

**OUTSOURCING GOVERNMENT
REAL ESTATE SERVICES -
learnings from recent case studies and
literature**

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Summary key points: “Outsourcing Government Real Estate Services – learnings from recent case studies”

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REASONS FOR OUTSOURCING

- The outsourcing of activities like real estate services is part of a fundamentally new and different international trend in how business and government deliver services.
- Outsourcing can result in reduced costs, but “value for money” must be the goal, with financial benefits balanced with meeting the organization’s programme objectives.
- Outsourcing can improve service delivery by providing organizations with special expertise and providing better information about operations.

CONSIDERATIONS FOR SUCCESS

The development of the outsourcing project is major initiative requiring support.

- The organization’s senior management and politicians must strongly support the initiative.
- An in house team of knowledgeable staff and representatives of all stakeholders provides the most effective process to develop the project, with the help of consultants with specialized expertise as needed.

The business case must be strong.

- The business case must establish value for money or the project abandoned.
- Consideration of the impact of outsourcing on the strategic directions for an organization must be the basis for deciding whether or not to outsource a function.
- An appropriate service provider consortium may have to be created for large scale outsourcing projects.
- A partnership approach between the organization and the service provider is required for most effective service delivery in large outsourcing projects.

A human resources strategy must cover all existing staff and new needs.

- Successful human resource management requires meeting legal and legislative requirements for union and other existing employees in a timely way, or the outsourcing programme can be significantly delayed.
- Staff transferred to an outsourcer are generally satisfied with their new positions, which provide better opportunities for development and promotion, and similar or better pay and conditions.
- Staff must have the new and different skills and knowledge to manage outsourcing contacts rather than doing the work.

- Staffing requirements must be carefully considered during the transition period to private service delivery, when the in house complement is reducing and the service provider has not yet sufficient staff.

Measures must be taken to mitigate risk.

- Outsourcing of government functions, compared to private businesses, requires additional steps to mitigate risk through the use of financial measures and performance standards, as well as providing for on going monitoring and dispute resolution.

The tendering process must be open and fair and facilitate competition.

- Additional measures must be taken by governments to ensure that the bidding process is fair and open and also be perceived to be so.
- The bidding process must encourage competition among potential bidders by being timely, providing needed information, and allowing for innovation.

Strong legal administration is required make the contract workable.

- Potential conflicts in the management of the contract can be avoided by careful considerations in setting out the contract provisions to ensure the needs of the government organization are met.

On going effective communications is essential.

- Effective communications are essential at all stages and with all players, given new roles are required by all: most problems with outsourcing are caused by poor communications, not technical or procedural issues.

OUTSOURCING GOVERNMENT REAL ESTATE SERVICES - learnings from recent case studies and literature

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SYNOPSIS

This paper examines why government organizations outsource and how the outsourcing of real estate functions can be made developed and managed successfully. It sets out key findings from a review of current literature and from several case studies of recent government real estate outsourcing projects. It concludes that outsourcing is a trend in how organizations deliver services, but it not always the answer. Further, many factors are needed to make it successful, including: support from the organization, developing an appropriate business case, managing human resource issues, considerations for mitigating risks, facilitating the tendering process, resolving legal issues and the ensuring good communications with all stakeholders at all stages.

KEY FINDINGS

Large scale outsourcing is the trend in delivering government real estate services. But, outsourcing is more effective in some situations than others, and is affected by many factors. Different players have different expectations: the public, client departments, in house staff, and the service provider. Government organizations have special needs in outsourcing to ensure accountability to the public. While there is no simple formula, success for all types of outsourcing projects is achieved when: targeted cost savings are achieved or better; service levels are maintained or improved; the users are satisfied; the service provider is responsive to the needs of the customer; there are few disputes; and the contract is renewed.

Review of current literature and the examples of current projects by the Real Property Services Branch of Public Works and Government Services Canada, the Ontario Realty Corporation, and the Department of Social Security in Great Britain suggest the following key reasons for outsourcing.

- The outsourcing of activities like real estate services is part of a fundamentally new and different international trend in how business and government deliver services.
- Outsourcing can result in reduced costs, but “value for money” must be the goal, with financial benefits balanced with meeting the organization’s programme objectives.

- Outsourcing can improve service delivery by providing organizations with special expertise and providing better information about operations.

The paper also develops the following considerations for the successful development and managing of programs for outsourcing of government real estate services.

The development of the outsourcing project is major initiative requiring support.

- The organization's senior management and politicians must strongly support the initiative.
- An in house team of knowledgeable staff and representatives of all stakeholders provides the most effective process to develop the project, with the help of consultants with specialized expertise as needed.

The business case must be strong.

- The business case must establish value for money or the project abandoned.
- Consideration of the impact of outsourcing on the strategic directions for an organization must be the basis for deciding whether or not to outsource a function.
- An appropriate service provider consortium may have to be created for large scale outsourcing projects.
- A partnership approach between the organization and the service provider is required for most effective service delivery in large outsourcing projects.

A human resources strategy must cover all existing staff and new needs.

- Successful human resource management requires meeting legal and legislative requirements for union and other existing employees in a timely way, or the outsourcing programme can be significantly delayed.
- Staff transferred to an outsourcer are generally satisfied with their new positions, which provide better opportunities for development and promotion, and similar or better pay and conditions.
- Staff must have the new and different skills and knowledge to manage outsourcing contacts rather than doing the work.
- Staffing requirements must be carefully considered during the transition period to private service delivery, when the in house complement is reducing and the service provider has not yet sufficient staff.

Measures must be taken to mitigate risk.

- Outsourcing of government functions, compared to private businesses, requires additional steps to mitigate risk through the use of financial measures and performance standards, as well as providing for on going monitoring and dispute resolution.

The tendering process must be open and fair and facilitate competition.

- Additional measures must be taken by governments to ensure that the bidding process is fair and open and also be perceived to be so.

- The bidding process must encourage competition among potential bidders by being timely, providing needed information, and allowing for innovation.

Strong legal administration is required make the contract workable.

- Potential conflicts in the management of the contract can be avoided by careful considerations in setting out the contract provisions to ensure the needs of the government organization are met.

On going effective communications is essential.

- Effective communications are essential at all stages and with all players, given new roles are required by all: most problems with outsourcing are caused by poor communications, not technical or procedural issues.

1. INTRODUCTION

This paper uses the term “outsourcing” to apply to the use of large and comprehensive contracts by private companies to provide the range of real estate services in lieu of in house service delivery. Outsourcing is a fundamentally different way of delivering services. It uses the term “real estate services” to describe the range of services required to support an organization, from portfolio planning to facility and property management.

Using current literature on the outsourcing of real estate functions and several case studies, the paper, first, in Section 2, summarizes the reasons for the use of outsourcing by businesses and governments. Then, Section 3 examines ways in which government organizations can plan to make their outsourcing initiatives successful. The case studies cover a range of current projects:

- Real Property Services Branch (RPS) of the Department of Public Works and Government Services (PWGSC), which outsourced many facility/property management functions in May of 1998 through 12 area contracts to one property management consortium and remains owner of the properties. (Appendix 1)
- Ontario Realty Corporation, which is outsourcing facility and land management, and leasing services to property management companies, with three contracts underway, two of which are regional and one for land management. Two regional contracts are still to be let. The government remains the owner of the property. (Appendix 2)
- PRIME (Private resource Initiative for the Management of the Estate), a project of the British Department of Social Security, which, in April 1998, transferred a portfolio of over 700 buildings to an international consortium lead by a bank, with services are purchased by the department in a 20 year contract. (Appendix 3)

Appendix 4 outlines the framework used by the government of Great Britain in evaluating projects under its Private Financial Initiative program, which supports and encourages public private partnerships. Finally, Appendix 5 provides information about outsourcing for information technology functions, for a comparison of issues and options with outsourcing in the real estate field.

2. WHY OUTSOURCE GOVERNMENT REAL ESTATE SERVICES?

There appear to be three main reasons why organizations outsource functions: outsourcing of service delivery is part of the international trend to new ways of operating both businesses and governments organizations in which the focus is on the core business and non-core operations are outsourced; outsourcing can provide a range of financial benefits, including reduced costs for services; and outsourcing can provide better service delivery than in house delivery.

2.1 Follow international trends in operating both business and government organizations

Outsourcing of service delivery has been increasing for both businesses and governments. Raymond Bayley, Chairman of Re-Sourcing Inc. ¹suggests that this is because businesses must operate in a fundamentally different way due to the impacts of the information age. Organizations must be more flexible and adaptable. Businesses are outsourcing “non core” functions, such as information technology and real estate services. Governments are following this trend, adopting a “steering not rowing” approach, popularized by Osborne and Gaebler’s 1992 book, “Reinventing Government”², which concludes that governments should develop policy and the private sector deliver the day to day services. Cost savings can be a secondary consideration.

In the last twenty years, outsourcing of government services has become common in the USA, New Zealand and Australia. In Britain, the Thatcher government began large scale outsourcing during the 80’s to reduce the role of government, to increase opportunities for the private sector, and to reduce the power of unions. The current Labour government’s Private Financial Initiative program continues the privatization of a wide range of government functions, including building and operating schools, bridges, water works, transportation and social housing. Companies formed by government department or agency staff operate some of these new businesses. The largest real estate initiative is the PRIME project for the Department of Social Security, described in Appendix 3, which is involved the transfer of the portfolio to a consortium.

Here in Canada, in the mid 90’s governments began alternative service delivery projects, including outsourcing and other private public partnerships. Canada Post was one of the first government agencies to undertake a major (over 100 buildings) outsourcing of property management to private companies. The services were formerly provided by Public Works Canada. The two major Canadian current projects are for the Real Property Services (RPS) Branch of Public Works and Government Services Canada and the Ontario Realty Corporation (ORC). These projects and the PRIME project were all initiated as part of the change in focus of governments and have had strong political support. The ORC Corporate Plan for 1998-1999 includes the specific government objective, approved by the Management Board of Cabinet in 1996: “Involve the private

¹ Bayley, Raymond, Chairman of Re-Sourcing Inc., Presentation to Public Works and Government Services Canada, 1997

² Osborne, David and Ted Gaebler, 1992, “Reinventing Government, How the “Entrepreneurial Spirit” is Transforming the Public Sector”, Plume

sector in the delivery of real estate services to increase efficiency and effectiveness.” This Plan helps implement the current Government’s “Blueprint for Action”. One of the key goals for the Federal Government’s ASD (alternative service delivery) projects is to distinguish between activities that the government must perform and those that could be efficiently and economically carried out by others, and to involve increasing private sector participation in service delivery.

Other government organizations, such as the City of Montreal, have made deliberate decisions maintain real estate functions in house. The Province of Alberta uses a mixture of in house and outsourced service delivery for real estate. Other organizations, such as the City of Toronto, which contracts out some of its real estate services, are debating options.

- **The outsourcing of activities like real estate services is part of a fundamentally new and different international trend in the delivery of business and government deliver services.**

2.2 Achieve financial benefits

Outsourcing can provide different types of financial benefits for an organization³, such as reducing costs, as discussed below, freeing funds available for other purposes, sharing risks with the private service provider, and accelerating the benefits of re-engineering. It can also provide funding for services that otherwise could not be afforded. The last point was a major consideration in the decision of the Department of Social Security in the sale of its properties, as it did not have sufficient funds to maintain its properties adequately.

Cost saving is considered by many organizations to be the only objective for outsourcing real estate functions. Property assets and their operating costs are major financial responsibilities, and are therefore often targeted to produce savings. Savings come from economies of scale and scope.⁴ Economies of scale result from spreading resources over different clients, from the purchasing power of larger businesses, and from the efficiencies of consolidating contracts. Economies of scope result from the ability to maintain sufficient distinctive expertise in areas of need. Outsourcing is also considered a way to save money by using non union staff. However, as noted below in Section 3.3, the service provider in the three case studies took on the union staff at rates equal to or better than the government rate.

