The Mapeley Primer

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1. INTRODUCTION

Property is a fundamental part of the infrastructure through which local authorities deliver services to their communities. As a result, local authorities tend to be significant property owners. According to the Audit Commission, local authorities own £140 billion of real estate assets in the UK, and property accounts for more than 8% of their annual expenditure.

But a sizeable proportion of local authority estates is not directly used in the delivery of local services. Retaining this non-operational investment property ties up capital that could be directed to areas of greater need. And in many cases, service delivery is constrained by an operational property portfolio that does not meet its business needs, with buildings that are surplus to requirements or are very costly to run. Cost cutting over a number of years has meant that many buildings are often in a poor physical condition and make public services difficult to access.

Local authorities are facing unprecedented rates of change in the way that public services are delivered. Political, technological and cultural change, combined with changes in the way that performance of public services are measured, have all affected the way that business is done in the public sector. But local authority estates are typically ill configured and insufficiently flexible to respond to this level of change.

Conventionally, local authorities have responded to these challenges by outsourcing management and service functions to private sector specialists whilst disposing of surplus assets gradually through a traditional agency based approach. This has left organisations with a legacy of inflexible leases and contracts, high costs, vacant space and facilities services which are inconsistent and not truly aligned to the needs of the business or the buildings they support.

A new vision for property in the public sector is needed; one which is not simply about reducing costs and raising capital, but about improving the workplace and helping the authorities adapt to the changing environment.

A Real Estate Partnership offers a solution which allows local authorities to dispose of the risks of property ownership and occupation and, through a single counterparty, enter a contract for the supply of serviced accommodation. In this way the accommodation provider, which is specifically geared to manage property and services risks, not only provides accommodation but manages and services the estate so as to draw maximum value from it.

A new type of organisation has emerged to support this new approach to property; one which can combine property ownership, capital and asset management services into a single unified whole.

Mapeley was created to specifically perform this role. It is capable of raising capital against the value of assets and managing the delivery of serviced accommodation that is the right size, functionally efficient and ideally located to meet the modern business need of the client organisation.

Over the last four years, The Inland Revenue, HM Customs and Excise & Valuation Office, the Department of Social Security, Abbey National, British Telecom and the BBC have all transformed their estates strategy by entering into Real Estate Partnerships. The combined value of these contracts is estimated to £4.0 billion in assets and £1.2 billion in annual charges.

Mapeley has mobilised two of these, The Inland Revenue and Abbey National and has implemented a £30 million programme in business infrastructure to support these two major outsourcing contracts. We now have an experienced team to analyse, structure and mobilise new deals. We are supported by highly developed IT systems that support improved asset management decision making, strong supplier relationships and a client interface needed to deliver these types of contracts.

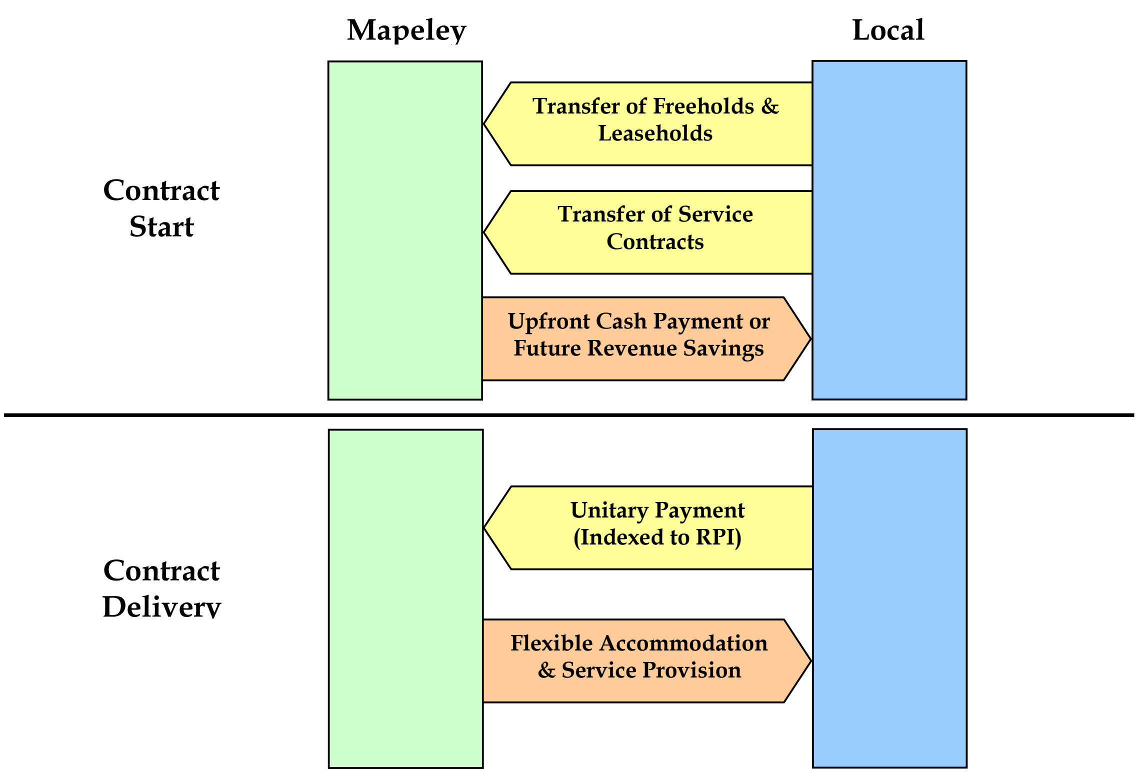
This document shows how a Real Estate Partnership could transform the delivery of services in your organisation. It explains both how Mapeley is organised to deliver the right solution to your accommodation needs, and how the Local Authority can get the most out of the relationship.

