5.

Box 5. Sequence of tasks required for UNOG

1. Feasibility Study
2. Outline Business Case, including the Public Sector Comparator;
3. Advertisement;
4. Pre-Qualification Questionnaire;
5. Long list of bidders;
6. Short list of bidders;
7. Best and Final Offer (a second stage bid in a public procurement competition);
8. Final Business Case;
9. Fiscal Commitments;
10. Contractual Close.

SECTION 3
IS IT FEASIBLE TO EMPLOY A PPP SOLUTION IN THE PALAIS?

3.1. This section looks at the question of the feasibility of employing PPP in the Palais in terms of:
- whether it is feasible to deliver a PPP solution from a legal perspective; and
- whether there is a case for adopting PPP for SHP.

LEGAL PERSPECTIVE

3.2. There are in fact two different perspectives which are relevant here:

- The perspective of the United Nations
- The perspective of the private sector

The perspective of the United Nations

3.3. There are two specific questions:

(i) Can the United Nations enter into a PPP with the private sector?

Under Article 105 of the United Nations Charter, the UN enjoys special privileges and immunities and is therefore not subject to the laws of its Member States. But pursuant to Article 104 of the Charter, the United Nations has full juridical personality and can therefore enter into any kind of contractual agreement, including with the private sector, such as a PPP agreement. Indeed, the United Nations has over the years developed a *modus operandi* to contract with the private sector for a myriad of goods and services. In light of a wealth of preceding and similar experiences, including the outsourcing of part of its building maintenance services, there are *prima facie*, no PPP-specific legal impediments that stem from the privileges and immunities enjoyed by the United Nations, for the UN to enter into a PPP.

(ii) Do UN rules on procurement allow UNOG to negotiate with prospective private partners in a 'competitive dialogue'?

The 'competitive dialogue' can drive competition amongst three short-listed bidders into various rounds so that the Procuring Authority obtains the best possible outcome. However, the currently applicable United Nations procurement methods are not particularly suitable for such type of negotiation. However there is Rule 105.16(a) of the United Nations procurement rules which provides exceptions to the use of formal methods of solicitation and authorises the Under-Secretary General for Management to deviate from the United Nations procurement rules for a particular type of procurement in the best interest of the Organization and for the benefits discussed in Section 1 above (on time, to budget, innovation and efficiency by the private sector over the whole life cycle, etc.).

Two options are, therefore, proposed to mitigate the rigidity of the United Nations procurement rules when it comes to a PPP agreement:

(a) By virtue of Rule 105.16(a) of the United Nations procurement rules, the USG for Management, and/or other authorized United Nations senior staff members (e.g. Controller or Assistant Secretary-General, Central Support Services), set aside some sections of the United Nations procurement rules for PPP arrangements in the context of the renovation of the Palais des Nations; and/or

(b) A General Assembly resolution to that effect.

The perspective of the private sector/lenders

3.4. There are three questions that the private sector will typically ask:

(i) What is the applicable law in the United Nations for the PPP?

Although the United Nations cannot submit to national laws, this does not mean that the United Nations does not have a body of norms which together with *lex mercatoria* constitute what might be referred to as the 'applicable law'. The Organization's procurement rules and regulations, as well as general principles of law, should apply as the basic law of the parties for the renovation of the Palais des Nations irrespective of the type of funding and contractual scheme (PPP or traditional procurement).

At the same time the United Nations is aware of existing Swiss construction, security, fire hazard, energy sustainability and other standards, which the private sector needs to also be familiar with. While there is no strict *de jure* obligation to comply with these standards, for practical reasons, UNOG will apply these standards in the contract for the renovation of the Palais des Nations. Practice has demonstrated that the private sector is comfortable working within the United Nations body of norms, and therefore the applicable law should not pose a barrier to private sector participation in a PPP scheme for the renovation of the Palais des Nations.

(ii) In case of a dispute does the private partner have any power to submit the United Nations to international arbitration in view of the UN's privileges and immunities?

As for international arbitration, it has to be pointed out that standard dispute settlement and arbitration clauses are typically included in contracts concluded between the United Nations and service providers, including submission to UNCITRAL arbitration rules. Other arbitration or mediation clauses are also possible. These dispute settlement and arbitration mechanisms offer the necessary assurances and confidence to lenders and investors to participate in a PPP project for the renovation of the Palais des Nations.

(iii) What guarantees and security interests do lenders have in case of non-payment by the UN partner?

