



Who Will Want to be a Compliance Officer?

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So Who Needs Technical Due Diligence?

- Lack of quality assurance systems or a failure to exercise proper quality control;
- Poor contractual arrangements as between professional and/or constructors and the project developers limiting scope of work and necessitating contract amendments and change orders, resulting in delays and increased costs;
- Non-compliance with environmental standards, health and safety regulations and labour laws, leading to fines, accidents, claims for damages and even suspension of development or operations;
- Occurrence of unforeseen or external events perceived as unlikely materialising, adversely affecting revenues or costs;
- Changes in market conditions, including adverse publicity or disruption from supplier or customer action, affecting either or both supply and demand for a project's outputs.

Clearly in the event of failure of a project backed by project assets the funder is protected from total financial loss, although depending on realisations it may bear some loss on any element of the funding that is unsecured. However, it is possible that the value of the security itself may be eroded by the problem causing the project's demise eg if a site over which the funder has a charge proves to be more seriously contaminated than anticipated and needs extensive and costly remediation before development can take place.

Brownfield sites can often have "negative values" and indeed, there are situations where a liability for remediation can attach to the funder if it assumes title to a problem asset in any recovery situation. Taking over a half completed project, or even a completed project, that for any reason has been abandoned is of no value to a funder unless there is a commercially viable alternative use.

If a funder becomes associated with a project that fails spectacularly or has infringed responsible ethical, environmental or social standards, it may be able to recover its investment or loan but could suffer a loss of reputation and, as a consequence, a loss of potential future business. Further, if physical or economic damage has been caused to a third party by the project or its outputs, a funder may be liable in whole or part if it is deemed to have exercised control or significant influence on the management of the project under the terms of the funding agreement or its staff or representatives sit on the management board.

To illustrate aspects of these problems we cite two examples of projects in the public domain where funders have incurred losses because technical risks, which in these cases were brought to their attention, were dismissed for political reasons. The first is the pUBLIC, a multi-purpose "international" community arts centre in West Bromwich, a facility that was intended to catalyse regeneration in this struggling Midlands town located between the two larger cities of Birmingham and Wolverhampton.

Originally estimated to cost £17 million, both the fitness for purpose of its design and its buildability were questioned. The project was eventually delivered after years of delay at an outturn cost of £72 million. After receiving an operating subsidy from the local authority of £2 million per annum it ceased to trade in 2013 after just 4 years. The building stands vacant without an alternative use.

The second example is the Turner Gallery of contemporary art in Margate. This project was to be constructed in the tidal zone off the pier so that the views that inspired the artist JM Turner could be recreated. For fairly obvious reasons, few if any fixed structures have been built in a tidal zone, but the design and procurement under a two stage design and build process was progressed to a point where a contractor was asked to commit to a fixed price. That price was more than three times the original estimate and the project was then aborted and the costs to date written off. A gallery was eventually constructed on terra firma.

A happier outcome was achieved in respect of the airport hotel at the New Athens Airport. The original design was for a five star property incorporating traditional Greek architecture - columns, fountains, statues and marble floors - on that basis that, as the first building visitors would see on arrival and the last they would see on departure, the Government wanted it to be "iconic" Due diligence consultants reported that most users of airport hotels stay for less than 8 hours and have little



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interest in the exterior of such hotels so the Airport PPP company accepted that the design concept had to be rethought. The result was a five star fit out and operation housed in a two star building, compatible with the terminal. It is now operating successfully as a Sofitel brand.

It should be emphasised that the objective of technical due diligence is not to redesign or re-engineer a project. Rather it is simply to review the proposals put forward together with the background studies, assess the risks of its deliverability and sustainability in as constructive a manner as possible and report accordingly. Typically the scope of a technical due diligence assignment covers the following aspects of a project:-

- Business Plan, setting out the key objectives of the project, the market opportunity, the economic and technical principles underlying the project, outcomes and measures of success (key performance indicators);
- The Project Team, the basis on which it has been assembled, the experience in advising on projects in the relevant sector and exhibiting similar issues of the professional firms selected and of the individuals who will be involved, references, where applicable, and how their respective inputs will be co-ordinated;
- The Project Site, examining the accessibility of the location and surrounding areas, geo-technical characteristics, environmental and ecological constraints, archaeological history and, if existing buildings and structures on the site are to be retained in the project, their condition and work required for their refurbishment;
- The Design and Engineering, examining the design development process, fitness for purpose of the designs and specifications per the business plan and brief, their integrity and the identification of key issues yet to be resolved, including the use of non-standard materials and equipment or long lead times;
- Procurement of contractors, the tender process including pre-qualification and selection, contract form, relevant experience of the contractors and references, where applicable, labour and financial resources;
- Programme, examining the reasonableness of the projected time pre-contract to secure appointments and consents and design development and the comprehensiveness of construction tasks identified and reasonableness of the time allowed for their execution;
- Planning and Statutory Consents, reviewing the likelihood of consents being granted and the conditions under which it may be from relevant correspondence with the various authorities or examining the practicability of the actual conditions imposed where consents have been granted, including financial contributions to community infrastructure schemes negotiated and/or levied;
- Building Control and Health and Safety Regulations, reviewing the general and particular requirements for the project as advised by those responsible for certification;
- Third Party Rights, reviewing the need for the developer to obtain agreements on party walls, rights to light, air rights, riparian rights as necessary and that adequate cost provision is made;
- Insurances, ascertaining that relevant professional indemnity, contractor insurances and employers liability insurances are in place, are current and that cover is commensurate with the size and complexity of the project;
- Collateral warranties ensuring that the design team and the contractors provide enforceable warranties in a suitable form to indemnify the funders if they are responsible for any unsecured losses;
- Construction Budget, reviewing the cost plan to establish that it is comprehensive, based on current labour and material prices and that the degree of cost certainty is in line with the relevant design stage;
- Development Appraisal, demonstrating viability, projecting values and costs, examining cash flow projections and applying sensitivity analysis enabling quantification of the impact of any key risks identified;

The above is necessarily a general summary of what may be required by funders but, in any event, instructions will vary considerably as between cases. Funders may restrict technical due diligence to particular areas of concern, they may call for a review at each of the design development stages and only agree to fund the following stages if they are satisfied that the project is progressing satisfactorily and they may instruct due diligence advisers, whether in house or external, to monitor progress through the construction phase (and even beyond into the operational phase).

It will also be apparent from the above that, although their focus will be different, there is an element of overlap between technical, legal and financial due diligence. Funders expect due diligence advisers to work closely together, share information and conclusions, and ideally provide them with clear unequivocal opinions that are complementary and consistent with each other.

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