CHAPTER 5

Special Report on the Newton Business Park

Introduction

Objectives of the Report

5.1 The Newton Business Park (the "Project") was selected for review from several projects which are being carried out by the Government of Barbados as Public Private Partnerships ("PPP") with private developers and contractors. The purpose of this report is to:

(i) review the procedures applied in selecting the contractor/developer of the Project;

(ii) evaluate the PPP structure adopted against best international practices;

(iii) assess the quality of the legal documentation used;

(iv) examine and appraise the project supervision and implementation; and

(v) offer preliminary recommendations for improving the execution of similar PPP projects in Barbados.

Scope of Evaluation and Methodology

5.2 An examination of the various project reports, memoranda and legal documents was carried out, and supplemented with interviews during the week of 18th to 24th November 2007. There were also interviews with key officials of the Barbados Industrial Development Corporation (BIDC), various consultants, and representatives of financial institutions involved in the Project. Because the Design Build Contract had been terminated, and there remained several important unresolved disputes between the parties, it was not possible to arrange meetings with representatives of the contracted company. However, interviews were conducted with several members of the contractor's project team including Architects, Mechanical

Engineers, Quantity Surveyors, Civil and Structural Engineers and the contractor's Project Manager, all of whom provided very valuable information about the Project and its implementation. Also interviewed was retired senior management at the BIDC who were involved in the Project in its early stages.

Summary of Main Findings

5.3 The BIDC is seeking to establish a business park at its Newton Estate in Christ Church to facilitate the promotion of knowledge-based industries (See 5.13). Requests for Proposals (RFP) for building design and construction were advertised, and a fixed price contract was awarded to a regionally based company for $18.5 million, while site work commenced in October 2003. The contract was terminated by the BIDC in March 2007 and the Business Park presently remains uncompleted. A summary of the main findings and recommendations are as follows:

(i) The Project was one of the first (PPPs), in which the contractor was responsible for both the design and construction of buildings, in the Public Sector. It was designed to be an important specialized business park to attract high-end technology investors from throughout the world.

(ii) There were only three proposals received for this project, however strong competition is essential if PPP deals are to achieve the optimal mix of price and quality. The absence of strong competition for this contract suggests that this type of project was not attractive to developers, and this would have limited the Corporation's choices in selecting a developer.

(iii) Financing of $18.5 million was obtained to construct the Business Park. This sum was disbursed to the contractor even though the project was not completed. The payment regime should have been structured in such a manner that the amount left to be earned in the contract exceeds the cost to complete the project.

(iv) In November 2006 the BIDC commissioned an independent consultant who determined that there were defects in the work and indicated that the cost to correct and complete the work was in excess of $7.0 million. The projected expenditure to complete the project was subsequently estimated at $10.0 million giving a new project expenditure of $28.5 million. If the arrangement had worked as intended the construction cost would have been capped and the contractor would have been responsible for any cost overruns.

(v) The Company was given time to rectify the defective work and to complete the project. The relevant action was not taken and the contract was eventually terminated by the BIDC which now has to institute legal action against the contractor in respect of any default on the contract.

(vi) The Performance Bond (surety) of $1.8 million was put in place, but was allowed to lapse, resulting in the BIDC not having access to funds to draw on as a result of the default.

(vii) A key feature in a PPP project is the appropriate transfer of risk to those better experienced to manage it. The way the project was organized transferred construction risk to the developer during the period of the contract. However, the absence of the performance bond limited the Corporation's ability to access funds for the correction of defects.

(viii) Inadequate monitoring of the project would have contributed to the defects not being detected on a timely basis.

(ix) In spite of the challenges faced during construction of this project the BIDC should be commended for its attempt to develop the Business Park which, when completed, should help to meet the requirements of the growing information sector.

5.4 Recommendations

(i) In developing PPP projects feasibility analysis should be required to determine whether a PPP option is more advantageous than the traditional procurement method before this option is taken.

(ii) Design-Build procurement contracts should be carefully studied before they are applied to any project, especially where innovative technologies are to be provided by a private contractor.

(iii) BIDC should upgrade their appraisal capabilities and use experienced national and international consultants to support existing staff in both PPP and traditional Public Sector procurement for large projects.

(iv) BIDC should be guided by the acknowledged fact that PPPs and other non-traditional procurement techniques require substantial project monitoring and supervision. There should be a dedicated project implementation team for any such projects.

(v) Standard PPP implementation agreements, concessions, and loan agreements will need to be designed for use by the Public Sector, following international best practices. Accordingly, there should be standard contracts and regulatory guidelines for all PPP projects. All financing agreements for PPP projects should be carefully vetted and approved by counsel, supported by experienced outside international counsel if necessary.