2. HOW REAL ESTATE PARTNERSHIPS WORK

Real Estate Partnerships work upon simple principles. It rests initially upon the transfer of the Local Authority's freehold assets and leasehold liabilities to a serviced accommodation provider. Mapeley thereby absorbs all the risks associated with the operation and ownership of the estate but commits to providing serviced accommodation back to the Local Authority for a fixed period, usually 20 to 30 years. Mapeley is then able to 'work the portfolio' and configure the estate according to the demands of the Local Authority's core business. In return for the provision of serviced accommodation the client pays an indexed Unitary Payment, which is a fixed payment combining an accommodation element and a services element.

It is against the value of the transferred assets that Mapeley is able to raise capital through a combination of debt and equity finance. The assets transferred to Mapeley are used to finance the payment of an upfront capital payment, which can be used to invest in the enhancement of the council's business infrastructure, in the elimination of backlog maintenance or in the improvement of local public services. Alternatively the capital raised can be used to reduce the Unitary Payment over the life of the contract.

Typical Structure

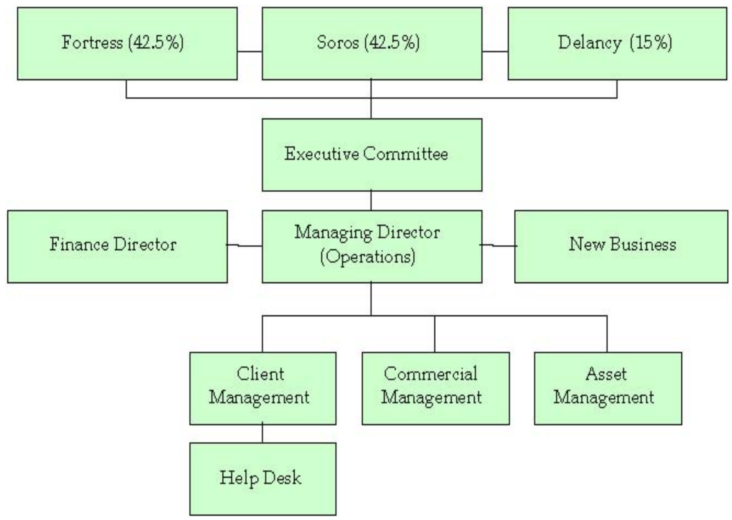


3. ORGANISATION AND STRUCTURE

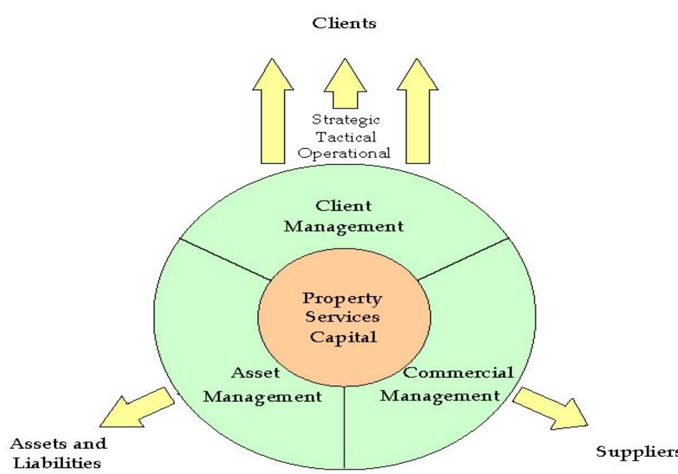
Mapeley provides long-term, flexible and serviced accommodation to the public and private sector by combining property management expertise, high level service delivery and efficient capital structuring in a single integrated contract.