Generally, lenders to PPP projects seek guarantees and/or security interests from the contracting authorities or its public backers as a prerequisite to their involvement in the project. Legally the UN cannot give such securities. However in the DBFM PPP model that has been proposed, the UN would not be applying for a loan from a bank. Rather it is the SPV which does this. It will therefore be the SPV who will have a set of securities where the lenders will have recourse to, in case of non-payment. These include a full range of assets and shares in the SPV and its cash flow (meaning its availability payments).

In the unlikely event of foreclosure, even in national PPP projects, such a security in the assets is more a fiction than a reality. How can a bank foreclose on a highway or a prison? And despite this, banks still lend to these projects. So this legal issue is not so critical as to deter the banks from lending to such a project. Moreover, if a government or a group of governments would guarantee the payments directly to the lenders, or if the General Assembly were to authorise the long term financing, this would of course make the money to the project significantly cheaper.

BUSINESS CASE

3.5. To show that a PPP is feasible relative to the alternative traditional public procurement, a common framework, begun in the UK and used by other countries as well, consists of the so called Five Case Model: The five elements of the model explore whether:

- the project is strategically justified, i.e. there is a case for change (the Strategic Case);
- the project provides Value for Money (the Economic Case);
- the project is affordable (the Financial Case);
- the project is commercially viable or bankable (the Commercial Case);
- the procuring authority has the right resources, skills and organisation to manage the process (the Management Case).

3.6. The following paragraphs examine the proposed PPP for the renovation of the PdN to determine the extent to which a case can be made in each case:

The Strategic Case

3.7. The UNOG's SHP has given a very powerful case for the intrinsic socio economic utility of the project: Unless the renovation is undertaken UNOG '*may be unable to continue to offer functional facilities to its many users*'[7]. This jeopardises the strategic output of the UN namely its contribution to health, human rights, peace, social cohesiveness and economic progress and these deliverables are of such tremendous value that their diminution as a result of closure of the PdN is unthinkable.

3.8. PPP is of course not just about preservation: it is also whether there is a strategic case for the transformation that PPP can bring to UNOG's renovation of the Palais. Here the following transformations that would occur through a PPP, provide a rather strong strategic case:

- the valorisation of unused or underused land and real estate;
- a focus on the provision of a service to users;
- a cultural change away from the 'build and walk away, neglect, renovate' model of public asset management, to a model that maintains the building over the lifetime of the contract; and
- a cultural change where strategic decisions are made considering full lifetime costs, removing many perverse incentives in the use and management of the building.

The Economic Case

3.9. The economic case establishes the project's Value for Money, defined as the optimal combination of whole life costs and quality and measured in net present value terms as the ratio of inputs (costs) to outputs (benefits). The business case should explicitly and accurately define the outputs provided by the project, in terms of services provided by the project, such as providing modern working facilities to UN staff, or the organisation of UN-sponsored conferences. Value for Money for the PPP option should be compared to that of a renovation under a traditional procurement process, referred to as the public sector comparator (PSC).

3.10. The most evident way to increase Value for Money is to reduce costs for a given level of service and/or improve the quality of the service. Compared to traditional procurement, the lifecycle cost of the PPP option can be significantly cheaper:

[7] Strategic Heritage Plan of the United Nations Office at Geneva, Report of the Secretary-General to the General Assembly, 8 August 2011

- construction costs could be lower than that of the public sector comparator;
- there will be no cost overruns;
- there will be price certainty, crucial to good UN budgetary management; and
- the entire *whole life* costs will be considered during the procurement phase, rather than merely construction costs (avoiding the risk of cheap construction leading to high maintenance costs).

3.11. Beyond cost reductions, Value for Money is proportion to the level of outcomes. A PPP usually helps deliver superior outcomes through:
- incentives for the private sector partner to deliver a high level of service throughout the duration of the contract; and
- innovative design options brought in by bidders during the procurement phase, with a specific focus on the level of service provided to users.[8]

The Financial Case

3.12. The financial case establishes the project's affordability and the sources of budget funding. It covers the lifespan of the scheme and all attributable costs. The case needs to demonstrate that funding is securable and that it falls within appropriate spending and settlement limits.