(vi) PPP regulations and policy guidelines should be developed, and should include practical criteria to be used in determining the cost savings to be achieved with PPP procurement, as against traditional procurement methods. Using criteria such as the need to finance a project off budget should be avoided.

Project Description

Project History

5.5 The Strategic Plan of the Barbados Investment and Development Corporation (BIDC) for the triennium 1997 - 1999 identified Information Technology (IT) as a major growth sector for investment promotion. This was after the Corporation's overseas offices had attracted the interest of an increasing number of clients in the implementation of projects in software development, call centers, e-commerce and medical transcription.

5.6 In order to fuel this new thrust, the BIDC decided to use 23.5 acres of land at the Newton Estate in Christ Church, adjacent to the existing industrial park, with which it had been vested by the Government for on-going industrial development, for the establishment of a specialized *Business Park*. The idea was to create an estate designed for state of the art buildings, in order to promote the continued growth and expansion of knowledge-based industries.


Newton Business Park

5.7 The transformation of the Newton Estate into a specialized Business Park was conceived in five (5) phases. Phase 1 comprised two components. The first component envisaged the development of the first ten (10) acres, including infrastructural development such as roads, utilities and landscaping. The second component contemplated the construction of two (2) office buildings covering an area of sixty-one thousand (61,000) square feet for high-tech and/or information processing operations. The completion of these two buildings was seen as the fore-runner to further development of the remaining acreage in the other four (4) phases.

Mode of Execution and Financing

Mode of Execution

5.8 At the time of conception Consultant Engineers of this project, the BIDC was operating under a directive from the Government that required it to seek private funding for its capital development.

5.9 In keeping with this new emphasis, and given the need to develop the new estate in as short a time as possible in order to take advantage of the opportunities identified in the high-tech and IT sectors, the BIDC decided on a fast-track procurement model that would benefit from external funding. Accordingly, a decision was taken in July 1997 to invite proposals from local and overseas companies, or joint ventures between local and foreign firms, for operation of a concession or other contract to finance the project by a Build, Operate, Transfer (BOT) Scheme, or any variation of this model consistent with a PPP arrangement as described in this Report.

5.10 In response to the Request For Proposals (RFP), three proposals were submitted from companies from the United States of America, Canada and Trinidad and Tobago. Of the three, an evaluation committee selected the proposal of the Trinidadian company, and recommended that the Management of BIDC negotiate a concession contract to be financed by a Trinidadian bank through its Finance Corporation.

Project Cost and Financing

5.11 The Project was approved by the Board of the BIDC on 27th May 1999, and by the Cabinet on 1st December 2000, while construction began on 23rd October 2003. The Project was to be constructed at a cost of $18.5 million through a PPP scheme covering 20 years. However, since the financing plan envisaged the capitalization of interest payments during construction, the total projected cost was estimated at $19.3 million.

5.12 The original financing structure contemplated that the BIDC, as sponsor, would lease the land to Newton Business Park Project Company Ltd. (NBPPCL), a subsidiary of BIDC, for a period of twenty-five (25) years. This subsidiary would, in turn, enter into a construction contract with the contractor to carry out the construction of the two buildings, covering an area of sixty-one thousand (61,000) square feet over a period of twelve

(12) months. The BIDC would commit to twice yearly lease payments to its subsidiary, commencing six (6) months after completion of the buildings.

Scope of Works

5.13 As described in the tender documents, the buildings were to be "state of the art intelligent buildings" providing telecommunications and information technology to businesses in software development, e-commerce, call centers, medical supplies and related high-tech operations. The Project also involves construction of infrastructure such as roads, utilities and landscaping.

Variations

5.14 In January 2002, Cabinet approved a number of changes in the Project, including: (i) an increase in the building area from 61,000 to 68,523 square feet in order to better utilize the land area; (ii) a reduction in the term of the loan from 25 to 20 years to provide for recovery of the Value Added Tax ("VAT"); (iii) an increase in annual payments from $2.3 million to $2.6 million, as a result of financing over the shorter amortization period of 20 years, and the capitalization of legal and other fees; and (iv) a concessionary rental rate for Building B to facilitate and retain an existing client. In addition, the Ministry of Finance issued a Letter of Comfort, in which the Government pledged to underwrite any shortfall in the semi-annual payments due under this long-term lease-back arrangement.

5.15 The specifications of Building B were modified to meet the requirements of an existing BIDC client. In 2004, this client decided not to use the facility because of delays encountered in completing the work. The client moved to another building owned by a private company elsewhere in Barbados.