For both the RPS and ORC projects, cost savings was one of the goals, with ORC anticipating saving in the order of \$80 million over the five year contract. These savings are achieved through the contracts, which include a built in guarantee a savings of at least

³ Manning, C, Mauricio Rodriguez and Stephen Roulac, “Which Corporate Real Estate Management Functions Should be Outsourced”, Journal of Real Estate Research, American Real Estate Society, Volume 14, Number 3, 1977

⁴ as above

10% of anticipated internal costs for both. The report⁵ of the Comptroller and Auditor General for Great Britain states that that the PRIME project is estimated to save 22% of the anticipated internal costs, as determined through computer modeling. The total is about \$1.3 billion for the 20 year term. The two major differences in the projects that result in the increased savings are: a) the length of the contract - 20 years for PRIME versus 5 to 7 for the others; and b) the transfer of the ownership of the portfolio as well as its leases to the service provider, Trillium, in the case of PRIME; Trillium is able to sell, lease or develop properties. In the other two cases, the portfolio is still owned by the government. No conclusions can be made as the long term effectiveness of the three cases, as the contracts have only been running a short time, but those involved advise that the financial savings are on target.

But, there is no simple answer to the question, “Does outsourcing save money?” Bergsman,⁶ reported on a 1994 NACORE (National Association of Corporate Real Estate Executives, a USA based organization) survey that 55% of respondents advised that outsourcing actually costs more than if the work is done internally. The contracts in the three case studies of this paper have not been running long enough to make any conclusions about their success, although they are on track. There are a number of problems in achieving real cost savings, as noted in the same article.

- (1) It is difficult to measure all costs. The real cost of doing the work may not show up as payroll or direct overhead, and costs such as for redeployment, transition, and management may be underestimated.
- (2) The service provider must be able to provide the services at less cost than in house operations, and allow for an adequate profit margin.
- (3) Outsourcing can result in unanticipated increased costs. If the service provider is unable to perform as required, costs can increase through procedures to end the contract or in paying extra to get the work done.
- (4) The service provider may underbid and plan to make profits on future changes. Also the service provider has an interest in cherry picking the most profitable functions, leaving the more costly functions or those that cannot be easily measured to be performed in house, including the strategic thinking and ensuring a responsive bureaucracy.

The British Private Financial Initiative guidelines⁷ provide a useful framework for evaluating financial benefits: that is to focus is on “value for money”, not cost savings. The outsourcing project must first meet the key programme objectives of the government organization and then the financial package is balanced with how the proposal meets those objectives.

⁵ Comptroller and Auditor General of Great Britain, “The PRIME Project, Transfer of the Department of Social Security Estate to the private sector’, April, 1999

⁶ Bergsman, S., “The Bloom is off: Why Real Estate Outsourcing Isn’t Always the Low Cost Solution Its Hyped to be”, Corporate Finance, Winter, 1994

⁷ Comptroller and Auditor General of Great Britain, “Examining value for money deal under the Private Financial Initiative”, August, 1999

- **Outsourcing can result in reduced costs, but “value for money” must be the goal, with financial benefits balanced with meeting the organization’s programme objectives.**

2.3 Improve service delivery

Outsourcing can improve service delivery by providing access to world class expertise, and improving procedures, as discussed below. Improving service delivery was one of the specific objectives for Federal Government ASD projects.

(1) Specialized capabilities

Outsourcing can improve service delivery by providing access to world class or specialized capability, and by providing resources not available internally or functions that are otherwise be difficult to manage. This is also often the primary reason for basic contracting out of specific services.

(2) Improving service delivery through better information about operations

Outsourcing can improve service delivery by forcing improved reporting on real estate operations.⁸ The service provider must provide the corporate managers with detailed information and timely updates. Such information is needed for cost effective operations. In house organizations generally do not have this level information. The increased focus on business planning and benchmarking by in house organizations can help to offset this problem.

- **Outsourcing can improve service delivery by providing organizations with special expertise and better information about operations.**

3. HOW CAN GOVERNMENT REAL ESTATE SERVICES BE SUCCESSFULLY OUTSOURCED?

There is no simple formula for success, as there are many factors involved. But in general, success for all types of outsourcing projects, including information technology⁹ mean that: targeted cost savings are achieved or better; service levels are maintained or improved; the users are satisfied; the service provider is responsive to the needs of the customer; there are few disputes; and the contract is renewed. For information technology projects, success also includes managing the uncertainties of technology that changes very quickly.

The review of literature and the organizations examined in the case studies has highlighted key findings in making outsourcing successful, and these are described in the

⁸ Manning, Chris, Mauricio Rodriguez, and Stephen Roulac, “ Which Corporate Real Estate Management Functions should be Outsourced”, Journal of Real Estate Research, American Institute Society, Volume 4, Number 3, 1997

⁹ Lacity, Mary C., Leslie P. Willcocks, David F. Feeney, “The Value of Selective IT Outsourcing”, Sloan Management Review, Spring 1996

sections below. The factors are: support from the in house organization, preparing the business case, managing human resources needs, considerations in mitigating risk, facilitating tendering, resolving legal issues, and ensuring good communications at all stages.

3.1 Supporting the development of an outsourcing project

Development of an outsourcing project requires considerable time and resources, and at the same time as planning an outsourcing initiative, the organization must continue to deliver services. The fear of change and downsizing result in low morale and key people leave. As well, pressure to downsize may leave the organization with insufficient people to work on the ongoing service delivery as well as on the outsourcing project. The case studies showed two important ways to manage the planning work: a) strong support from senior management to provide direction in a time of transition and uncertainty for staff; and b) establishment of an in house team of people with on going understanding of the business and of the interrelationships within that business. For government, strong political support is also critical.

Committed senior management and political supported all the three case study projects. All also established temporary separate staff organizations to do the planning work. The staff teams involved all key players to ensure the necessary interests were considered. In each the role of consultants was limited to bringing special expertise and providing an outside perspective.

- **The organization’s senior management and politicians must strongly support the initiative.**
- **An in house team of knowledgeable staff and representatives of all stakeholders provides for the most effective development process, with the help of consultants with specialized expertise as needed.**

3.2 Preparing an effective business case

Review of literature and the cases examined suggest that the following three factors are key to developing a successful business case: showing how the project will achieve value for money, deciding on what functions to outsource, and ensuring there is an appropriate service provider.

(1) Benefits through major changes in operations

Literature¹⁰ on outsourcing suggests the major benefits of outsourcing come from significant changes in how a business delivers its services. The three cases in this paper have done that. Rather than in house staff managing many small contracts, ORC created regional contracts to be managed by an outsourcer, for a period of up to 5 years. The

¹⁰ Manning, Chris, Maurico Rodriguez, and Stephen Roulac, “ Which Corporate Real Estate Management Functions should be Outsourced”, Journal of Real Estate Research, American Institute Society, Volume 4, Number 3, 1997

savings are to come from the management of a comprehensive package of services, including bulk purchasing, economies of scale, and innovation in service delivery. RPS approached the business package in a similar way. The PRIME example, however, involved the transfer of all the property as well as all the existing leases, and the payment for services in a 20 year contract, so the change was much more dramatic. It provides much more room for innovation, as property can be sold or redeveloped, and the large amount of vacant space leased to others or sold. The PRIME project also did not divide the portfolio on a regional basis, although the project is managed on that basis, because the quality of the properties was too varied, with some parts not having much value to there would be no private service provider interested. The April 1999 report of the Comptroller and Auditor General on this project¹¹ considers the project, after a year of operating, to be acceptable in terms of anticipated value for money, based on the computer modeling of projected space needs and costs.

(2) Achieving value for money

The development of outsourcing projects must focus on achieving value for money, according to the guidelines published by the Comptroller and Auditor General of Great Britain¹². These guidelines stress that the organization must be clear about its objectives for the project and about establishing what it needs from the outsourcer in the most general way, to allow for innovative ways to achieve the most cost effective arrangement.

On the other hand, the threat of outsourcing can often be an effective way to make improvements. One example is the proposal to outsource the operations of the sewage plant in the Regional Municipality of Ottawa-Carleton. The existing operation was undertaken partly in house and partly outsourced. The staff bid for an amalgamated operation was \$17 million, while the lowest private sector bid was \$22 million. The major cost reductions were the result of new union agreements to allow greater flexibility in staff working arrangements.¹³ A business case is based on comparing costs of what the in house organization can produce, and where benchmarking shows that there can be improvements, outsourcing should be considered. But when there are no clear benefits, as noted in the Ottawa-Carleton example, the project should not be pursued. The British guidelines for “value for money” stress that organizations must abandon projects that do not make provide this value.

Organizations may introduce outsourcing to improve service delivery where in house functions that are not operating effectively. Good service delivery depends on knowledgeable and experienced staff, so making the existing organization more effective can, in some cases, be a better option. The organizations can take steps to improve economies of scale, hire better managers, improve staff performance, and retain good

¹¹ Comptroller and Auditor General, Great Britain, “PRIME, the transfer of the Department of Social Security Estate to the Private Sector”, April, 1999

¹² Comptroller and Auditor General of Great Britain, “Examining value for money deal under the Private Financial Initiative”, August, 1999

¹³ Tunnacliffe, Nick, Commissioner of Planning and Development Control, Regional Municipality of Ottawa-Carleton

staff. But as experienced in the information technology area¹⁴, major improvements are often brought in by outsiders because in house improvements may be difficult to achieve because of existing institutional procedures and approaches.

- **The business case must establish value for money or the outsourcing project abandoned.**

(3) Deciding which functions to outsource

Decisions about whether to outsource or not should be made in the context of the strategic objectives of the organization. This consideration is increasingly important, as recent studies¹⁵ of real estate trends show that that private companies in the USA and Europe now consider real estate as a key component of their business strategy. In contrast, prior to 1970, businesses tended to manage property as custodians.

The PRIME project is an example of a strategic approach to real estate operations. The business needs of the Department of Social Security were to reduce space, as less was needed due to computerization, and to find ways to fund improvements to the buildings and space that was still required. It did not have sufficient resources to make the improvements needed, and could not sell or develop land and retain revenues. Therefore it was feasible to develop a package that included the disposal of the property portfolio and payment for good space. The Canadian cases are examples of outsourcing driven primarily by the downsizing of government.

“Theory of the firm” literature¹⁶, examines functions that are kept within an organization and which are outsourced, and states that the key factors to consider include transaction costs, as well as the extent of efficiency gains on production costs and management of processes. Generally, routine transactions, the “how to do” tasks, more efficiently carried out by outside service providers, who have a specialized focus and therefore result in economies of scale and scope. Further, it is more difficult for a service provider to act “opportunistically” in routine tasks. Therefore, in the real estate area, most outsourcing is carried out for functions such as brokerage, construction and property management.

The “what to do” functions, such as policy development and strategic company wide real portfolio management, can generally be better performed in house. Innovation requires a good understanding of the business. Costs for these functions are often hard to measure, and it is more difficult to ensure that the work is done efficiently when the assignment is complex and the anticipated results unclear. Outsourcing of these functions can negatively affect the strategic direction of a business. There can be a loss of critical knowledge about an organization and loss of the ability to innovate and develop strategy for the future of the organization.

¹⁴ Earl, Michael J, “The Risks of Outsourcing IT”, Sloan Management Review, Spring 1996

¹⁵ Vascoe, Barry, “Trends in Corporate Real Estate Practices, Devising a Strategy to Support Key Business Objectives”, Office Life, June 1999

¹⁶ Manning, Chris, Maurico Rodriguez, and Stephen Roulac, “Which Corporate Real Estate Management Functions should be Outsourced”, Journal of Real Estate Research, American Institute Society, Volume 4, Number 3, 1997

Government staff must provide information to senior management and politicians; these are requirements for accountability, which cannot be outsourced. As well, these needs result in additional operating costs that need to be considered in the business case. This type of work must be flexible to respond to urgent needs and is hard to measure and to cost.