3.13. In the present case, the budget currently allocated to the Palais des Nations is very unlikely to cover usage payments at the level necessary to accomplish the renovation. Therefore, all potential resources should be considered:
- existing resources, currently allocated to the Palais des Nations (UNOG);
- savings arising as the result of the PPP, e.g. budgets currently allocated to the rental of offices for organisations that could move into the Palais des Nations;
- charging certain users (e.g. private sector users) at market rate;
- the development of existing (e.g. entry tickets for guided tours) and new additional sources of revenue not related to the Palais des Nations' 'core business'. The development of underused land and real estate could bring significant additional revenue;
- the sale or long-term lease of assets such as land and construction rights; and
- an increase in the part of the UN budget allocated to the Palais des Nations.

The above could be structured within the PPP or be raised directly by the procuring authority (as a separate 'fund-raising' project to undertake the renovation of the Palais).

3.14. Adequate accounting standards should be used in order to fairly compare the financial cost of a PPP to other options. Accounting should be on an accrual basis rather than cash basis, consistently with the UN's move to IPSAS standards (International Public Sector Accounting Standards).

The Commercial Case

3.15. The commercial case assesses the likely attractiveness of the project to a private sector partner(s), as part of a single or several deals. Interviews with private companies suggest that UNOG will not have many difficulties in attracting market interest for this project. In addition the private sector will be attracted by the DBFM model because of its comprehensive nature and their wish to do the whole project rather than one or two of the phases. Formal market testing would be carried out prior to any procurement to prove sufficient bidder appetite exists to successfully deliver the project.

[8] It should be noted that the economic case is extremely sensitive to the discount rate used. A lower discount rate will put the public sector option at an advantage, while a high discount rate will advantage the PPP option. In the absence of UN guidance on discount rates, the discount rate should be thoroughly justified. Another important issue in comparing PPP and PSC is the valuation of the amount of risk transferred from the public authority to the private partner, which increase the value of a PPP.

The Management Case

3.16. The management case is concerned with the deliverability of the proposal and must clearly set out management responsibilities, governance and reporting arrangements.

3.17. In UNOG's case, the management of a PPP presents several challenges:
- the lack of PPP experience;
- the absence of a PPP Unit in the UN context to give it support;
- the size of the project (and, to a certain extent, its relative complexity);
- the UN's unique governance and political process; and
- the large number of stakeholders involved.

3.18. UNOG will need to increase its in-house PPP capacity for a credible management case to be made. UNOG can however rely on good will of many countries (most of whom are in fact members of the UNECE International PPP Centre of Excellence) with world class experience in PPP and which they can share with UNOG via UNECE, and ensuring that there is a united effort from all states to develop successful PPP in the PdN. In addition, there are many skilled advisors in this area, and some level of technical consultation will almost certainly be required. The cost of PPP advisors would be considered as one of the project costs in the Feasibility Study.

Conclusion

3.19. With respect to the two aspects above discussed of the feasibility of doing a PPP – whether there are any legal issues and whether the business case for doing a PPP is sufficiently strong - in the Palais:

Legal perspective

3.20. There are no major legal impediments to undertaking PPP both from the UN and from the private sector perspectives. However, there is one small caveat: with respect to the UN Office of Legal Affairs in New York there has been as yet no definitive statement on whether PPP conforms to UN rules and regulations. It might be suggested to hold an expert event on PPP in New York to obtain clarity on whether prospective investors in PPP in the Palais are assured that their investments would be consistent with prevailing UN rules and regulations.

Business case

3.21. We cannot answer conclusively whether it is feasible to do PPPs in the Palais. A full comprehensive PSC to assess the Value for Money - economic case - would have to be done. However, there are sufficient positives from the other cases to certainly recommend to Member States that they invite UNOG to undertake a full comprehensive PSC that will completely answer the question whether it is feasible to do PPPs for the renovation of the Palais.

SECTION 4
HOW THE RISKS IN SUCH A PROJECT MIGHT BE ALLOCATED AND MITIGATED?

4.1. As stated in Section 1, one of the ‘cons’ to PPPs is the perception that there is a shift of risks to the private sector, but at the expense of the latter charging inordinate amounts for taking on this burden. It is perfectly true that the private sector will charge for taking on risks – for example, in a renovation project, there is always the possibility that latent defects will be discovered after the project has commenced. But the private sector has a very strong incentive to make the project work and to ensure that projects do take place. Accordingly, nowadays there is a greater recognition that risks should be shared in a balanced way; and this balanced sharing of risks ensures that public funds are put to the best possible use.