PPP Procurement Strategy

5.16 There are no universally recognized definitions of PPPs, but most authorities would agree with the European Union Guidelines for Successful Public Private Partnerships published in 2003, which stated: "Under PPP arrangements, Private Sector contractors become long term providers of services rather than simply upfront asset builders, combining the responsibilities of designing, building, operating and possibly financing assets in order to deliver services to the Public Sector."[1] All PPP arrangements involve a contractual relationship between a Public Sector entity and a private contractor, which transfers substantial risks from the Public Sector to the Private Sector in providing a service or facility for public use.

5.17 According to BIDC, the Project was to be carried out as a Build, Operate, Transfer style PPP, based on the following rationale:

> "The main purpose of PPP is to allow Government to expand and improve infrastructure by tapping resources outside of its own budget allocations and other commitments".

For the projects being considered the PPP option would:

- Provide foreign financing;
- Allow a faster model for procurement of goods and services, development of infrastructure, and construction of new buildings;
- Commence the development of the new Business Park, create 50,000 sq. ft. of new state of the art information technology buildings, and repair 55,432 sq. ft. of existing building in two years;
- Develop infrastructure and construct new buildings in a short time;
- Permit transfer of the entire facility at the end of the concession contracts;
- Permit the Corporation to more readily achieve strategic objectives."

[1] EU Guidelines for Successful Public Private Partnerships, Director General of Regional Policy

5.18 To facilitate the process a call for technical and financial proposals to develop a business park under a PPP scheme was placed in newspapers locally, regionally and internationally.

5.19 It was clear from all of the memoranda and recorded decisions of Cabinet and the Ministry of Economic Affairs that the PPP strategy was strongly endorsed by Government. For instance, the paper which was presented to Cabinet, dated 5th December 2000, stated in pertinent part: "The financing arrangement, Build, Own, Operate, Transfer (BOOT) is in keeping with Government's expressed policy of encouraging Private/Public Sector partnerships in financing, rather than direct use of Government funding or loan financing."

5.20 Government entities, especially those with limited experience in PPP procurement, should not undertake PPPs without careful preparation and feasibility studies. There is not a lot of experience in PPP projects in Barbados. In Europe where they are more prevalent, the European Union "Guidelines for Successful Public-Private Partnerships" states: "PPP arrangements should not be entered into merely for the sake of undertaking a PPP project. <u>A detailed review of the costs and benefits of Private Sector involvement versus public alternatives must be undertaken to ensure that a PPP enhances the public benefit. The degree of private involvement needs to be carefully matched to the objectives and needs of the project and the public.</u> Appropriateness, cost and the ability to effectively implement and manage should be paramount considerations in selecting a PPP structure"[2] (underscoring added).

5.21 In relation to this project, it was evident that although the criteria for evaluation of proposals were extensive in scope, criteria for assessing the contractor company's technical and financial qualifications and prior experience were not included.

Project Risk

5.22 The essence of a Public Private Partnership initiative is the identification of risk associated with each component of the project, and the allocation of that risk factor to the parties best able to manage those risks. This process

[2] EU Guidelines

minimizes costs while improving performance. Examples include design risks, construction/implementation risks and operating risks.

5.23 An underlying objective of a PPP is to have the Private Sector assume some of the operational risks which are transferred back to the Government at the end of the term. Value for money[3] in a PPP is achieved through lower costs, for construction and operation during the project's life cycle, than would be incurred if the traditional Government procurement model was used.

5.24 In this Project, the contractor assisted in arranging the financing, but did not assume any financial risk for the Project. Under the Design-Build Construction Contract ("DB Contract")[4], the contractor was responsible for the design of the facility and its construction under a fixed price equal to $18,563,266.00, as stated in its proposal letter to BIDC dated 14th September 1998. Meanwhile, under this proposal, BIDC retained virtually all of the project risks both before and after project completion.

5.25 If the Project was abandoned, or construction was not completed within 90 days of the scheduled completion date in the Design Build Contract, there would be a default and the BIDC would be required to repay the full amount of the loans outstanding as stated in Section 8.3 of the Implementation Agreement. Following Project Completion, the repayment obligation on the loans is to be carried out through lease payments from BIDC to the Project Company. These payments are fully guaranteed by the Government of Barbados under the Comfort Letter from the Ministry of Finance dated 14th January 2003.

5.26 The contractors' risks were confined to the construction phase. The proposed project was nevertheless a PPP, because it contemplated significant risk transfer to the contractor through the Design Build contract. Design Build contracting is also an innovative form of construction procurement, which is especially difficult to implement in small countries or

[3] Value for Money (VFM) is defined as the all-in present value cost of the project during its life cycle achieved in a PPP compared to the risk adjusted all-in present value costs of the same project using traditional Public Sector procurement. In other words, VFM is a sophisticated financial and economic tool used to quantify the relative costs to government resulting from using PPP procurement compared to traditional government procurement. Where the costs of PPP procurement exceed those obtained under traditional government procurement, the government should follow its conventional procurement procedures.