Since 2000, Mapeley has grown to be a significant business. Even though Mapeley's core business only employs 170 staff, we manage the delivery of £55m of services per annum, employing 3,500 sub-contractors. In 2002 we had a turnover of £301m and assets of £800m. We operated 1,900 buildings and to date we have completed 120 refurbishment and capital projects worth £70m.

Mapeley is a private company, owned and funded by three highly experienced real estate funds: Fortress Investment Group, Soros Real Estate Partners and Delancey. Fortress is a $3.0 billion global investment company which invests across a variety of asset types; Soros is a $1.0 billion investment fund which focuses on real estate platforms in Western Europe; and Delancey is the leading private property investment company in UK with assets under management of £700m.



Mapeley faces three ways: towards our clients, towards our suppliers and towards our assets. Our organisation has been specifically structured to reflect this. The Asset Management team works the estate, releasing property value and mitigating any potential liabilities. The Commercial Management team focuses on getting the best from our suppliers. The Client Management team builds relationships to maximise the benefits of working together.



Client Management functions at three levels: strategic, tactical and operational. The Contract Board meets at the strategic level, addressing the big issues and monitoring the overall success of the project. Dedicated client managers work on the tactical level, ensuring that contract delivery meets the client's requirements. And everyday, operational level interactions take place through the Help Desk, so that every part of the client's business has access to Mapeley 24-hours a day.

4. CORE CAPABILITIES

Unlocking value in the council's estate

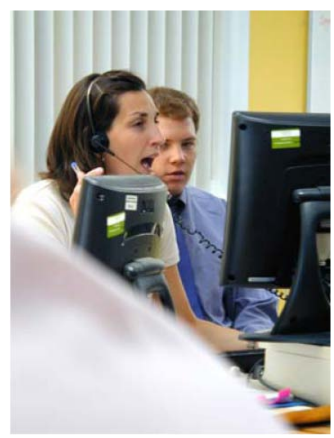
Mapeley's asset managers work the estate to release the intrinsic value from the Local Authority's property. They use Mapeley's market position not only to release cash from freehold assets, but also to extract value from occupied leaseholds. And we work to mitigate any losses from surplus space. The capital raised can then be reinvested in business infrastructure, or in the core business itself.

For example, in the Inland Revenue estate, Mapeley identified the opportunity to buy the underlying freehold of a property and to re-gear the lease. As a result, Mapeley were able to reinvest in the Inland Revenue estate.

Managing the supply chain

The Commercial Management team builds a relationship with our suppliers. They harness Mapeley's buying power and our national framework contracts to ensure consistent quality and low prices. Our contracts incentivise the suppliers to perform and we monitor service delivery in a way that focuses on outcome. In this way we ensure that the services you require offer the best value and can be relied upon in every part of your estate.

Working with the council to secure accommodation needs



The Client Management team provides a dedicated single point of contact. It supports effective and rapid decision-making by calling on specialist expertise and commercial analysis from across Mapeley. It is exactly this approach that has enabled Mapeley working in partnership to procure on behalf of the Inland Revenue and HM Customs & Excise additional buildings and execute numerous projects. Moreover we were able to implement the plan for a fixed agreed cost.

In a challenging business environment, change is constant. We help you adapt to any changes not only by recommending an effective response based upon informed analysis, but also by taking responsibility for acting on that recommendation. Moreover Mapeley has the in-house expertise to be proactive in keeping your business infrastructure ahead of the game.

We would seek to optimise your occupation strategy and could help you introduce "new ways of working" to increase efficiency in the workplace. This means that you can concentrate on the important decisions that affect your business, confident that your accommodation will always meet your needs.

Integrating capital, property expertise and service delivery

By combining property ownership and management, Mapeley is able to makes decisions based upon the impact on the whole estate over the whole life of the contract. Because Mapeley has principal at risk, and because a majority of the returns on that principal typically are driven by the sale of the properties at the end of the contract term, we are incentivised to deliver operational solutions that maximise the value of the estate over the long term.

This integrated approach will save your business money and improve its effectiveness.