4.2. In addition, proper procedures are employed to avoid undesirable eventualities in the middle of a project such as the uncovering of a risk that had not been allocated properly and the public sector finding itself facing huge unexpected costs.

4.3. It is now understood that project risks should be allocated to the party that is best able to control their occurrence or manage their consequences. In addition, nowadays, these risks are carefully identified and allocated beforehand. A ‘risk matrix’ is created; a simplified example of a risk matrix is displayed below. In the contract all the risks are carefully allocated and when the contract is signed this puts a ‘cap’ on the risks and associated costs. Measures are adopted to mitigate identified risks.

4.4. True, there is initially in the project a discussion over which partner assumes which risk. Risk allocation is not a science; it is a negotiation. But as said before, the parties generally want the project to succeed; hence today more risks are shared by both partners. A sample risk allocation matrix, divided according to the project life cycle phases, is provided *below*.

4.1. In conclusion, the risk allocation is a balancing act, and correct allocation and mitigation of risks are major factors in making projects bankable, whereas if most of the risks are transferred to private sector, the project might even fail.

RISK MATRIX

Risk to be addressed	Public	Shared	Private
OVERALL			
Technical Interfaces		X	
Change in law (Inc.Tax)	X		
Project changes/modifications of the scope	X		
BEFORE CONSTRUCTION			
Permits and Authorizations		X	
Land acquisition	X		
Geological risks		X	
Archaeological risks		X	
Design			X
DURING CONSTRUCTION			
Site safety and security			X
Construction risk			X
Technical conformity			X
DURING OPERATION			
Maintenance and heavy maintenance risks			X
Performance risk			X
Insurance		X	
Demand risk	X		
END OF CONTRACT			
Hand-over			X
Contract termination	X	X	X

SECTION 5
RECOMMENDATIONS AND CONCLUSION

5.1 First, the report recommends to UNOG on the basis of the preliminary findings in this study that the next step for the General Assembly is to authorise a feasibility study to be carried out by the United Nations. This would give the necessary data by which the Member States can see whether the PPP option provides better value for money than the traditional form of procurement.

5.2 While the study has pointed out some positive features of PPP and even a useful model which encapsulates these features – certainty of outcomes, *whole life* costing, regular funding for maintenance and so on – nothing definitive can be said about the advisability of using PPPs for this specific project until this feasibility study is carried out.

5.3 This being said, the initial challenge for UNOG to bring the idea into reality will require new capacity, and the investment in creating such capacity. UNOG also because of the tremendous goodwill of its Member States can rely on top level expertise on PPP from governments, who are also members of the UNECE International PPP Centre of Excellence. In terms of this stage of the development of PPP inside the Palais des Nations, the following three additional recommendations are made:

(i) An event may be held in New York to discuss PPP options and whether they are compatible with UN rules and regulations;

(ii) A component of the feasibility study, i.e. a PSC could be carried out under the auspices of the UNECE TOS PPP; and

(iii) Studies and materials collected for providing advice to UNOG should be made available to Member States interested in using PPP models for renovation of their public buildings.

Annex 1

COMPARISON OF PPP MODELS

D:Design B:Build R:Rehabilitate M:Maintenance O:Operate F:Finance

For the simplification purpose, it is shown as “B (Build)” in this table, even though this project is an “R”(Rehabilitate/renovate)” project.

Options	Scope of works
Traditional	– UN raises funds for the renovation and selects a private entity for design and construction – UN pays renovation cost during the construction period – After the renovation is finished, the UN performs operation and maintenance (some services may be outsourced)
DBM	– UN raises funds for the renovation and selects a private entity for design, construction and maintenance as one contract – UN pays renovation cost during the construction and maintenance period – UN pays maintenance cost on periodical basis – UN performs operation as it is (some services may be outsourced) – UN owns the real property rights
DBMO	– UN raises funds for the renovation and selects a private entity for design, construction, maintenance, and operation as one contract – UN pays renovation cost during the construction, operation and maintenance period – UN pays operation and maintenance cost on an annual basis – UN owns the real property rights
DBFM	– Private sector prepares financing for capital expenditure – UN selects a private entity for design, construction, and maintenance as one contract – UN pays renovation cost during the construction and maintenance period – UN pays maintenance cost on an annual basis – UN owns the real property rights
DBFMO	– Private sector prepares financing for capital expenditure – UN selects a private entity for design, construction, operation and maintenance as one contract – UN pays renovation cost during the construction and maintenance period – UN pays operation and maintenance cost on an annual basis – UN owns the real property rights
Lease	– UN transfers real property rights to a private entity – Private sector prepares financing for capital expenditure of the project and for the property rights – Private entity performs renovation, operation and maintenance as an owner of the property – UN pays renovation cost and operation and maintenance cost as lease payments
Concession**	– UN gives concession contract to a private entity – Private sector prepares financing for capital expenditure of the project and for the concession right as a one-off payment – Private entity performs renovation and maintenance as a concessionaire – UN may pay some portion of the renovation cost but usually the concessionaire bares the demand risks