Therefore, in determining whether to outsource a function, careful consideration should be given to such questions as: a) what are potential future impacts on the core business and strategies; b) are there economic benefits from economies of scale and scope, and c) are there other advantages of carrying out the functions in house, such as through synergies with other aspects of the business? RPS used an explicit “filter” process to review of functions for their impact on their business objectives, a good example of a process for deciding what to outsource and what to keep in house. About 85% of functions were determined to be non-core. Services such as strategic real estate services and the management of properties used for high security functions, such as the Department of National Defence and for the Parliament Buildings, are kept in house. In another type of operations, airlines do not outsource information technology for reservations systems, a key business function.

- **Consideration of the impact on the strategic directions for an organization must provide the basis for deciding whether or not to outsource a function.**

(4) Finding an appropriate type of service provider

Special steps had to be taken to examine the market for both the PRIME and RPS projects, as they were planned to be at a much larger scale than past projects. For PRIME, the British property management industry found was to be too small and fragmented for the size of the portfolio, and not interested in collaboration. So there was an international search with the resulting decision to focus the project at a multinational level with leadership from banks. The RPS process included discussions with potential bidders and consortiums and a staged bidding process to ensure that there would be companies interested in and capable of taking on the project.

- **A service provider consortium may have to be created for large real estate outsourcing projects.**

(5) Developing a partnership approach with the service provider

For large scale projects, the best¹⁷ service provider companies are in the business for the long haul, can develop long term relationships and fit with the corporate culture, avoid long learning curves, and assist the organization by allowing it focus on its core business and by having the creative ability to think outside the box, and help give the business an advantage during a tight market. Service provider companies, in contrast tend to operate on the letter of the contract. The PRIME project describes its relationship with Trillium,

¹⁷ Ronco, William, “Managing Outsourcing, Trends, Challenges and Successful Strategies”, Corporate Real Estate Executive, June 1999

the service provider, as a partnership, and the two work together to resolve issues with the contract as they arise. PRIME and ORC have special incentives for profit sharing built into the contract to encourage a partnership approach. The Economist¹⁸ noted that the estimated profit for Trillium over 20 years is \$2.3 billion, so this project has great values for the service provider.

- **A partnership approach between the organization and the service provider is required for most effective service delivery.**

3.4 Managing human resource needs

There are two main different types of concerns in the management of human resources for an outsourcing project: the treatment of existing staff under union and other agreements or policies, and the need for different types of skills and knowledge to manage contracts rather than doing the work. But an underlying issue is the need for effective communications throughout the whole process, as discussed 3.8 below.

(1) Dealing with existing staff

In the planning process for an outsourcing project, adequate time must be allocated to make any needed changes to existing agreements or policies, so that ensure that appropriate resolution can be made as quickly as possible. ORC went through two sets of negotiations with their unions to make the necessary changes, contributing to a two year delay in implementation of its outsourcing program. In the case of RPS, the option of an employee takeover was offered. But the union leadership rejected the employee takeover option, on the basis that the unions did not have the expertise to run the business and that it would therefore be too risky for its members. The fast resolution of this alternative helped keep the project on its timelines. But the alternative of employee companies, which have the advantage of knowing the business and where costs can be reduced, are increasingly common in Great Britain. Employees also have an interest in making sure the new company works, as shareholders. The new companies that replaced British Rail included many new businesses operated by former union staff.

The procurement documents for the three case studies included provisions to require protection of affected staff in accordance with legal requirements. ORC offered incentives to the service providers do so in the best way possible for the staff. In the two Canadian examples, the successful outsourcer provided a better package than required, and reports advise that staff are generally satisfied with their new jobs, but with ORC it is too soon to tell. The PRIME service provider has met the same levels of compensation, as required by legislation, and all staff who wished to are now working for the service provider.

It is also important to note that employees often have better opportunities to develop their skills and knowledge working with outsourcers. Large companies may offer better opportunities for promotion as well.

¹⁸ Economist, "Goldman's Booty", April 3, 1999

- **Successful human resource management requires meeting legal and legislative requirements for union and other existing employees in a timely way, or the outsourcing programme can be significantly delayed.**
- **Staff transferred to an outsourcer are generally satisfied with their new positions, which provide better opportunities for development and promotion, and similar or better pay and conditions.**

(2) Ensuring new and different skills and knowledge for in house staff

Staff must be reskilled and new staff hired to take responsibility for managing the new outsourcing programs. The issue of staffing for new ways of operating was highlighted as an issue for Canadian governments in the next few years in a survey of Deputy Ministers and CAO's of municipalities across the country, reported in the Institute of Public Administration's magazine.¹⁹ ORC has had training programmes and is currently in the process of hiring new staff with needed skills to meet the needs of managing its outsourcing initiative.

- **Staff must have the new and different skills and knowledge to manage outsourcing contacts rather than doing the work.**

(3) Planning for the transition to the service provider

Another problem is the loss of knowledgeable staff during the transition period, as staff are leaving the organization and the service provider has not yet sufficient staff. Having staff of an organization move quickly to the outsourcer helps. Both these situations occurred in the RPS and ORC initiatives, and both planned for the need of extra staff in the transition, but RPS managers still reported there were problems.

- **Staffing requirements must be carefully considered during the transition period to private service delivery, when the in house complement is reducing and the service provider has not yet sufficient staff.**

3.5 Mitigating risk

While businesses manage risk, government organizations must mitigate risk because of their additional responsibilities to assure the public that it is operating in an appropriate way. The article, "The risks of outsourcing IT" recommends that insourcing be considered first.²⁰ If the outsourcer fails, there is no easy way to go back. In London, England, a company called ONYXX underbid to win the garbage collection contract for 33 local authorities, but was unable to deliver.²¹ The project had to be re-tendered, and a local authority team won the contract. In another British example, the government outsourced the passport office to a company to operate a complex new computer

¹⁹ Marson, Brian, "1998-1999 Deputy Ministers' Survey", Public Sector Management, Vol.10 No.1, 1999

²⁰ Earl, Michael J., "The Risks of Outsourcing IT", Sloan Management Review, Spring 1996

²¹ Haywood, Ian, Ian Haywood Partnership, London England

programme. The programme was unable to deliver so the government had to hire many new staff and use the old manual processes to meet the demand.

To ensure that risks are mitigated, the development of the whole outsourcing process must be examined carefully, and specific steps included such as the use of financial measures and performance standards in the contract, and providing for on going monitoring.

(1) Use of financial measures

One of the ways the PRIME project reduced risk in the transfer of its properties to the outsourcer was to require an up front payment for the transfer, to reflect their value, although this added costs to the contract. The ORC contracts reduce risk by holding back 10% of the service provider's management fee, which can be released when performance ratings are over 80%.

(2) Use of performance measures

The contracts for all of the case studies include complex provisions for ensuring performance levels are met, as well as incentives for further cost savings. This approach replaces the use of prescriptive requirements used in simple contracting out of tasks. Also the objective of achieving value for money replaces the use of awarding contracts to the lowest bidder. But for large comprehensive outsourcing it is hard to measure the balance of cost savings and service quality. For example, what happens if an office occupational health and safety committee is concerned that the service provider is not meeting the past in house standards of support and responsiveness? Or how can a contract define "clean"? How can a contract manager ensure that the service provider is not cutting corners, particularly when problems from poor work or lack of proper maintenance appear long after a contract is completed? Poor service by cleaners, on the other hand, is immediately apparent. RPS also uses the retention of core expertise to provide yardsticks for ensuring standards are met.

(3) Providing for ongoing monitoring.

Both PRIME and RPS operate single central call centres which provide information on service delivery, and therefore provide for monitoring of problems. ORC undertook a survey of customer service before the implementation of outsourcing to benchmark existing service levels, and there will be further surveys after implementation. ORC is also further developing its performance indicators. It is also using spot audits to check for compliance. RPS is undertaking a survey this fall to determine customer satisfaction, to reflect the conditions. Satisfaction surveys need to be carefully managed and the results reviewed as the contradictory objectives of participants may deliver conflicting results. For example, an outsourcing company may be successful at meeting financial targets by pushing departments to pay fees on time, but the department may not like this pressure and therefore report unacceptable service.

The PRIME and ORC contract also include a dispute resolution process and penalties for non performance. For PRIME, the 20 year contract, the Department management report

the need for ongoing negotiations resolve day to day issues as to what the words in the contract really require.

- **Outsourcing of government functions, compared to private business, requires additional steps to mitigate risk through the use of financial measures and performance standards, as well as providing for on going monitoring and dispute resolution.**

3.6 Facilitating the tendering processes

Tendering processes are more complex for government organizations than for private business. As well as making the bidding as competitive as possible, the processes must be clearly open and fair and be seen to be so. Unlike in private business, governments must provide reasons why a bidder is unsuccessful and the unsuccessful bidder can attempt to change the results or obtain other benefits. Three key considerations in making the bidding process successful for both the organization and the bidders are discussed below.

(1) Ensuring the process is fair, open and transparent

The contracts are for huge sums, so political influence is a potential issue. Additional steps, not required in private business outsourcing, must be taken, adding to costs. For example, ORC and RPS, as well as carefully planning the outsourcing program, took the extra step of hiring a Fairness Commissioner in its program to review the RFP and bidding processes to ensure that all was and was seen to be carried out correctly. Despite this, one of the unsuccessful bidders in the ORC project is suing the government.

(2) Making the procurement process short

The shortest total time frame and the use of staged submissions are important for bidders so that they can minimize expenditures and plan for their future in an efficient way. Competition is increased when more companies are able to bid, and more innovation is encouraged. The PRIME project was developed and implemented within a planned time frame of two and a half years to the selection of the successful proponent. The process also included stages, so that bidders did not make detailed submissions until later in the process. Both the Department and bidders agreed that this process was acceptable. The Canadian examples also included staged submissions. The total length of time is also important because delays can result in an obsolete business case, as occurred with the ORC project.

(3) Providing sufficient information to bidders

This allows bidders to submit a relevant response in a cost effective way. Because of lack of available information for properties in the case of PRIME and ORC, special steps had to be taken to provide the information. For PRIME, an additional stage in the bidding process was required so that the department could help bidders by providing information about the portfolio that had not been available, due to changes in ownership. This extra work resulted in an increase of 4% in cost to the department, as noted in the Comptroller

and Auditor General's report²². The report suggested that all the bidders and the department could have pooled resources to develop a shared data base. For ORC, the contract provides that the service provider must collect and verify the appropriate information within a year.

(4) Encouraging innovation

To maximize opportunities for financial benefits, the organization should determine what it needs to meet its objectives in terms of outputs or results, not detailed requirements. The guidelines of the Comptroller and Auditor General²³ strongly support this approach to encourage opportunities for innovation so that the needed services are provided in the most cost effective way. The PRIME project proposal was flexible in terms of what the service provider was to provide in contrast to the more detailed requirements of the Canadian examples. The ORC contract establishes performance indicators not prescriptive standards to increase innovation and flexibility in meeting requirements.

- **For governments, measures must be taken to ensure that the bidding process is fair and open and also be perceived to be so.**
- **The bidding process must encourage competition among potential bidders by being timely, providing needed information, and allowing for innovation.**

3.7 Avoiding conflicts through careful legal administration

As the contract becomes the basis for operations, it is critical that requirements and standards be set out as clearly as possible, although, as noted above, this may be difficult, and that there be clear processes for dispute resolution, also noted above. Large scale government outsourcing initiatives raise a number of legal issues, with items such as (2) below, that are not applicable with private business. The following are some of the issues that were considered in the ORC project.

- (1) Assignment of liability is affected by the decision as to whether the service provider is an agent to the government or an independent contractor. If the outsourcer is an agent, the government, as principal, is legally liable for the actions and non-actions of its service provider.
- (2) The extent of the requirements for compliance by the outsourcer with government policies depend on the legal relationships. BCBC, the British Columbia Building Corporation, as a schedule 2 agency of the British Columbia government has much more independence in policies and operations than ORC, a 4 agency of the Ontario government. For ORC, ownership of the properties is with the Management Board Secretariat, and therefore ORC is an agent of MBS and is bound by government policy whether it is a schedule 4 or schedule 2 agency. PWGSC as a department is

²² Comptroller and Auditor General, Great Britain, "PRIME, the transfer of the Department of Social Security Estate to the Private Sector", April, 1999

²³ Comptroller and Auditor General of Great Britain, "Examining value for money deal under the Private Financial Initiative", August, 1999

tied to government requirements. Compliance with government policies may add to the service provider's costs.