Mapeley can 'spend to save' and can therefore achieve greater efficiencies because we can make significant investments in the estate in the early years, spreading the cost over a 20 year contract term. Contrary to intuition, this approach results in even lower costs than five yearly market testing, as these short-term contracts are not able to re-coop significant investments before the contract is re-tendered.

Because Mapeley both owns and maintains the properties, it can ensure that all decisions reflect the values of the assets over the whole life. Conventionally decisions associated with design, construction, maintenance and lifecycle replacement are considered in isolation. This simply incentivises the lowest cost individual outcome, putting off disproportionately greater costs until later. It is usually the occupier which pays the price for this, either in erosion of capital value, or in a dilapidations claim. By ensuring that all activities consider the value impact on each other, Mapeley can solve for the optimum whole life cost.

Mapeley's approach is not only designed to improve your cost line but also to improve your revenue line. Because we are able to forecast the cost of change in advance we give your staff the tools to make faster and more effective decisions whilst offering certainty of outcome. How much easier would it be to make a decision to move a team within a building if the cost of that relocation is known in advance?

In equal measure, we take responsibility for managing the tasks that distract your business and demoralise your staff. By offering every employee easy access to the Mapeley Help Desk, day-to-day issues can be transferred to a support infrastructure simply and easily, before they distract or annoy.

Mapeley Help Desk (Statistical Averages 2003):

- 153,702 calls handled
- 4.28 minute call duration
- 98,179 service orders
- 3,000 furniture orders
- 2000 minor works requests
- Speed of pickup 6 seconds
- Complaints < 1% of total calls

5. RELEVANT EXPERIENCE

Mapeley operates two contracts that are similar to a transaction encompassing the Council's office accommodation: STEPS and Columbus.

STEPS – The Inland Revenue, HM Customs and Excise & Valuation Office (the Departments)

Under the STEPS contract, the Departments transferred 200 freeholds (book value £220m) and 400 leaseholds (rent £120m p.a.) to Mapeley, and entered into a 20-year flexible serviced space contract for an annual charge of £200 million, indexed to RPI.

The Departments needed accommodation that would allow them to adapt to change resultant from the rapidly changing UK taxation environment and the increasing prominence of the Inland Revenue in government policy. At the same time they needed to upgrade the estate to meet statutory compliance and "fitness for purpose" criteria without incurring an increase in costs.

Mapeley committed to maintain the estate to the Required Accommodation Standard and to save the Departments £1.0 billion over the life of the contract (Source: Sir Nicholas Montague, Chairman of the Inland Revenue). In addition, Mapeley improved the Departments' ability to adapt to change in their core business. In a current case, the Departments are required to undertake a significant reorganisation as part of the "joined up government" initiative, but this would leave them with 8,250 sqm of vacant space and a loss of £1.5m p.a. They asked Mapeley's Client Manager to help them with this problem, and we responded within three weeks with a costed proposal which is estimated to save them several million pounds p.a. This is just one example of how working closely together has benefited the Departments well beyond the expectations of the original contract.

Columbus – Abbey National

Under the Columbus contract Abbey transferred 400 freeholds (value £467m) and 900 leaseholds (rent £60m p.a.) to Mapeley, and entered into a 20-year flexible contract for an annual charge of £80m, indexed at 3% annually.

Abbey not only needed a solution to manage the property risk during a period of transition, but also needed to release capital in a short time frame. Mapeley was able to create a partnership structure which enabled Abbey to raise a large capital sum upfront, transfer all property related risks to Mapeley, and achieve the operational flexibility needed to support the core business. Moreover, we were able to complete and mobilise the contract in only three months. This was achieved through the use of a change mechanism, which allowed the transaction to go ahead with minimal due diligence. The mechanism is in its third and final iteration and has proved a great way to simplify and speed up the execution of transactions.

6. APPROACH TO REAL ESTATE PARTNERSHIPS

Mapeley's solution starts with the business, not the property

A great Real Estate Partnership is not about property, services or capital, but about the requirement of the core business for somewhere to work, supported by services which look after your non-core tasks. Mapeley's approach is different because our solution starts with the 'front line' business of our clients. We start with your needs, and then we see if there is a property element, a services element or a capital element to the way that we respond to those needs. We do not start with the element that fits our current business plan and then try to impose a deal purely to suit ourselves.

The importance of mutually aligned interests to retain focus on business needs

This contract will need to work for both the Local Authority and Mapeley over a long period of time. Since both parties will, sooner or later, act in their own interest, there is a danger that any initial spirit of partnership could be eroded, resulting in waste. The only way that you can be sure that the contract will continue to offer best value throughout its life is if it is in the interest of both parties to cooperate. Even a watertight contract will break down if there is no underlying alignment of interests.