* This table should be modified according to the United Nations’ procurement rules, general conditions of contracts, accounting, and taxation in relation to the private sectors.

** In principle, concessions are used only on projects paid by user fees. There is almost no user fees associated with this renovation. Thus, concession is excluded from the following comparisons.

'PROS' AND 'CONS' OF VARIOUS PPP MODELS AND FINANCIAL OBLIGATIONS

<table>
<tr><th></th><th>Pros</th><th>Cons</th><th>Evaluation</th></tr>
<tr><td>Traditional</td><td>– Faster and cheaper procurement because it uses existing procurement system
– UN Staffs are familiar with the system
– Less "soft cost" for comparison of methods and studies
– Member States are familiar to the system</td><td>– Short-term heavy financial burden on Member States
– Difficult to optimize flow plan and O&M efficiency because design and O&M are separately outsourced
– Life cycle cost may not be reduced because maintenance services are procured separately
– UNOG bears the risks associated with O&M</td><td>– Unless UNOG finds a decent financial source, this will not solve the financing issue that UNOG has encountered
– Difficult to reduce the O&M costs</td></tr>
<tr><td>DBM</td><td>– Better Flow plan and improved maintenance (energy efficiency) because maintenance efficiency is optimized in design
– The private entity can bring their expertise and innovation and can reduce the maintenance costs
– UNOG can transfer cost-overrun risk to the private entity</td><td>– Short-term heavy financial burden on Member States
– Corporate tax may be imposed on the reserves for future repairs and replacement cost and thus unitary payment increase accordingly
– UNOG bears the risks associated with O&M</td><td>– Unless UNOG finds a decent financial source, this will not solve the financing issue that UNOG has encountered
– Difficult to optimize the energy efficiency and reduce the O&M costs</td></tr>
<tr><td>DBMO</td><td>In addition to the merits in DBM:
– Better O&M efficiency because O&M optimization is fully considered from the earlier phase
– Better energy management and human resource management can be achieved
– Improved service and efficiency in O&M
– Some risks in operation such as change of utility cost can be transferred to private</td><td>– Short-term heavy financial burden on Member States
– Corporate tax may be imposed on the reserves for future repairs and replacement cost and thus unitary payment increase accordingly
– Continuity of employment of general staffs who are currently involved in operational services
– O&M methods after the contract period should be sought out</td><td>– Unless UNOG finds a decent financial source, this will not solve the financing issue that UNOG has encountered
– Comprehensive contract throughout the project life cycle may reduce project life cycle cost and improve the service</td></tr>
<tr><td>DBFM</td><td rowspan="2">In addition to the merits in DBM、DBMO:
– UN do not need to prepare short-term heavy finance
– Capital expenditures can be deferred and leveled for long term</td><td rowspan="2">In addition to the demerits in DBMO:
– Capital cost may be more expensive in private finance than UN financing
– Corporate tax may be imposed on the reserves for future repairs and replacement cost and thus unitary payment increase accordingly
– UNOG should guarantee the future payments (long-term financial obligation)</td><td>– Operational costs may not be reduced and energy management may not be optimized</td></tr>
<tr><td>DBFMO</td><td>– Comprehensive contract throughout the project life cycle may reduce project life cycle cost and improve the service
– If some revenue generating programs are bundled, UN may be able to reduce the obligation for capital or operational expenditure</td></tr>
<tr><td>Lease</td><td>In addition to the merits in DBMO, DBFM, DBFM:
– Risks associated with owning buildings (e.g. force majeure etc) can be transferred to the private entity
– Repair risks can be transferred to the private entity
– Less complexity in contracting</td><td>– Property taxes might be imposed
– Bankruptcy risk may be higher because no SPV is established
– Lease may increase</td><td>– DBMO can be contracted out in comparatively simple form
– Total commission may be higher due to property taxes and profit of lease agency</td></tr>
</table>