[4] A Design Build Construction contract is a contract where the contractor assumes responsibility for the project designs as well as the physical construction of the facility. The proposal included a DB Contract prepared using the International Federation of Consulting Engineers (FIDIC) forms for **Conditions of Contract for Plant and Design Build** of 1999.

regions where the construction industry is controlled by a few small contractors.

Design-Build Option

5.27 It should perhaps be noted that Design Build contracts are ideally suited to situations where the Government is anxious to cap construction costs with a fixed price contract. In a Design Build contract, the contractor will be assuming the design risks and therefore will be barred from requesting price adjustments based on design defects. Design Build contracts are supposed to be more efficient in synchronizing the work of the contractor and the design architects, and thus create a better template for managing construction costs.

5.28 In deciding whether to use Design Build contracting or traditional Design-Build procurement, owners typically are expected to carefully consider the suitability of the project to the form of tendering.

5.29 Most public procurement specialists will want to ascertain how many contractors are able and willing to contract under Design Build parameters. For instance, if there are few companies in the local market capable of assuming the greater risks involved in Design Build contracting, it may not be reasonable to expect that a Request for Proposals will elicit enough qualified bidders to produce a suitable level of competition.

5.30 The available evidence suggests that some projects lend themselves to Design Build contracting more than others. For instance, repetitive types of projects that allow the use of standard designs such as tract housing or franchise restaurants may be good candidates for Design Build contracts.

5.31 It is therefore not surprising that BIDC only considered two proposals for this PPP, and that there were no Barbadian Companies which expressed an interest in bidding.

Newton Park PPP Evaluation

5.32 The evaluation reports show that consideration was given to a Guaranteed Government Bond Issue or commercial bank loan, but it was concluded that these options obtained negative net present value results. It was concluded that the contractor‘s proposal offered the best option because it would reportedly attract foreign financing and allow the transaction to remain off budget.

5.33 An examination of the evaluation criteria also revealed that BIDC was particularly impressed by the quality of the designs of the contractor's proposal under the Design Build contract. Interviews with BIDC officials confirmed that the designs and power point presentations were very effective in convincing BIDC of the superior merit of its designs. Visits by these officials to Trinidad and Tobago to examine the contractor's projects, such as the Hilton Hotel in Tobago, further strengthened the contractor's proposal. But there was no evidence that the contractor had ever carried out a Design Build contract similar to the one contemplated here. In addition, there was no evidence that BIDC had subjected these designs to an appraisal by its own independent architects and engineers. This would have been an effective means of quantifying the relative merits of PPP procurement versus traditional procurement.

Project Implementation and Supervision

Project Supervision and Reporting

5.34 During its gestation, the Architects responsible for designs, and the Civil and Structural Engineers and Quantity Surveyors responsible for assembling costs, formed part of the contractor's construction team that provided inputs to the contractor's Proposals. Interestingly, the contractor had developed a team of local consulting engineers and architects to participate in the design and implementation of the Project. However, the record shows that it gradually replaced them with in house staff during the course of the construction. It is not clear whether this contributed to the problems that arose during construction, but many of those familiar with the Project believed that this decision by the contractor weakened its ability to efficiently manage and execute the construction works.

5.35 A Senior Management Team within BIDC was assigned to the Project Implementation Unit. While BIDC retained administrative oversight for the Project, local consulting engineers were commissioned after construction started to supervise the Project on behalf of BIDC. As noted later in this report the supervision procedures applied by BIDC rested heavily on the role of the consulting engineers.

5.36 The duties and responsibilities of the engineers are described in the letter agreements which they exchanged with BIDC during that period. These included:

(i) Review of Architects' drawings in order to ascertain the general specifications and requirements, and the sufficiency of information for construction;

(ii) Review of civil and structural engineering drawings and specifications in order to ascertain the various design parameters and their appropriateness, in addition to the sufficiency of information for construction;

(iii) Prepare and submit a report on the findings from their review of the drawings;

(iv) Construction Stage:

- Make periodic visits to the site to determine that the works were generally being carried out in accordance with the drawings and specifications, and otherwise in accordance with good building practice;

- Prepare records of deviations or deficiencies that were found during site visits. Any such deviations or deficiencies would be drawn to the attention of the contractor so that proposals could be provided for correcting the deficiency. The consulting engineers would comment to the Client on the acceptability or otherwise of these proposals, and advise on the minimum action that should be taken in such situations to rectify unsatisfactory work;

- Review all relevant reports required under the contract and in accordance with the specifications;

- General review of shop drawings.