So Mapeley puts the development of a commercial structure which aligns incentives at the heart of its outsourcing approach.

Key to aligning incentives is a creative approach to risk transfer. For example, in a transaction currently active, Mapeley is using incentives to ensure that we minimise the space the client occupies and its rent payment, without exposing either the client or Mapeley to contingent liability. This is done by setting the rent below market so that Mapeley is incentivised to sub-let as much space as possible.

The overriding ethos is that the contract structure is simple and fair.

Complexity breeds game playing and eventually affects trust, partnership and value.

7. LESSONS LEARNED FROM PAST TRANSACTIONS

Mapeley's operating platform and our approach to Real Estate Partnerships has been developed from our experience of past deals, both the successes, and the failures. The lessons learned can be summarised under the headings of: Commitment, Clarity, Commerciality, and Communication.

Commitment

Although the benefits of outsourcing accommodation can be great, the process of procurement can be long and tough. To close the deal, both the Local Authority and Mapeley need to know that each is committed to giving its all. Deals that are attempted in a spirit of an "evaluation of options" tend to fail.

In a current transaction there is a real example of why this matters. The client is transferring freehold value to Mapeley to fund statutory compliance works and backlog maintenance over five years. Mapeley is taking the risk that we will be able to realise sufficient value to pay for the works. Because the client is cash constrained, this risk transfer has real benefits. If they did it themselves they would bear the risk that their works could stop half way, with all the costs associated with putting a project on hold. But pricing this risk transfer is not straightforward. It requires dedication from the team, supported by commitment from the top.

Obviously commitment must not go beyond what is economically rational. But the chances of success are vastly improved if the board of both the Local Authority and Mapeley are fully committed to the deal.

Clarity

If Mapeley is to submit a proposal that will meet the Local Authority's needs, we must understand what those needs are. In our experience, too often the client hides their motivation. This results in significant wasted effort, second-guessing whether our proposal will be acceptable to the client, when we could be finessing the price. Lack of clarity in broad objectives can lead to confusion and dispute when it comes to final contract negotiation.

In the Columbus transaction, Abbey was clear about its objectives from the start. This meant that whenever there were any issues with the contract, it was easy to see whether a potential solution would be acceptable, and as a result negotiations were concluded in a very tight time frame.

Whilst accurate data is essential to price the deal, it is better to achieve an appropriate level of accuracy on an appropriate level of data, than to attempt to gather the ideal and complete dataset. I.

Mapeley would be happy to provide a prioritised data list to the Local Authority to indicate the information that is most valuable, and the information which can be collected at a later date.

Commerciality

Mapeley believes that the contract should follow the commercial agreement, and not the other way round. It is our experience that once a transaction is expressed in a legal format, people start arguing about words, and do not focus on the operational and economic realities. In a recent transaction this happened even when both sides agreed that the draft contract was illustrative. Legal issues need not be solved in a legalistic way.

The main legal issues which will be covered by the contract are generally well understood: contract expiry, flexibility, profit share and so forth. As long as the commercial terms are discussed with these issues in mind, Mapeley believes that there is no need to formalise until the basic structure is agreed.

Once the deal is signed, it must be mobilised, so it is essential that the contract is practical. In most cases this means that it should be expressed simply, so that it is easy to tell whether or not Mapeley is meeting its obligations. For example, our experience of designing and operating Performance Measurement Systems is that a simple system, geared to the needs of the user, delivers much better value than a complex set of rules and regulations. Complexity and detail are essential for critical activities in critical areas, such as cooling systems in computer server rooms. But it is unnecessary and expensive for standard office buildings. And it is much more important to make sure that the front door is unlocked on time each morning than it is to monitor whether leaking taps are mended within three hours.

Communication

During the procurement process, most clients have a tendency to deal with contractors at arms length. They sometimes even refuse to meet face-to-face, leaving all interaction to their advisers. Whilst we can understand the need for protection and advice afforded by an intermediary, it seems a strange way to start a long-term relationship. Shutting out Mapeley and our competitors will exclude a vast amount of market experience. And because the deal is likely to be scrutinised by a host of lawyers, auditors, surveyors and consultants, it would be difficult for any contractor to gain any unfair advantage. Mapeley is excited about the Local Authority's interest in a Real Estate Partnership and we are confident that a transaction is achievable. If and when the Local Authority decides to come to the market with a potential transaction it is massively important that we are aligned from the outset and that communication is in place.