- (3) Where there are existing contracts with service providers, the government's legal obligations must be covered. ORC and RPS required that the service provider take over the existing contracts, as did PRIME.

- **Potential conflicts in the management of the contract can be avoided by careful considerations in setting out the contract provisions to ensure the needs of the government organization are met.**

3.7 Providing on going communications

NACORE (National Association of Corporate Real Estate Executives) members, surveyed²⁴ regarding outsourcing, stress lack of listening and lack of partnering between different organizations as the key problems, while technical levels of service or professional skills of service providers were not considered an issue. For example, problems arise when cultures do not fit, relationships are poorly designed, a "them versus us" mentality develops, and there is resistance to change through lack of co-operation, insubordination, subterfuge and sabotage. RPS recommends, in the review of its project²⁵, that while major efforts were made to ensure good communications, if the project was to be repeated, a more extensive program should be provided, as they have special communications needs arising from the diverse nature of its portfolio and users, and locations in all parts of the country. Ways to develop good communications are summarized by William Ronco²⁶.

- (1) Relationships between the service provider and in house management can be assisted by increasing the amount of information to be exchanged, maintaining gatekeeping control by keeping critical functions in house, constantly raising expectations, and using formal partnering arrangements to bring service providers together to address issues.
- (2) Service to clients can be difficult when they cannot directly request improvements from the service provider, they do not want to give the service provider requested information, as well as when there are different styles and cultures. Ways to make outsourcing work more effectively include clarifying information needs and roles and responsibilities, increasing the role of in house staff in facilitating interaction between the customer and service provider, and involving the clients in selection of the service provider. The importance of clarifying roles was stresses in the ORC pilot projects and in the implementation of the new contracts.
- (3) In house staff need help with anxiety over job loss, and organizational changes than affect job priorities, expectations and outcomes. Strategies to deal with these issues are to: provide more information than seems necessary on retention, job advancement

²⁴ Ronco, William, "Managing Outsourcing, Trends, Challenges and Successful Strategies", Corporate Real Estate Executive, June 1999

²⁵ AFD Transition Task Force, "Alternative Forms of Delivery at Real Property Services", April 1999

²⁶ Ronco, William, "Managing Outsourcing, Trends, Challenges and Successful Strategies", Corporate Real Estate Executive, June 1999

and changes to the organization, and use of quarterly not annual performance reviews to clarify and update specific job requirements.

- **Effective communications are essential at all stages and with all players, given that new roles are required by all: most problems with outsourcing are caused by poor communications, not technical or procedural issues.**

4. LESSONS FOR GOVERNMENT ORGANIZATIONS

The paper has highlighted key considerations in why government real estate functions are outsourced and why other functions are kept in house, and what factors affect the success of an outsourcing project. The trend is to large scale outsourcing as a way of delivering real estate services. But, decision making is difficult and complex. Outsourcing is more effective in some situations than others, and is affected by many factors. Cost savings, while generally anticipated, are not necessarily produced nor are they always the prime motive. Different players have different expectations: the public, the client departments, the in house staff, and the service provider. The special needs of government organizations with respect to mitigation of risk and tendering processes add to the costs, so analysis of costs and benefits or “value for money” is difficult.

But, to be successful in the end, outsourcing must support and be part of the strategic objectives for the organization and add value to it. Consideration must be given to a wide range of matters: how to support the development of the project, preparing the business case, managing human resource needs, mitigating risk, facilitating tendering, resolving legal issues and ensuring on going communications with all those involved in the project. It is too soon to tell how the cases reviewed in this paper will fare over time and further examination will not doubt take place in the future as to the success of these and other projects.

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APPENDIX 1

Public Works and Government Services Canada (Real Property Branch)

Synopsis

In 1966, the Real Property Branch launched the first large scale major property and facility management outsourcing program to be undertaken by a Canadian government real estate organization. 18 contracts for the management of land and buildings cover all provinces and territories, with most outsourced to a single private consortium. The purpose of the program is to increase efficiency and affordability by contracting out the day to day delivery of certain services to the private sector while continuing to retain full accountability for program management and the quality and client service dimensions of the outsourced functions. Special purpose buildings and strategic functions remain in house.

1. Description of the organization

1.1 Purpose/accountability

The Real Property Services Branch of PWGSC is one of the largest property managers in the country, the primary landlord for a significant proportion of the federal government's real property holdings in the Parliamentary Precinct and most of the office buildings used by departments and agencies across the country. It provides space for 160,000 staff in about 2,500 facilities. The Department has provided services including, fit up advice on the use of buildings, and the ongoing care and maintenance of assets, and administers 3,000 leases.

1.2 Organizational structure

In 1995, the department undertook a major reorganization, creating the Real Property Branch, consisting of the former Public Work Department's Real Property, Realty, and Architecture & Engineering Services Branches. To meet the government's Program Review/downsizing objectives, the Branch decided to become smaller and more focused while continuing to be the first point of contact for departments seeking a full range of property services. Since 1995, it has downsized, as a result of federal government downsizing initiatives and contracting out. The staff union is the Public Services Alliance of Canada.

1.3 Property assets - type and value

The portfolio contains 5 million square metres of space, from office buildings to warehouses and laboratories. Administering the 3,000 leases brings in \$550 million a year. Of the approximately 487 buildings owned by the crown, more than 100 were excluded from the outsourcing project, including the Parliamentary Buildings and Department of National Defence buildings. The remaining 377 buildings were grouped by geographical area into 18 large portfolios.

2. Reasons for outsourcing

2.1 Policy direction

During the mid nineties, as part of the program to reduce debt and therefore the cost of government, the Federal Government began to focus on “getting government right” by providing only those services that are core to government, and partnering with contractors and provincial governments to deliver services that do not need to be carried out in house. At the same time the Government introduced an early departure incentive and early retirement incentive to encourage people to leave without pension penalties. As a consequence, there was a substantial reduction in the number of staff available to do the work.

2.2 Branch objectives

The key objectives of the Branch are to: assign non-core functions to alternative service providers, improve response to clients, provide overall cost savings, and provide a seamless service to clients. The Branch planned to avoid common problems they identified with outsourcing - the fact that successful bids were generally won by the lowest bidder as cost not service was the key consideration; problems in exercising proper accountability to ensure getting value for money; and the failure to retain sufficient in-house expertise to manage the contract performance.

Rather than seeking the establishment of a separate business unit, the Branch decided to become more efficient and contract out the day to day operations of certain services through large management contracts. Greater savings were anticipated than the use of in house management of many small contracts. Accountability remains with the Crown and the relationship with the service provider is collaborative and contractual. PWGSC labels the program Alternative Forms of Delivery. (It considers Alternative Service Delivery to be the creation of a separate business unit that reports directly to a Minister, bypassing normal departmental structures.)

The transfer of services was targeted for April 1, 1998 and was actually accomplished on May 25, 1998.

3. Development of the Outsourcing Program

3.1 Management of the outsourcing project

Early in the planning process, an AFD Transition Task Force was established, reporting to the RPS Management Committee. The Director of the Task Force reported directly to the Assistant Deputy Minister, RPS. The Task Force consisted of a broad range of departmental staff with the expertise to ensure that the business and technical requirements in the contract were appropriate. Its staff teams dealt with specific issues - business and finance, procurement, technical, service delivery through the provinces and territories, human resources management, and communications. Key staff were seconded to the project. Consultant studies were used as needed to provide information and verify, but did not play a major role in the development of the programme. A Fairness Advisor was engaged to ensure the processes were fair and transparent.

Effective communication was considered a high priority and a comprehensive program was developed. Consultation took place continuously with stakeholders, including central agencies, employees, unions, client department, and private industry.

3.2 Business case for outsourcing

The Transition Task Force developed a comprehensive business case, including the assessing, analyzing and recommending for resolution, issues affecting RPS financial and business management practices as they related to the AFD contract.

The first estimate of cost savings potential was in the range of 10 to 15% of the total operating and maintenance budget, calculated for Crown-owned office facilities in 1995/6 to be in the order of \$330 million. Thus savings would be at least \$33 million a year. The one time transitional cost for departure packages was estimated to be between \$66 and 110 million. The risk of failure to meet this payback considered to be very low, 1.25 to 3.3 years, especially if a performance based contract was adopted. The cost savings were assured through the contract which took into account the reduced spending levels and also specified appropriate performance standards.

The business case evolved, and was finally based on:

1. The number of affected employees. The number was reduced from an initial 1700 to 850 because of decisions to exclude certain non-core activities, and to limit contracts to building operations and maintenance alone, and, as well, because of staff attrition.
2. The size of projects managed by Architectural and Engineering Services to be included in the contract.
3. The size of capital projects included.
4. The cost of managing the contract.

3.2 Functions to be outsourced

A “filter“ process was used to decide which functions could be outsourced. The filters of “mandate” and “strategy and management” were first used to establish potential non core activities. Then the “client relationship” and “private sector” filters were applied to establish which should be the non core activities and which the protected activities. Functions were divided into core and non core. Core task were those that must be delivered in-house to meet the Branch’s legislated and policy responsibilities, such as advice to clients, strategic planning, quality assurance, and risk and program management. Also included were real estate expertise to ensure that RPS could carry out its role as a real property advisor, and buildings requiring special security, such as the Parliament Buildings and Department of National Defence properties. Non-core work to be performed by the private sector fell into operational areas - property management, building operations, construction, land surveys and property appraisals.

The following services were then determined to be appropriate to outsource:

- portfolio management planning and analysis, building inspections, assessments, annual building planning
- property management administration, building operations, cleaning, maintenance, security, pest management, material management

- environmental protection and conservation, health and safety requirement, emergency preparedness
- commercial and retail leasing
- project management and delivery services - capital and repair projects, emergency projects, tenant projects
- signage, maintenance of fine art

3.3 Potential service providers

Two different options were reviewed as well as outsourcing to private companies - transferring work to the provinces and territorial governments and employee take overs. Given the Treasury Board's concerns about the welfare of the RPS employees and on-going initiatives to streamline government, the option of employee takeover was given first priority. This option was rejected after consultation with and agreement by the union, for the following reasons: there were not the necessary economies of scale; there were heightened risks for the long term security of employees; and the growing realization that the scale of work being proposed required mature, experienced companies to ensure success.

Priority was also given to provinces or territories that were interested in taking on the work over the private sector. PWGSC had been working with provinces and territories on improving efficiencies in service delivery and cost savings. Such partners were considered to be of less risk than the private sector. BCBC is now implementing one contract. On the other hand, ORC was developing its own outsourcing program and therefore was not included as a potential service provider.

3.4 Ensuring accountability

The guiding principles used by RPS to maintain asset integrity, drive exemplary performance in client and owner satisfaction, and ensure value for money, are:

1. a client-centred focus, value added service delivery, timeliness and affordability;
2. retention by RPS of accountability for the quality of products and services and for the management of the inventory; and
3. retention by RPS of in-house capabilities to understand and evaluate client needs, deliver service solutions, and ensure performance by service providers.

A performance based approach was established by the Contract Working Group in the Technical Team. Key indicators were developed for the areas of asset integrity, satisfaction, and financial considerations. The Quality Assurance framework supports the performance based relationship.

The contract includes a primarily performance based compensation system, allowing the service provider the flexibility to innovate. 15% of the total possible fees are paid only on acceptable performance. The 32 performance indicators in the contract include energy consumption, information, quality control, security, accuracy of year end forecast, value for money, occupancy levels and rental rates, and three Key Performance Indicators:

1. asset integrity, which measures the quality being maintained in the building structures, systems, equipment and grounds;

2. a dual measure of how well the tenant and PWGSC has been satisfied with the service; and financial management.