5.37 The consulting engineers were also identified in the Facility Agreement between the Loan Agency, the Project Company ("Borrower") and the Trustee. Under the Facility Agreement, disbursements could only be authorized if the consulting engineers gave the relevant approval to the Project Lender certifying that all conditions precedent had been complied with. In accordance with standard practice for such agreements, one of the key conditions precedent for disbursement is that there be no default or potential event of default in the project. This meant that the consulting engineers should not have authorized disbursements if, at any time, they concluded that there was in fact either a default or potential default under the Design Build Contract.

5.38 A representative of the consulting engineers stated in an interview that he had pointed out to BIDC that his firm's responsibilities under the various contracts were not properly aligned with its terms of reference under its contract with BIDC.

5.39 A sample of the certificate prepared by the consulting engineers and forwarded to BIDC and the Loan Agency merely stated: "We hereby certify for payment to the Contractor, the sum of **$**____ as shown on our Interim Certificate No. ____ enclosed." The Interim Certificate states simply: "We certify that the Works and Services for which payment is due have been completed to the value indicated in accordance with terms and conditions of the contract between the BIDC and the Contractor". From discussions with the consulting engineers and comments received from BIDC on this report, it appears that there was some confusion about the role of the engineers in monitoring and approving disbursement of funds under the Facility Agreement and the construction contract.

5.40 There was a difference between the various agreements which were in place on respect of the project. The facility agreement between the lenders and BIDC precluded disbursement of loan funds if there was Event of Default or circumstance which with the passage of time would eventually result in an Event of Default ("Potential Event of Default"). On the other hand, the agreement with BIDC and the contractor restricted the right of the Engineer to withhold an Interim Certificate for payment once such work was completed.

5.41 Consistent with best practices the standard construction contract used in this Project should have been adjusted and synchronized with the financing arrangements to better protect the interests of BIDC and its subsidiary in the event of substantial delays or other likely default in project construction.

5.42 Provisions in other recognized international construction contracts and project loan agreements more clearly address the problems that arise when a contractor is unable to meet the scheduled completion date, and should have been considered before the execution of this contract.

Full Disbursement of Loan Although Project Not Completed

5.43 The consulting engineers should have played a more proactive role in the Project. In my view, the consulting engineers should have alerted the BIDC of any likelihood that the Project would not realistically achieve completion as defined in the Design Build Contract. This is more evident when we consider that the last valuation was submitted by the Contractor on 16th June 2006, with the corresponding certification (No. 19) from the consulting engineers for payment on 2nd July 2006, even though it was already clear by that time that scheduled completion would not be achieved.

5.44 **It should be noted that all loan funds under the Facility Agreement with the Loan Agency have been fully disbursed, even though the Project has not been completed.** If funds had been withheld from the contractor at an earlier stage when problems were obviously delaying construction, the parties might have been able to avoid total shut down of construction.

Reporting

5.45 While the interim certificates prepared by the consulting engineers were not consistent with international best practices, their monthly reports were generally well prepared and timely delivered to BIDC. In the early stages of construction, a typical report would provide a technical accounting of works in progress or completed, review the valuations presented for payment, and determine, based on the engineer's review, whether the amounts charged were fair and reasonable, and consistent with the technical requirements and specifications of the Contract. In many instances, there were adjustments and reductions in the authorized amounts for disbursement. For instance, the first monthly progress report was prepared by the consulting engineers for BIDC, dated April, 2004. This report set the stage for a detailed informative summary of work up to the end of the reporting period. At that time, earthwork and substructure construction works were completed. Overall construction of both buildings was 32% completed, with the contractor estimating that works were three weeks behind schedule.

5.46 The reports also indicated approximate dates for full completion which were significantly beyond the scheduled completion date. Over time, it was noted that there was a decline in the substance and content of the reports, which focused mainly on project cash flow and disbursements. The consulting engineers' reports considerably understated the degree of compliance achieved in terms of time or costs. Under these circumstances, it is difficult nevertheless to understand why BIDC did not, at an earlier date, seek reassurances from the contractor concerning the completion date, and require further details about the viability of the financing plan.

5.47 Obviously concerned about the delays and reported difficulties with the contractor, at the end of 2006, BIDC commissioned a firm to conduct a condition survey of the buildings and provide an opinion on the current status of the buildings. The firm was also instructed to identify any defective work uncovered through their inspection of the buildings, including any electrical or mechanical aspects of the Project. The firm's report, prepared in late 2006 and presented in January 2007, provides a third party technical assessment of the project works. Its conclusions therefore were helpful in understanding the nature of the implementation problems which affected the Project.

5.48 The report concluded that although Building A was incomplete at the time of the inspection, several aspects of this building were found to be non compliant with the specifications as stipulated in the Architect's and Engineer's drawings, and required by good engineering practice. It was therefore concluded that a significant amount of retrofitting needed to be carried out to make this building suitable for its intended use.

5.49 With respect to Building B, the report concluded that the structure was generally complete, although there were several issues that needed to be addressed to provide a durable building that can provide effective use for its economic life.

5.50 The BIDC initiative in commissioning the firm's report is commendable. However, it would have been more helpful to have conducted this study when there were still undisbursed loan funds, which might have been applied to improving performance.

5.51 It appears that the quality of the work and its execution were not consistent with the Government's intended reason for applying a PPP procurement strategy. Sadly, the Project was delayed well beyond the original scheduled completion date, was over budget, and was not executed in accordance with good engineering practices.

Review of Legal Structure

PPP Legal Documents

5.52 In the United Kingdom and other countries which have aggressively developed PPP programs, there was an early recognition that PPPs require the development of standardized documents to ensure consistency across the Public Sector, in the allocation of risks between the parties, and to help reduce the transaction costs and legal fees associated with PPP procurement.

5.53 According to the counsel who were involved in the early discussions of the Project with the contractor, the legal structure that was developed by the contractor and its counsel were presented to the BIDC and its attorneys for their review, shortly after the contract awarded. That same document listed all of the relevant legal documents which were to be executed at financial closing. These included the Implementation Agreement ("IA"), the Facility Agreement ("Loan"), Deed of Charge/ Mortgage, the Lease Transfer Agreement ("Lease") and the Deed of Agreement ("Deed").

5.54 The Implementation Agreement is a tripartite agreement between the BIDC, the Project Company, and the contractor. Such agreements are normally intended to outline the rights and obligations of the key parties with respect to the project. In this Project, the BIDC is liable for the repayment of the loan from the Loan Agency. Under Section 8, BIDC committed itself to repaying the loan if there is any event of default under the Design Build Contract or the Facility Agreement. In addition, BIDC's obligations are counter guaranteed by the Government of Barbados under the Comfort Letter, dated 14th January 2003. The Implementation Agreement thus represents a guarantee of the financing, and thereby removes all repayment risk from the contractor and the Project Company to the statutory corporation, BIDC and the Government. The Implementation Agreement also allowed the lender to insulate the loans from any underlying project risk arising either from the construction or operation of the Project.

5.55 The Loan was entered into by the Loan Agency, the Project Company and BNB Finance and Trust Corp. Although the agreement was clearly a standard financing agreement applied by the lender bank, it contains few of the features which are used for project financing. This may be because, as noted in the discussion on the Implementation Agreement, the lender was not bearing project risks. Its repayment obligations are fully secured and guaranteed by the Government. In addition, it has been granted collateral in the form of mortgages on the property of the Project Company, and a performance bond from the contractor equal to 10% of the Contract sum. Under these circumstances, the Loan Agency is not assigned any specific role in monitoring execution of the project or the Design Build Contract with the Contractor. The latter role was assigned to the consulting engineers, acting as agent for BIDC. This was also consistent with the original Term Sheet from the contractor and the Loan Agency which was presented to BIDC in 1999.

Lease Between BIDC and its Subsidiary

5.56 The legal structure deployed in the Project was consistent with the objectives outlined by the BIDC in its original presentations to Cabinet. However, it is difficult to understand why it was necessary to use a lease between BIDC and its subsidiary NBPPCL to repay the loan. Typically when a Build Lease Operate (BLT) structure is applied in project financing, the objective is to provide the lessee with certain tax advantages under a capital lease which allow the private party to use the depreciation allowance, and thereby improve its overall return on its investment.[5] However, in this case, the private contractor plays no role in the financing and therefore would not derive any advantage from repaying the loans through a lease payment. Lawyers for the BIDC who participated in the negotiations were unable to explain the legal justification for this structure. They stated that it was recommended by the contractor and the lender, who had developed all of the legal documents for BIDC's review.

Security

5.57 The Loan was structured as a secured loan with the security consisting of the following key elements:

- Assignment of the lease payment from BIDC to the Loan Agency which would become operative following completion of the construction (ref to Loan Agreement);

- A Performance Bond equal to 10% of the Contract Amount in favor of BIDC, and assigned to the Trustee Bank;

- Assignment of the contractor's All Risk Insurance policies to the lenders in an amount sufficient to cover "the usual perils", including hurricanes related to the preconstruction period;

- A Letter of Comfort from the Government of Barbados assured the settlement of any shortfalls in the lease payments of BIDC during the life time of the lease;

- Mortgages on land and building issued to the Loan Agency as Mortgagee.