3.5 Human Resource Management

Two Treasury Board policies set the framework for managing human resource matters - the "Employee Takeover Policy" and the "Work Force Directive, Part VII, Special Provisions Regarding Alternative Service Delivery", dated July 16, 1996, which outlined responsibilities concerning employees directly affected by the alternative service delivery initiatives. At the same time the government was offering early retirement and early departure incentives.

RPS decided that at least 50% of the affected staff would have to be taken by the service provider, and further, that the new salary level for the group of employees included in any contract could not be less than 85% of the government salary for that group or and that no individual employee would be offered less than 70% of his or her current salary, and an equivalent level of benefits were required, following policy requirements. Affected employees were determined on the basis of what work they were doing on March 4, 1997.

The winning private contractor of the 13 contracts, in fact, took almost all the affected staff that remained and paid them at their government salary levels. A recent survey by BLJC (the successful bidder) indicates that 85% of former staff now working with the service provider is satisfied.

4. Procurement process

To expedite the process, the procurement process was divided into 3 stages:

1. industry consultation, briefings and advice;
2. request for qualifications; and
3. request for proposals.

The stages allowed for the detailed development of the contract proposals and for the potential bidders to prepare.

The RFP, dated July 2, 1997 contained 4 volumes - invitation and preparation directions, statement of work, terms and conditions, and information about the 13 portfolios that were being offered to the private sector. The ceiling priced services contract included three major elements of work - property management services, project delivery services, and retail lettings, each of which had its own budget. The budget amounts included cost-pass-through elements such as utilities, firm-priced elements such as projects, and fees. The contract included the use of performance measures and incentives for continuous improvement.

The scope of the contract is "all inclusive" - property management, project delivery and retail lettings - to allow for innovative ways to save money and provide services.

The 18 contract packages were primarily delineated along provincial and territorial boundaries, except where the business volume and budgets were considered too large to be tendered as a single package. Of the 18 contracts, 2 were awarded to provinces and territories, and 13 to private companies, and 3 have been retained for various reasons.

The contracts are for 3 years, with options of an additional 4 years for a maximum of 7 years.

110 requests for tender packages were made, with 28 companies finally submitting. The 60 submissions from 12 bidders were evaluated at the RFP stage under the following considerations - profile and organization, delivery of AFD services, financial proposal and human resources plan. A Fairness Monitor reviewed the process to ensure integrity, fairness and objectivity. All bidders were given the opportunity to discuss their bid afterwards and none challenged the results.

The service provider had to meet objectives including a cost reduction of at least 10%, taking on at least 50% of existing staff and the ability to meet high service standards in all parts of the operations. Weighting in the judging was 35% for human resources matters, 35% for the service delivery approach, 20% for company profile and 10% for price.

The one company chosen for all 13 of the private sector contracts, Brookfield LePage Johnson Controls, demonstrated that it had the size, expertise and financial strength to protect the government's assets. The contract, valued at \$174 million and covering 300 buildings, was announced on December 12, 1997. The successful proponent's submission of 13 bids cost them in the order of \$300,000, and required a cross functional team of 20 people.

5. Implementation

5.1 Transition

A transition period was planned to allow for the smooth transition. The decreased number of staff to transfer, due to leaving incentives and the retention of more staff for in house work, created some problems in service delivery.

To help manage the anxiety of staff, the service provider began an in house newsletter to deal with issues of concerns such as compensation, security, parking and protocol, and also established a toll free help line that could, among other things, deal with confidential issues. In addition there were meet and greet sessions across the country.

5.2 Successes

The RPS project, given its huge scale and complexity, has gone extremely well, and is now used as a model for others. Staff are now working with the service provider are generally satisfied, with the main concern being the loss of the expected life time employment. Staff have also more flexibility in carrying out their functions and as part of

a large company have increased career options and opportunities for training and development and relocation.

Cost objectives are met because the required savings were, in effect, deducted up front off the top of the amount to be paid for the work.

Timing for the initiative was very tight given the deadlines for expiry for certain staff entitlements under government retirement and departure incentive programs. Because the unions agreed not to support the employee take over option, potential delays from the sequential decision-making process regarding service providers were avoided. Also time was saved though the sequential procurement processes.

A tenant satisfaction survey is to be undertaken later this year. It has been delayed to allow for the new program to take effect.

5.3 Issues

In retrospect RPS, would have strengthened the communications program to better reflect the different needs of its staff across the country - differences in culture, language, regions and time zones.

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APPENDIX 2

Ontario Realty Corporation

Synopsis

The Ontario Realty Corporation (ORC), a Schedule 4 crown corporation which operates as an agency of the Management Board of Cabinet (MBC). It is responsible for managing the real estate assets of the government of Ontario. ORC is in the process of outsourcing its facility and land management services, as part of the Ontario Government's commitment to increased efficiency. The large scale program to outsource the non core functions includes facility management, leasing, development of projects under \$200,000 and asset planning. Two of four regional contracts have been awarded for these services and commenced October 1, 1999. One land management services contract has been awarded and commenced August 1, 1999. Contracts for the two remaining regions are being retendered.

1. Description of the organization

1.1 Purpose and Accountability

As an agency of the Management Board of Cabinet, ORC is responsible for managing the real estate assets of the government of Ontario. Its customers are provincial ministries and agencies and in some cases the private sector. ORC has a Board of Directors, which includes private and public sector representatives, and reports to Cabinet. The intent of ORC was to move towards Schedule 2 agency status, which would provide the ORC with complete autonomy, keep its revenues, and flexibility on provincial policies.

The key areas of responsibility are facility management for properties currently in use, land management for properties that are currently in uses, land management for properties that are land banked or that are surplus and awaiting disposal, and real estate services. Ministries like Natural Resources and Transportation operate independently for program related functions, such as acquisition of property for roads.

1.2 Organizational Structure

Headed by a CEO and President, the organization currently has a staff of about 150, reduced from 750 in early 1999. The ORC is organized into two operating divisions and two support areas.

Operating Divisions

- The Real Estate and Sales Division will primarily be responsible for the disposition of government real estate assets. It will also maintain a balance between the supply of owned and/or leased properties and the demand for space to meet customer service requirements. This Division will consist of three principle branches – Real Estate and Sales, Property Preparation and Real Estate Planning.

The Facility Services Division will be responsible for the asset management of the portfolio and will be the primary customer service contact for any local facility or planning issues. The focus of this Division will not be on direct delivery of services, but on the management of large, comprehensive services contracts to ensure a high level of performance and customer satisfaction. Included in this Division is Project Management which will manage the entire major capital development process on behalf of ministries. It will co-ordinate all technical consulting services and will acquire and manage other specialised consulting services.

Support Areas

- The Finance and Administration Division will be responsible for the financial support services for ORC and will be the main liaison between MBS and ORC for reporting purposes. It will also be responsible for the management of ORC's human resources and information technology functions.
- The Corporate Relations Unit will continue to be responsible for developing a plan to maintain appropriate communications with the government, ORC Board of Directors, employees and the public. It will maintain a close working relationship with the MBS through the Minister's office and Agency Relations Unit.

1.3 Property Assets - Type and Value

ORC manages 49 million square feet of space in approximately 6,000 buildings and 52,650 acres of land province-wide. The portfolio is classified as follows: 32% office space and 68% special purpose, such as courthouses and jails, 83% owned and 17% leased with an annual income of \$160 million, 60% in the GTA.

2. Reasons for outsourcing

The Ontario Government is revitalizing its infrastructure in order to prepare for the Future. A Super Build Growth Fund will be established to, among other things, renew Ontario's network of hospitals, educational facilities and highways. Another key component of the government's mandate is outlined in the "Blueprint for action" in the category of "selling Things we Don't Need". The goal is to "maximize value by selling surplus land, buildings and other non-essential holdings that are tying up our previous resources." ORC is repositioning itself to support the Government's initiatives. ORC will continue to providing day to day operations including accommodations advice, design services, new construction and capital improvements. ORC is determined to continue to deliver the optimum mix of quality services at reasonable cost.

The fundamental purpose of ORC is to ensure the commercially-oriented orderly disposition of Provincial real properties to optimize value for the Ontario taxpayer. ORC will continue to manage core government assets with the goal of achieving high professional standards and customer satisfaction. Over the next few years, the Management Board Secretariat will focus on improving customer service and delivering open, accountable and effective management. As outlined in the Blueprint for Action, a

key element will be to move away from direct delivery of services that are not for core government services. ORC is participating, through outsourcing of facility management and land management services.

3. Development of the Outsourcing Program

3.1 Management of the outsourcing program

A special dedicated transition team was assembled develop the outsourcing program. The team included an executive lead, a lawyer, people from operations, financial and human resources areas, and a project manager. The consulting firm of Price WaterhouseCoopers assisted primarily in the earlier stages of the planning. The role of in-house staff was important because of their familiarity with all aspects of the organization, its client Ministries, operations and planning to date. The Transition team consisted of six members – an executive lead, one operational staff, one in-house legal counsel, one financial staff, one human resources consultant, and an overall project manager.

The communications program included weekly bulletins from the CEO, produced by the Transition Team, presentations to the Accommodations Council members, and to tenant groups. Early on in the process, a consulting firm provided training and consultation to ORC and client tenants to assist with the transition to the new environment. A number of presentations were made to the various union committees and the MBS Human Resources Branch to set up a number of information sessions to provide ORC employees the various options available to them. The Transition Team also contacted and set up a number of vender consultations with various firms for the purposes of re-tendering the remaining two regions.

3.2 Business Case for Outsourcing

The past practices of many ministries, like government bureaucracies, were not business focussed. For example, there were incentives to spend what was left in a budget before year end, rather than develop and follow a business plan. Price WaterhouseCoopers was hired to advise and develop the business plan for the outsourcing initiative. The NDP Government's objective, at the time, was cost savings. Benchmarking studies formed part of the analysis and BOMA standards were used for this purpose. Each business was analysed to see to see it was cheaper to outsource or operate in house. The firm of Price Waterhouse was used as they had experience in the area and credibility with the government. The role of consultants decreased as the importance of in house continuity and knowledge became increasingly key timely and effective implementation so that all the pieces fit together.

Pilot projects, carried out by ORC for properties in Guelph and St. Catherines, with service providers Brookfield LePage Johnson Controls, showed the benefits of an outsourcing initiative, although each project was one building not a portfolio. The principles established through these two pilot projects and the experience gained were utilized in developing and modeling the regional portfolio of ASDs. These pilots offered good opportunities for ORC to see if tenants were satisfied and costs reduced. The pilot

project required monthly reports from the service provider, which provided ORC with the tool to manage the service provider and monitor how well the project was doing.

3.3 Functions to be Outsourced

Facility management, which includes the management of both owned and leased space, is the only area where large scale outsourcing is underway. . Before the major outsourcing initiative, 80% of the work was already contracted out through a number of small service contracts. The private sector was growing at a rapid rate and was quite capable of undertaking the work. The advantages to outsourcing all the services in the manner in which ORC has undertaken included cost savings through managing consolidated contracts. Dealing with one service provider who would be able to ensure these savings through a number of mechanisms, and the opportunity for ORC to get out of direct service delivery by enabling staff who carried out this work to be employed by the service provider. This greatly reduced the number of staff and could easily be severed from the delivery of services currently offered by ORC to its clients.

All constructions projects carried out by ORC are outsourced, with staff carrying out the tendering and project management functions only. It is not considered cost effective to outsource large complex projects, those in excess of \$200,000.

The Real Estate and Sales group is group of approximately 39 in-house staff and consists of a Real Estate Marketing Group, property Preparation Group, and a Real Estate Planning Group, with service support functions. Strategic control of real estate is considered a core business and remains in house. Further, there are few private sector firms that can provide the strategic functions such as expropriation.

Property enhancement functions make use of planning consultants for information about properties and their potential, but the strategic decision-making, which is politically sensitive, will continue to be undertaken in house. The Bay Wellesley and Cornell developments are examples of joint ventures in the sale and development of properties, where risk is shared and as well as profits.