5.58 From the above it appears that in some circumstances, the loans may have been over-guaranteed. Since the BIDC was liable for any default by the contractor under Section 8.3 of the Implementation Agreement, and its obligations were guaranteed under the Comfort Letter issued by the Ministry of Finance, it is difficult to understand the significance of the mortgages in favor of the lenders on the property. It may be that this

[5] See Peter Nevitt & Frank Fabozzi, Project Financing (7th Edition, Euromoney 2000), Ch 13-14.

structure was borrowed from an earlier transaction carried out by the contractor in Trinidad, since its attorneys had worked closely with the Loan Agency in developing the documentation which was used in the Project. Attorneys for BIDC indicated that their role during the negotiation of the legal documentation was limited to reviewing and commenting on the documents presented by the Loan Agency and the contractor.

Performance Bond

5.59 A performance bond is a surety issued by a financial institution, and guarantees that in the event of a contractor defaulting on a contract, funds are available to assist in the finishing of the Construction Project. For reasons that are still unclear, the bond was allowed to lapse. The importance of this event cannot be understated since, without the performance bond issued by a creditworthy entity, the BIDC and the lenders had no third party guarantees to support project performance up to completion. Moreover, in case of a default by the contractor, BIDC will have to pursue legal remedies against the contractor, which at that time may be declared bankrupt or in receivership. Under those circumstances, the chances of recovery of damages by the BIDC or the Loan Agency is severely limited.

5.60 Failure to maintain the performance bond constitutes an event of default under the Design Build Contract and the Loan. The Audit Office was not able to review the procedures applied by the Trustee Bank to which the performance bond was assigned. Its contract with the Loan Agency and BIDC did not specify whether the Trustee Bank was expected to take timely action to ensure that the Performance Bond was effective at all times. However, there is no evidence in the written record that any such preemptive actions were taken by any of the parties of the Loan to avert the default. As noted previously, this defect should have been highlighted by the Engineer who was expected to certify that there was no default under the loan facility.

5.61 It is recommended that BIDC make sure that in future PPP agreements, it deploys legal instruments which contain monitoring and oversight provisions, to avoid impairing the project security offered by private contractors to mitigate the performance risks assumed by BIDC or statutory corporations. When coupled with earlier observations about monitoring of disbursements, it is easy to see how these shortcomings could prove costly.

Conclusions and Recommendations

5.62 A review of the written record related to the Newton Business Park project and the interviews conducted with many of the people involved in its planning and execution cannot accurately capture the full dimension of the difficulties encountered in planning and executing this innovative facility. It is difficult to assess any complex project being carried out over a seven year period.

5.63 BIDC should be credited with trying to develop this project through an innovative procurement strategy, using a fixed price design build contract to comply with a Government directive to minimize the budgetary impact of the financing. However, as noted throughout this report, PPPs are not easily implemented in the absence of in depth feasibility analysis, which would quantify the benefits and costs of this procurement strategy, and compare them with the costs achieved under traditional procurement. Without a serious feasibility analysis, it will be difficult, if not impossible to know whether the PPP procurement will yield positive present value.

5.64 In the Project it was observed that few people within the BIDC were familiar with PPPs. The Contractor's proposal was selected because it appeared to offer an opportunity to fast track the construction while keeping the transaction off budget. However, careful review of the contracts has revealed that BIDC was assuming virtually all of the risks, and would be relying on the Fixed Price Building Contract to protect it against cost overruns and contractor defaults. Under the circumstances, it was therefore critical that an appraisal committee conduct a careful, in depth due diligence on the contractor and its performance record in similar projects. I did not see anything in the record to confirm that such due diligence was done.

5.65 Measures for optimal performance need to be built into the contractual structure to ensure that the private contractor fully complies with its commitments to the Public Sector. In this Design Build contract, reliance was placed on the liquidated damages provisions, the retainages and the performance bond, to compel contractor performance. In many instances these contractual remedies may be sufficient. However, if the contractor is relatively inexperienced in this type of project, is facing financial difficulties and does not have sufficient funds to maintain 100% performance throughout the term of the contract, costly delays can accumulate. Agencies must remain actively involved in monitoring their construction projects even where the contractor is operating under a fixed price contract. This will allow timely efforts to maintain full contractor performance, or its early termination and replacement with another qualified contractor.

5.66 Monitoring of this Project rested heavily on the consulting engineers. However, it was observed that the consulting engineers' disbursement certificates were issued with no consideration given to the inability of the Contractor to comply with the scheduled completion date. Also, in light of the report prepared by the reviewing firm, there were serious qualitative shortcomings in the construction works that had been certified for payment. International best practice in project finance assigns to the Independent Engineer considerable power to withhold loan funds from contractors in any situation where the Independent Engineer determines that the contractor is actually or potentially in default of its commitments under the Design Build Contract. The Audit Office concludes that BIDC should strengthen the role of its engineering consultants in the monitoring of its projects in future contracts.