3.4 Ensuring accountability

Various provisions to ensure that performance and the achievement of cost savings are carried out to meet ORC's requirements are specified in the contract. The key item is the Performance Incentive Bonus which can be awarded if the performance rating is above 80% according to key performance indicators established and agreed upon by both parties. Where the Bonus is granted, the service provider may share up to a maximum of 50% of the savings realized in a subject year. The four key objectives for the performance indicators are: management performance, financial performance, asset integrity and customer services. Detailed breakdowns of categories for scoring are included for each of these. In addition to the PIB, the contract provides for a 10% holdback of the service provider's management fee which can be released once the performance rating is over 80%.

3.5 Human Resource Management

Although much of the property management services were already outsourced to some extent, the facility management staff are the ones most affected through the initiative. As a result of two lengthy rounds of negotiations with the Unions, the Collective Agreement includes mandatory requirements for “reasonable efforts” when outsourcing the current work carried out by staff. The RFP required that the service provider must offer a staff member at least 85% of their current salary level and recognize years of service for the purpose of seniority and severance. An affected staff member could opt out of the RFP before the RFP was awarded. However, if staff remained attached to the RFP this means that the staff member would not have advance notice of the compensation and benefits offered by a successful service provider.

Approximately 40% of ORC opted to stay attached to the RFP and those staff that opted out were declared surplus and would receive special surplus packages. They were then free to apply separately to the service provider, however, there would be no guarantee of the type of compensation structure offered to staff that stayed attached to the RFP.

The selected service provider actually provided ORC staff who remained attached to the RFP an excellent package by offering 100% of their current salary levels, as well as guaranteeing benefit levels. Of the staff that opted out, a number were able to bridge to an early retirement pension and then apply to the service provider. OPSEU staff who were attached to the RFP and did not want employment with the successful service provider received the legislated severance but not the enhanced severance. AMAPCEO and PEGO staff were able to turn down the service provider’s offer and still be eligible to the enhanced package.

4. Procurement process

A Request for Qualifications process was initiated by ORC early in 1997, however, amidst growing resistance from the Unions and the time restrictions on outsourcing, this process was cancelled and ORC proceeded directly to the Request for Proposals stage. The RFQ process was not entirely lost as the ORC Transition Team were able to carry out vendor consultations which focused on the type of expertise in the industry, the availability and willingness of firms in the private sector to bid on this contract and to solicit feedback on the structure of the RFPs.

A detailed RFP was prepared by in house staff, which included an introduction, instructions to proponents and the agreement on work that was to be outsourced. The RFP also included criteria for selection which covered such areas as experience, quality assurance, human resource requirements, management, operational and financial planning, etc. Experience evaluation teams were set up in each region and a due diligence function was also established to ensure a fair and equitable evaluation process followed. An independent consulting firm was selected to provide ORC the fairness commissioner throughout the evaluation and award process.

Four facility management services RFPs were developed, one for each of ORC’s regions. A land management services RFP was also developed for the Province’s major land

assemblies. The RFPs for the Greater Toronto and Southwestern Regions have recently been awarded to Profac. DEL Management Solutions was awarded the contract for land management.

Approximately four facility management proponents submitted bids in each region; only two proponents had affordable prices. The highest ranking in all four regions was afforded the opportunity to select two regions of preference. Obviously the GTA and Southwestern regions were selected because of their size. One of the criteria approved by the Management Board stipulated that one firm was able to win two of the five contracts and would not be able to bid on any retendered contracts. With the bids being unaffordable in the remaining regions, ORC opted to retender for the North and Eastern Regions. The successful proponent would not be allowed to bid on these regions as they already won two of the five contracts. ORC is in the process of retendering the remaining two. Although ORC initiated the outsourcing of its facility and land management services to acquire cost savings, one of the unsuccessful proponents is suing ORC, even though their bid was clearly not affordable to ORC. Their motion for injunction to halt the retendering of the remaining two regions was not successful and ORC is proceeding to retender for these services.

5. Implementation

5.1 Transition

The DEL contract for land management commenced August 1, 1999. PROFAC assumed full responsibility of ORC's facility management services on October 1, 1999. Prior to the transfer dates, there was a shortfall (2 months for DEL and 4 months for PROFAC) hand over period to facilitate the hand over of responsibilities to each firm. Each organization assembled a team of hand over specialists to ensure the transfer was as seamless and transparent to ORC's clients. The transition to the transfer to the outsourced model required ORC to establish a number of small decommissioning teams to close off and start up the new organization. These teams are short term solutions to an interim organization until such time that the various functions of the new organization are up and running.

5.2 Successes

The ORC successfully transitioned its operations to DEL and PROFAC. Both service providers are currently carrying out the services previously delivered by ORC. In addition, ORC staff were offered excellent job offers which satisfied their unions. And finally, the OPC outsourced its services through affordable prices which will impact the rents paid by their tenants.

5.3 Challenges

The length of time to develop the program and award contracts has created a number of concerns. Two of the four regions will be operating through the outsourced model and the remaining two will continue with current operations until the summer of 2000. Resources are limited in the remaining two regions as many good staff have left ORC. The

organization is split into two modes of operation until the entire outsourcing program is complete.

In the coming year, ORC faces several key challenges. It must effectively respond to ministries changing accommodation requirements as the Ontario Public Service continues restructuring. ORC will continue preparation for the millennium and the Y2K's impact on embedded building systems. The outsourcing of facility and land management services will test ORC's ability to manage fundamental change to business processes while still delivering regular operational services. The outsourcing will save approximately \$80 million over the five year contract term.

IPC is undergoing the most significant changes in its history. There have been some delays during this process. ORC must proactively identify and manage controllable risks in order to mitigate damage and achieve anticipated savings.

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APPENDIX 3

Department of Social Security, Great Britain, PRIME Case Study
September 19, 1999

Synopsis

The first major (700 buildings) property transaction by a UK government department, under PRIME (Private sector Resource Initiative for the Management of the Estate), was implemented in April 1998 with the awarding of the contract to a private sector consortium, called Trillium, led by Goldman Sachs, the US investment bank. Trillium acquired most of the properties owned and used by the Department of Social Security. The Department retained rights to occupy the buildings for 20 years and pays annual charges for services in the use of the buildings, and estimated a 22% savings for the period.

1. Description of the organization

1.1 purpose/accountability

The Department operates the national social security program and has offices across the country. The government's Treasury Department controls expenditures. The department contains a number of agencies operating in a decentralized way, with the Benefits Agency taking 95% of staff.

1.2 organizational structure

In 1996, the Cabinet Office of the Civil Estate gave the Department of Social Security responsibility for its properties. Prior to that, responsibility was with the Property Services Agency of the Department of Public Works and, for a short time, with a central Property Holdings organization.

The Department employed 210 staff on property related functions and more in business units that managed the 160 service contracts. Now there are 127 staff located in 6 regional offices and at a central office responsible for contract management. The staff component is to decrease further. The Prime Project Section of DSS under the Director of Estates, manages the contract, compiles strategies for the use of properties in liaison with business units and Trillium, and ensures that Trillium adheres to the performance and standards in the contract and that the Department's interests are protected.

1.3 property assets - type and value

The Department had responsibility for 700 buildings, located across the country. This is the largest civil estate of the government, with 1.8 million square metres of space or 16% of the total floor area used by the national government. It includes mainly traditional office buildings in towns and cities across the country, with some properties having little value. It includes 158,000 square metres of vacant space, costing \$27.6 million a year to maintain. Thirty seven percent of the property is owned and the rest leased, 14 % for periods of 99 years.

2. Reasons for outsourcing

The project was part of the British government's programme to outsource non core functions, which developed into an extensive program covering a wide range of activities, called the Private Financial Initiative. The Department had already outsourced its information technology functions and therefore its senior management decided to look at outsourcing responsibility for managing its properties, as this was seen as an opportunity to resolve major problems with the portfolio. The major problems identified were: the need for costly extensive refurbishment and maintenance for which the Department did not have sufficient resources and for which increasing backlogs were not acceptable; the high cost of vacant space, which was mainly in leased property, and the amount of vacant space was to increase through reducing staff and by increased use of information technology, particularly for record storage; and the fact that there was a complex and fragmented network of service contracts that were inefficient and costly to manage. Rationalizing the portfolio was seen to be difficult with a small capital budget.

3. Development of the Outsourcing Program

3.1 Management of the outsourcing program

The Project Team consisted initially of 5 in house staff and a Project Director, who had experience with private sector project management, and increased to 25. Because of lack of experience with the Private Finance Initiative, staff were given training and external assistance, and advice was sought from the Private Finance Panel Executive, a government advisory body, and from other outsourcing projects. The team appointed ten advisors to help with legal, financial and property matters, as well as for information technology issues.

A departmental steering committee, supported by the Project Team, was responsible for preparing and agreeing to the Departments requirements, setting up and maintaining data bases, setting up a data room for bidders, compiling financial data, negotiation with bidders, and managing the implementation process. The Project Team, with inputs from business units, developed a Departmental Estates Strategy, which identified core buildings which were required to meet needs for 15 years, and flexible premises, which were unlikely to be required for so long, as well as properties that were surplus. Existing strategies had not been linked to business plans.

3.2 Business case for outsourcing

The project started from the premise that the private sector was better able to manage maintenance, capital works, accommodation services and the disposal of surplus property. The Department's objectives in outsourcing were: management of the estate to meet business needs, reduced costs of accommodation, removal of responsibility of the ownership of the estate, reduction and removal of the burden of surplus accommodation, transfer of appropriate risks to the private sector, and flexibility to meet changing needs. The business strategy for the Department affecting real estate included further reductions in staff, increased use of information technology, greater emphasis on providing modern working environments to enhance productivity and constraints in capital and running costs allocations.

In 1995, the Department with the assistance of consultants, undertook a feasibility study that reviewed international examples. The results confirmed that multinationals and consortiums in the private sector were willing and able to take over the ownership and management of the Department's properties. Property management companies in Britain were too small and not interested in the opportunities offered, but consortiums headed by banks were. The eventual winning bid was from a consortium called Trillium, which was led by the US investment bank, Goldman Sachs and includes Whitehall Street Real Estate, a property investment fund managed by Goldman Sachs; Mychand, a property investment, development and trading specialist; Archon, a subsidiary of Goldman Sachs, providing property and asset management services; Debt Funders; and Abbey National Bank.

To maximize private sector interest, the key factors in the programme were determined to be: the need for the Department to commit to occupy at least 60% of the estate for at least 15 years; a clearly defined and rapid timetable for the transaction; the need for bidders to have reliable information on the estate; and a single contract for all of Britain, including a wide range of facility management services.

The business case, developed through computer modeling, looked at costs for the capital expenditure required over 20 years to maintain the quality of accommodation; maintenance and facility management costs; payment for rent and related expenses; and the revenue comes from the sale of surplus property and the residual value of the estate at the end of 20 years. It determined that outsourcing would produce an estimated present value of cost savings over 20 years of \$1,334 million (all costs are in Canadian dollars, using a conversion factor of 2.3 dollars to the pound sterling) or 22% of the estimated in-house costs, with savings coming from much lower capital expenditure and facility management costs, resulting from improved management methods and economies of scale. The idea of regional contracts was rejected as the portfolio was considered too mixed in value. The property values in some areas were very low.

The Department transferred the service provider ownership of most of the freehold premises and the leasehold properties to operate for 20 years. A separate project was underway for properties in the Newcastle area and therefore were excluded. In order to reduce risks of the transfer to the Department, the Treasury required the outsourcer to pay \$575 million up front to transfer the properties, even though that payment will add to costs for the outsourcer to borrow the funds, and therefore increase costs to the Department. The properties were valued at about \$700 million. The remaining portion is covered by an agreement that the ownership of some large properties can revert back to the Department. The Department is to pay almost \$600 million a year for accommodation services, including cleaning, maintenance, catering and security, as well as energy and utility management. Trillium operates one call centre, and had contracts with one catering contract, 2 cleaning companies, 3 building maintenance companies and one security company.

In order to be able to be flexible over the 20 year contract, the Department and Trillium will manage their contractual agreement as a partnership. The Department will receive a 50% share of net profits on the disposal or redevelopment of vacated

property, but not share in losses. At the end of 20 years, the property remains with Trillium and the Department may continue to occupy the space on 5 year leases or vacate it.