5.67 The absence of a valid performance bond was also of some concern. The performance bond of $1.8 million should have remained in force, and this would have given the BIDC recourse to funds, given the defects discovered on the Project by the reviewing engineers. In addition, 5% of the contract funds should have been retained until a Certificate of Completion was approved. It is inexplicable that all funds could be disbursed while the Project remains uncompleted.

5.68 Finally, it was noted that the Loan Agency assumed very limited project risks under the terms of its Facility Agreement with the Project Company. The Loan Agency was given a Comfort Letter which effectively insulated it from any risks related to the operation and leasing of the facilities. It also had no construction risks since under the terms of the Implementation Agreement it could call the loans if the contractor defaulted on its obligations under the Design Build Contract. The Contractor, it was seen, had assumed the design and construction risks but, in case of bankruptcy, would not be able to cover its liabilities to the Government or BIDC. The absence of a valid performance bond should have been promptly addressed by the Trustee Bank or the consulting engineers.

Recommendations

5.69 PPP guidelines should be developed with the assistance of experienced consultants to assist Government ministries and statutory corporations in planning and executing PPP procurement.

5.70 PPP projects will initially require the support of experienced advisors and consultants who should be engaged throughout the project cycle.

5.71 Government should continue its training programs in PPPs and Project Finance and ensure that key personnel are given opportunities to deepen their understanding of all facets of PPP procurement in the relevant ministries and statutory corporations.

5.72 PPPs should only be undertaken where a comprehensive "value for money" analysis has been performed quantifying the likely benefits to be derived under PPP procurement. PPPs should not be chosen solely to achieve short term off budget advantages.

5.73 Legal instruments should be developed with the assistance of experienced lawyers to be used in PPP projects. To the extent possible, such contracts should be based on model contracts such as those followed by the UK, South Africa and Australia. These contracts will contain standardized legal documentation. Government should therefore study the economic and financial benefits and costs involved in using Design Build contracts in Public Sector procurement. In any move towards PPP procurement, the focus should be always on the *value for money* using the latest techniques adapted to small markets.

5.74 In undertaking PPPs, Government should carefully review and negotiate any financing agreements used in these projects, to ensure that it is not left with unintended repayment obligations to the lenders, when the developer or contractor is in default on underlying project documents such as the construction contract. This can only occur if disbursements are closely monitored as well as any security offered to support the obligations of the contractor/developer. Therefore, as consideration for providing its guarantees to the project lenders, Government should also require the lenders to assist in monitoring the contractor's performance by tying disbursements to the presentation of a project performance certificate.

5.75 ***BIDC's Response***

The BIDC retained and expected the consultant engineers to supervise the Project in specific accordance with international best practices. Article A7 of the Agreement states that the consultant engineers, is responsible for monitoring the construction for the work required for the erection of new buildings and associated infrastructure.

As noted in your Report the consultant engineers failed to provide qualitative opinion or comment on the work. Indeed, the consultant engineer's reports considerably understated the degree of compliance achieved in terms of time or costs.

Although the Project certainly has encountered issues, the BIDC is unprepared to conclude that the design-build method, directed by the Government and followed by the BIDC, delayed completion of the Project.

The facts demonstrate that it was the Contractor's failure to properly implement its plans on schedule and the consulting engineers failure to supervise and manage the Contractor in accordance with its contractual obligations that prevented the Project from being completed on scheduled.

Your Report makes a point about contractual arrangements which allow the Engineer to withhold "Loan Funds" where the contractor is actually or potentially in default relative to completion dates. The (FIDIC) Contract expressly stipulates the contractual provisions for certifying payments, and failure to comply can give rise to breach of contract. British case law supports the importance of cash flows as the life blood of the construction industry and the practice recommended by your Report may be inappropriate for the traditional Standard Forms in use, and certainly did not apply to the(FIDIC Design Build) contract which governed this project.

LIST OF ACRONYMS

BIDC	Barbados Industrial Development Corporation
BLT	Build Lease Transfer
BOOT	Build, Own, Operate, Transfer
BOT	Build, Operate, Transfer
DB	Design Build
DBFO	Design, Build, Finance and Operate
EU	European Union
IA	Implementation Agreement
IT	Information Technology
LA	Loan Agreement
LD	Liquidated Damages
NBPPCL	Newton Business Park Project Company Ltd.
PPP	Public Private Partnerships
RFP	Request for Proposals