The benefits to the outsourcer are: the revenue from the sale or lease of vacant space, the profits from redevelopment of sites; and the overall management of the large portfolio. The Department has rights to give up the uses of additional space without penalties, but will be heavily penalized if it uses more space than allowed for in the contract. So far the Department has had to do use additional space, as operational changes took longer than anticipated, but potential future changes to computerize paper records will substantially reduce its needs. The April 3, 1999 article in the Economist, "Goldman's Booty" suggests that the total profits to the consortium over 20 years is in the order of \$2.3 billion, depending on the state of the real estate market.

3.3 Functions to be outsourced

The most of the portfolio of owned and leased space is transferred to the outsourcer, in exchange for the provision of accommodation services.

3.4 Ensuring accountability/managing risks

The contract with Trillium included several clauses requiring essential capital investments and maintenance. Also there were provisions for sharing in profits but not losses with different arrangements for different aspects of the business - maintenance, utility cost savings, changes in contractor's service methods, landlord's service charges on rental properties, development of disposal properties, and disposal of properties. The report of the Comptroller and Auditor General advised that the allocation of risks was similar to other Private Finance Initiatives projects. Bidders considered it to be appropriate, except for the risks associated with legislative and regulatory changes, but for the Department, these risks were normal parts of carrying out a business.

The bidding documents required the setting out of approaches to delivering the services, the establishment of a help desk to request services and bring deficiencies to the attention of the contractor, and to propose a performance monitoring system. In most Private Finance Initiatives, clients are to specify outputs in terms of detailed standards of service required, and criteria to achieve those standards, in order to allow bidders to make innovative proposals. But this approach was considered too complex for facility management matters, so the contractor's performance is measured on compliance with standards, such as the frequency of cleaning, and the handling of requests for service within agreed response times. The Department and Trillium have subsequently had to negotiate to make this approach work in a clearer way, and to add to the performance system measures of customer satisfaction and incentives for improved service.

The performance measurement system is operated by Trillium, but the department has access to the information produced and rights to audit it. The system is primarily concerned with compliance with procedures and the Department obtains information through complaints recorded at the customer service centre, liaison with customers, independent assessments of office, and accompanying Trillium on quality

assessments. Payment mechanisms in the contract ensure that accommodations are up to standard, with penalties where space is not available at agreed conditions. Some penalties have been paid to date, but these are not significant.

3.5 Human resource management

Over 500 affected staff, mostly in security, were transferred to Trillium, with their conditions of service protected by legislation. Another 104 were transferred to other work in the Department, including management of the new contract. No staff were made redundant. Much of the facility management functions had previously been outsourced in a number of small contracts.

4. Procurement process

The process began at the beginning of 1995 with the invitation to potential bidders to express an interest and 28 submissions were made, 12 from consortia, eight of which were led by banks. A shortlist of 6 bidders submitted proposals in mid 1996, with the preferred bidder selected in mid 1997, and the contract was implemented in April, 1998. Because bids submitted included conditions, the Department added a second stage from two bidders to obtain firmer prices. Final negotiations included a measurement of the estate, which resulted in 4% increase in cost, and arrangement were made to allow some flexibility in the provision of services. Trillium's bid was \$623 million lower than the other bidder.

The British government is concerned generally about high bidding costs in PFI projects, as this is seen to deter competition from bidders. The total procurement cost for the Department, for staff and consultants, was \$23 million, and for Trillium, in the order of \$92 million.

The process and timing was considered generally acceptable to the Department and bidders, with the planning starting at the beginning of 1995 and the decision made on the successful bidder in mid 1997. The major problem was that there was insufficient information about the estate, such as the terms of the existing leases, details of service charges by landlords of rented accommodation, accurate floor area measurements, and details of energy consumption. This problem arose because the responsibility for the properties had been with other organizations in the past. The Department offered a joint survey process to develop the needed information on the properties, but too late in the process. A single survey would have reduced time frames and bidder's costs, and created a single data base to work from.

5. Implementation

5.1 Transition

As implementing a contract of this size, the Department recognized that there would be a period where problems would have to be resolved. Primarily issues arose about what was meant in the contract regarding different services, such as what constitutes "clean". The main problems that arose were: the Customer Service Centre's lack of ability to meet target times for answering the phone, and response times that were longer than specified in the contract; substandard provision of security in some areas; and uncertainty under the contract as to whether Trillium could bill the Department

for certain services, such as for staff moving between offices. The dispute resolution in the contract was found to be too cumbersome. Ongoing efforts are required to resolve issues. Some penalties have been given and some revised procedures put in place. The value of penalties has not been significant given the total value of the contract.

5.2 Successes

The project is deemed to be successful at this stage. A Public Accounts Hearing by a committee of members of Parliament and attended by staff of the Treasury and Audit Office and staff of Trillium and the Department, held in July 1999, supported the project.

The Auditor's report states that the project's anticipated savings appear realistic, with savings attributed to economies of scale and bundling of services, as well as to the improved planning and management of the portfolio, and the spreading of the risk in the large portfolio. There are also estimated savings from rental to third parties and better values in the sale of surplus property. However, sales to date have not shown profit.) Trillium had higher costs than the Department of obtaining capital, bidding costs of LST 42 million, as well as the LST250 cost to transfer the property, but significantly lower capital expenditure and facilities services costs. The Department concluded that the lower costs do not create undue risks.

Trillium has negotiated lower electricity charges for 63 sites with high consumption, and will share equally with the Department the 11.7% savings, and has identifies 22 further sites for negotiation. The savings were possible because of the use of a dedicated team.

5.3 Issues/Lessons learned

The following are the recommendations for other such projects by the Comptroller and Auditor General, as set out in the report reviewing the project.

- (1) As the control over accommodation is taken away from the departments, top management and ministerial support must support the initiative, as there may be internal opposition.
- (2) Departments must assemble data on the properties in advance to reduce the costs and time frames for bidding and therefore encourage competition. Where this cannot be done, there should be a polling of resources by the department and bidders to develop the information so that all can work from common assumptions.
- (3) Flexibility to vacate accommodation without payment increases the costs as suppliers have less certainty of income. Variant bids should be provided by suppliers to assess the price to pay and whether this is reasonable.
- (4) Up front payments to reduce the risks when the properties are transferred also increase costs, so there should be information provided on the options.

The main points that the PRIME case brings to the discussion of outsourcing of real estate functions in Canada are:

- (1) The project is part of a major program of the British government, the Private Financial Initiative, begun under the Conservative government and continuing

under Labour. As a result, there is strong support for innovative and creative projects.

- (2) The outsourcing of the portfolio rather than of facility management services, provides significant additional opportunities for both the Department and the outsourcer, but requires multinational consortiums and financial institutions to take the lead.
- (3) While legislation to support unions is much weaker in Britain, the employees were not negatively affected by the transfer to the outsourcer.
- (4) Encouraging the bidding process is important to achieving the most effective contract, and cost effective bidding is supported by timely deadlines and the provision of necessary information about the properties.

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Sources

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2. meeting with Bill Frost, Director, Prime Project Management, September 7, 1999
3. Economist article, "Goldman's Booty", April 3, 1999
4. Various publications on the PRIME project by the Department of Social Security

APPENDIX 4

Examining the value for money of deals under the Private Financial Initiative, Report of the Comptroller and Auditor General, August 13, 1999
September 17, 1999

The following is a summary of the points included in the National Audit Office of Great Britain's framework for examining value for money, based on experience with projects under the Private Financial Initiative programme since 1997.

1. Make the objective clear

Top management has the responsibility to establish what is being looked for and how that will be delivered. There must be a partnership between the public sector to meet the objectives of the department and the private sector to make use of its capabilities in the most effective way. Four key steps are required.

(1) Select the best projects to pursue

The best projects are those that the department cannot finance conventionally. Examples include funding of construction projects or operations, where there is insufficient funding available in the budget. The department must clearly establish what services are required and what the full costs are over the long term. The risk is that a department may focus its priorities on PFI projects rather than what services it is to provide.

(2) Make the deliverables clear

In order to provide the private sector with the most opportunity to use its capabilities, the objectives must be clear and unnecessary constraints removed. The principles to achieve this include:

- focus on outputs required, what the department wants
- have regard for private sector capability, what is achievable such as routine tasks rather than policy development
- undertake a preliminary assessment of benefits at an early stage
- understand the constraints from legislation and policies that will affect the project to communicate to the private sector

(3) Determine the best forms of partnership

For efficiency, the department must provide a framework for the partnership to limit options. The relevant considerations are:

- identify feasible project mechanisms, in broad terms
- identify scope for innovation, and ensure that any restrictions on innovation are justified, given that best value for money results where there is maximum scope for the private sector to develop innovative ways to deliver the service or outputs the department requires.
- identify the scope for risk transfer, including consideration of any aspects of the deal that could stand in the way of allocating risk optimally, such as creating new risks that would fall on the private sector

- establishing the likelihood of an affordable value for money project, through predicting when the market is unlikely to be able to deliver a proposed requirement, with the use of external advice as appropriate

(4) Produce an outline business case

The outline business case should include the objectives of the project, an option appraisal showing the PFI approach is the best direction, a timetable, evaluation criteria for examining bids, and an indication of the financial commitment that may be necessary to pay for the project.

2. Applying proper processes

The department's planning team should establish the appropriate procedures for procurement, including ensuring procedures are in compliance with legal requirements, and result in value for money, be fair to bidders, and not place unduly onerous requirements to discourage bidding. The principles to consider are noted below.

(1) Thorough planning

The steps to successful planning are:

- Assemble a qualified project team, including people with prior experience negotiating PFI deals where possible, and use external advisors with previous successful experience in PFI.
- Investigate the market for the services in question, including discussions with potential suppliers, so that the project can be presented in a way that they will appreciate the business opportunities offered.
- Consider potential issues in negotiating the contract, drawing on experience with previous similar projects.
- Develop a strategy and timetable to encourage bidding, including the use of staged bidding to limit the number of bidders requiring extensive bidding costs.
- Use a tendering strategy to provide a brisk timetable in order to maintain tension to get the best value, but also allow for sufficient time to resolve important contractual issues, and advise the potential bidders as to what is involved, and to allow for limited changes to strategy.
- Establish a public sector comparator, based on the outline business case, and review and update it.

(2) Establishing conditions for a successful competition

Competition is essential to getting the good value for money. The key conditions for successful competition are:

- Develop a good list of firms invited to tender, by simulating interest and giving guidance according to the relevant legal framework.
- Establish clear specifications of requirements based on desired outputs, and without excessive detail to encourage innovation.
- Ensure that competitive tension is maintained throughout the procurement process.

(3) Regularly reassessing whether the project is worthwhile

Someone not directly involved in the project, such as an external consultant or internal auditor should advise senior management on whether the expected outcome is

likely, so a decision can be made on whether to change the project's objectives or abort the project.

(4) Controlling costs

The principles for controlling costs for a department undertaking a PFI project are:

- Establish initial budgets for external consultants on a project basis and where possible on a task basis, not as part of the annual budget.
- External consultants should be hired using a competitive process, and full account should be taken of quality as well as price so there is value for money.
- Costs should be monitored and managed.

3. Selecting the best available deal

Selecting a winning bid is more complex in PFI than in normal tendering, as there must be multidimensional considerations of: price, technical compliance with the service specification, as well as the degree of risk taking by the potential suppliers, the extent of innovation, and trade-offs between price and quality. The method of evaluation must include informed judgement, and be based on the consistency with the department's objectives for the project and what the tenders have been told about it. The key steps are:

(1) Obtaining a good range of solutions

Obtain a good range of solutions (variants in design, operations, financing, deliverables, and risk transfer) by expressing the department's specifications by outputs not inputs.

(2) Evaluating elements of the bid

Evaluate elements of the bid (financial, risk transfer, financial stability of the bidder, quality of service) using separate working groups in the department to examine each aspect of the bid.

(3) Selecting the most economically advantageous bid

Select the most economically advantageous bid by using informed judgement, as arithmetically weighted criteria cannot deal with the tradeoffs needed between price and service quality, opportunities for innovative solutions and different payment mechanisms. Aspects to consider are cost, bidder track record, design features, operational features, and impact of risk.

(4) Measuring differences between the winning bid and the contract

Manage differences between the winning bid and the final contract in terms of cost, design deviations, operational deviations, deliverables, and risk allocation. Because of the complexity of the projects, there is often negotiation following submission of final bids. During this process the department must continue to monitor impacts of potential adjustments and concessions, including the possibility of concessions putting the winner below the next bidder. Departments should be prepared to walk away from deals that are not value for money.

4. Make sure the project makes sense

Before final approval senior management must undertake a final review to ensure the project still makes sense. The following should be considered.

(1) Measuring the real objectives

If the terms in the market are not satisfactory or the department's objectives are changed in ways that potential tenderers may see as fickle or reduce the public sector's future prospects of getting good PFI deals. Legal advice should be sought if the objectives are changed to ensure there is no risk of legal challenge by the bidders.

(2) Eliminating alternatives

The department must establish that the project is superior to realistic alternatives by comparing the project with the outline business case and refinements to it made during the development of the project. The Treasury's "Green Book" provides technical advice on carrying out comparisons, and the advice of an external consultant on technical analysis and to review work of staff can be helpful. Over-elaborate financial and economic models are not helpful except where such detail can assist in decision making. The department should examine the sensitivity of the conclusions to variations in the key assumptions.

(3) Ensuring delivery of services over the contract life

The checking process must include considerations of whether the project has adequate incentives, remedies and safeguards to satisfy the department that services will be delivered to a satisfactory standard during the contract. The department should be satisfied with the following:

- adequacy of arrangement to manage the contract
- appropriateness of incentives provided by contractual sanctions and bonuses
- appropriate arrangements for compensation for poor performance by the contractor
- specification of termination or hand over arrangements
- appropriate provisions for dealing with changing requirements

(4) Affordability in the short and long term

Before entering into a PFI deal, the department must verify that they will have access to the funds needed to meet the contractual arrangements, including capital costs in the short term and long term on going commitments to pay the private sector partners.

APPENDIX 5

Lessons from Outsourcing of Information Technology

Synopsis

The considerations for outsourcing real estate and information technology are generally very similar. Both real estate and information are functions within an organization that primarily support the business of the organization. Both areas have been outsourced as non core functions, and in some aspects are primarily retained in house where they are integral to the business. They are different in one key respect - information technology continues to evolve at a tremendous rate, and outsourcing decisions also must include consideration of technological changes. IT contracts are generally shorter and careful attention must be paid to the potential impacts of outsourcing on the core business, as IT systems are often critical to its success.

1. Comparisons with real estate

The transactional aspects of information technology is outsourced as a non core function, there are a number of considerations that make it different from other support functions like property management, mail room, legal departments etc. The special considerations include:

- (1) IT is not homogeneous but comprises a wide range of activities. And these activities interact with business processes, such as accounting. IT can integrate product design, material purchases, sales and customer services etc.
- (2) IT capabilities continue to evolve at a fast rate. Thus predicting IT beyond 3 years is difficult. A 10 year contract with a vendor using obsolete technology is problematic.
- (3) Gauging the economics of IT activities in the longer term is difficult. Computing costs have been going down at a fast rate. What appears reasonable today will be expensive in the future when cheaper alternatives will be available.
- (4) Economic efficiency has more to do with IT practices than economies of scale. Many medium sized companies operate at scales that can be cost effective for IT. Cost savings by vendors may be hard to achieve except by management practices, such as consolidation of data centers.

2. Considerations in outsourcing IT

The two main objectives for outsourcing IT are similar to those for managing real estate - cost cutting while maintaining or enhancing services, and a desire to focus on the core business of the organization. Outsourcing is seen as an opportunity to reduce costs from 10 to 50%. In some organizations, the executives were uncertain about the value of IT, and therefore wanted to minimize its cost. Outside vendors were seen to be able to deliver better services cheaper because of economies of scale and technical expertise.

Other objectives result from the special needs around the speed of change in technology. One objective is to subcontract the responsibilities for operating and maintaining “legacy” systems (old systems that still need to be operated until they are phased out), and another to keep up with new technologies.

2.2 Business considerations

Successful sourcing begins with analysis of the whole business. Conventional wisdom in IT activities is that commodity functions such as payroll and data centre operations can be outsourced but strategic functions, such as an on line reservation system, should be kept in house. But roles depend on the business and can change over time, such as with ATM’s which were first strategic and are now commodities. As well all IT activities may be classified as commodities, but may provide a business value, such as reducing the costs of core functions.

2.3 Financial considerations

Outsourcing is considered cheaper because of the opportunity to reduce costs through economies of scale. But these benefits can also be achieved in organizations of sufficient size, or through consolidation of functions to create an appropriate level of service. The real key to vendor’s ability as an outsider to reduce costs through implementing more efficient management practices. IT managers of in house organizations are often hampered in efforts to make such improvements, as they have no authority to make the needed changes in the operations of business units. The threat of outsourcing can drastically improve in house costs and service delivery. Savings of up to 45 % have resulted from improved in house practices, such as standardization of software.

Another financial consideration is that vendors may underbid, to obtain the contract and then charge high rates for any change, recognizing the company is captive. Also outsourcing has been used to obtain revenue for a company by its selling off assets and transferring staff to an outsourcer.

2.4 Technical considerations

Outsourcing technically mature activities is less risky than to organizations as they are able to clearly define their requirements. IT activity has high maturity when it represents the well established use of familiar technology, such as accounting systems and operations. On the other hand outsourcing of activities that are not clearly understood can result in major cost and delivery problems. In such cases, expertise can be bought but the external resources need to be strongly integrated into an internally managed team.

Where technical integration of IT with other business processes is high, outsourcing of a function becomes problematic. Existing businesses may be disrupted and the scope of a project will have to be increased to ensure operations are not negatively impacted. Where there is a high degree of integration, there must be a close working relationship between the business and the vendor.

2.5 Types of outsourcing

Services can be provided on a continuum from totally in house - managing and delivering services by staff, to buying services but managing them internally, to totally outsourced.

There are four types of contracting strategies:

- (1) buy-in: Companies buy vendor resources to meet a temporary need, and contracts specify the skills needed and the cost per person
- (2) contract-out: The vendor is responsible for the results. This strategy is most successful when the company can clearly define its needs, and specify precise service levels, with penalties for non-performance.
- (3) preferred supplier: Companies develop a close relationship with vendors in order to access its resources for ongoing activity. An incentive based contract defines complementary goals.
- (4) preferred contractor: Contracts with vendors are designed to mediate risk. The vendor is responsible for the management and delivery of an activity. To ensure performance, the company includes incentives to ensure shared goals. It is like a shared company.

3. Considerations in implementation

At the basis of decision making about whether to outsource a function or not is the balance of risk. The paper, "The Risks of Outsourcing", describes potential risks, suggesting that the reasons to insource should be explored first.

3.1 Organization

To reduce risks, the good management is needed. If a service scores low on operational performance, whether real or imagined, there will be pressure to outsource. Consideration should be given first to how the internal situations could be improved. Poor performance can be a result of inadequate economies of scale, which may, of course, also be improved by centralized rationalization. Also poor performance could be improved with hiring better managers and by improving internal performance.

If the function is outsourced, then there must be in house staff to manage the external provider. So different skills are required to manage contracts with legal competence. Also, the outsourcer may not be better, so additional support may be needed. Also vendors may not be supportive of weak management.

3.2 Business planning considerations

If a firm decides to outsource IT services to cut costs as part of an assumption that IT functions are not critical to the core business, it may find at a later date that it no longer has the crucial competencies to deal with unanticipated future business demands. It may have to pay high costs to obtain needed services later.

Uncertainty is a key consideration in IT, where users are not sure of their needs, new technology is risky, business requirements change, and implementation is often not a straight forward process. Therefore contracts should be short or be subject to annual reviews, but these can be costly and time consuming. Contracts should have a process of

conflict resolution to deal with inevitable uncertainties. Insourcing may be the best option.

Much of learning in IT is in doing. The unlinking of business and IT functions is particularly critical where strategic opportunities are missed. Strategic partnerships between the two may not be very workable for either.

Contracts focus on cost reduction so external outsourcing often cannot provide what is needed for innovation - slack resources, organic and fluid organizational processes, and experimental and intrapreneurial competencies. Innovation requires an understanding of the business.

Outsourcing of IT relies on the supply side, the “how”, not the demand side, the “what”, so it does well with operations, development, service and training, But it does not do so well in providing acceptable innovative application ideas, or in the commitment required in implementation to harvest benefits.

3.3 Financial considerations

If cost reduction is the objective of outsourcing, and where there are outdated technological skills, the outsourcer must be able to keep up in reducing costs through improvements. If a vendor cannot meet the targets, the option is to find another vendor. Alternative vendors can be rare, especially for large scale contracts.

When cost reduction is the main objective of outsourcing, it is critical to take into account all the potential costs. Companies tend to underestimate the costs of setup, including redeployment costs, relocation costs, and transition costs, and of management costs due to the time and resources needed.

3.4 Human Resource issues

Personnel policies are needed to ensure that appropriate staff are available. One of the arguments for outsourcing is that specialist companies are likely to have better IT specialists. But in some cases, weaker staff go to the outsourcing company which is also not a real benefit. In others, a company would transfer staff temporarily to the outsourcer to ensure continuity of service and knowledge in the short run. A bigger risk is that the winner of a large outsourcing contract would hire the best staff.

3.5 Accountability

In IT the key players are the users, the IT specialists, and the business analysts that often act as interpreters. Where the IT specialists are external, the communication problems are exacerbated. The company wants people to work with that understand them, and vendors have to learn about the organization.

3.6 Technical issues

As systems become more complex, the usefulness of outsourcing may be reduced. Outsourcing may be workable when it involves separate activities, such as running data systems or commissioning separable applications, as control can be obtained through

benchmarking, service level agreements, efficiency incentives, and annual reviews. As IT moves into the desktop and user oriented environment, the interdependencies with business considerations increased.

3.7 Effectiveness of outsourcing

Success can be measured by the following: targeted cost savings are achieved or better than anticipated; service levels are maintained or improved; user management was satisfied; few client-vendor disputes; the vendor was responsive and attentive to the needs of the customer; the outcomes met the objectives for the outsourcing; and the contract was renewed.

4. Conclusions

The 1996 Sloan Management Institute paper, “The Value of Selective IT Outsourcing”, in 1996, reported on a survey of 36 companies with a wide variety of sizes, businesses and sourcing decisions. Its conclusions, which are also applicable to outsourcing real estate, summarize the pros and cons of outsourcing and of keeping functions in house, as follows.

- (1) The option of total outsourcing, characterized by long term megadeals, after a short honeymoon, often result in loss of alignment between IT and business strategy, failed to access new technologies, and incurred greater costs than current market prices, due to excess charges for missed items. Also contracts were expensive to get out of.
- (2) The option of total insourcing has problems because of internal monopolies and the creation of obstacles to improvements. Outsourcers are seen to be able to make needed changes, while internal units may lack the needed clout. The threat of outsourcing can force changes, as outsourcing methods can act as a benchmark to enable improvements to the internal IT units.

Further, a reasoned, incremental, and selective approach appears to have been most successful. Few total outsourcing initiatives have met the all the customer’s needs. The most effective approach overall is for vendors to take over lower value-added tasks while companies manage the higher value-added tasks internally. Because of the changes in technology, the preferred contract is for only three years. The biggest gains from outsourcing IT are in increased ability for IT enabling business transformations and in the deploying of IT to improve the business’s revenue.

In all cases, the in-house arrangement plays a critical role. To ensure success the organization must have the capability and ability to: track, assess, and interpret changing capability and relate this to business needs; work with business management to define needs over time; and identify the appropriate way to use the market, to help specify and manage the sourcing, and to monitor and manage contractual arrangements.