Business Unit Review – Property Partnerships

Trillium provides Property Partnership services in the outsourcing and Public Private Partnership (PPP) markets. In the six months under review it generated 19.9% of the Group's underlying operating profit, some £57.8m. This business now has 4.8 million m^2 of floor space under ownership or management. It is involved in 123 long-term partnerships, providing accommodation services to more than 455,000 people.

Trillium delivered strong results for the six months under review and made excellent progress on its new business pipeline with £65m invested in seven new PPP acquisitions and a further £209m invested since the period end. In addition to the underlying operating profit of £57.8m, the business also generated £25.1m of profits on disposal.

The outlook for Trillium is positive in terms of new business prospects. In its Pre Budget Report, the Government reiterated that £22.2bn worth of PFI projects (which are part of Trillium's PPP market) are expected to reach financial close before April 2011, and that PFI should continue to form a significant part of the Government's strategy for delivering high quality public services. As a leader in the education and health markets, we believe Trillium is well placed to take advantage of these opportunities.

In addition, the Government restated its objective of selling public sector assets totalling £30bn by 2011. This sales programme will include a significant amount of property assets and the Trillium partnership approach can offer long-term operating efficiencies as well as capital realisation, a potentially more attractive solution.

Trillium Financial Results

The results for the period are set out in the table below:

Table 1: Trillium financial results

	Six months ended 30 September 2007 £m	Six months ended 30 September 2006 £m	Year ended 31 March 2007 £m
Contract level operating profit			
- DWP	**45.2**	42.8	81.0
- Norwich Union	**4.8**	3.9	9.2
- Barclays	**0.9**	1.2	3.3
- DVLA	**1.8**	0.7	1.7
- Telereal II	**7.6**	7.0	16.1
- Accor	**11.6**	-	1.5
- Royal Mail	**2.1**	-	-
- BBC	**-**	-	2.8
Bid costs	**(3.1)**	(1.4)	(2.8)
Central costs	**(15.4)**	(5.7)	(14.0)
Other	**2.3**	3.3	-
Underlying operating profit	**57.8**	51.8	98.8
Net (deficit) / surplus on revaluation of investment properties	**(8.8)**	0.3	(13.6)
Profit on disposal of properties	**15.1**	8.5	7.5
Profit on disposal of a PPP project (Meterfit)	**10.0**	-	-
Segment profit	**74.1**	60.6	92.7
Share of profit / (loss) from Investors in the Community (IIC) (joint venture)	**0.1**	(1.1)	(3.0)

Capital employed	**2,135.2**	663.7	2,032.5

Existing contracts

On the Department for Work and Pensions (DWP) contract, we disposed of 35,380m^2 of surplus leasehold space and 33,500m^2 surplus freehold accommodation. The proceeds from the freehold disposals were £46.9m, which showed a net profit on book value of £14.1m after gain share.

DWP issued vacation notices during the period on 67,026m^2 (63% leasehold and 37% freehold) and actual vacations during the period were in line with expectations. The negative impact of vacations on our profitability was offset by a one off payment for backdated services, and income growth due to indexation.

We have completed a programme of 13 refurbishment projects on the Royal Mail portfolio and let or disposed of 10,200m^2 of surplus space, which is ahead of our expectations at the time we won this contract.

On the DVLA contract, we have been awarded three scope extensions to provide an additional 7,000m^2 of accommodation with capital investment of approximately £26m over the next 18 months.

The turnover on the Accor hotels portfolio increased by 5.6% over the period. However, as a result of yield re-pricing in the property investment market, there was only a small underlying increase in investment value (excluding purchase costs) during the period.

The increase in central costs primarily reflects the inclusion of the SMIF and IIC businesses.

New business

In July, Trillium announced the purchase of AMEC's Project Investments business for £163.5m which included AMEC's interests in nine signed PFI projects in healthcare, transport and education, one preferred bidder project, and the PFI/PPP bidding and asset management team. Some of the projects were in joint ownership and were subject to pre-emption clauses in favour of the joint owners. As a result of the exercise of pre-emption clauses on two small projects our acquisition now relates to seven signed projects and one at preferred bidder stage for a total net consideration of £152.4m. The purchase was completed after the period end. Since the period end, we have also completed on the purchase of nine new PPP health assets from United Medical Enterprises for a total consideration of £56.6m.

For the Northern Ireland Civil Service, the new Assembly Government has confirmed its support for the outsourcing proposal, and we now await the outcome of a legal challenge to the shortlist selection process. We are one of two shortlisted parties who will be invited to submit best and final offers once this has been resolved.

On the Defence Training Review (DTR) outsourcing contract, our Metrix consortium with Qinetiq remains as preferred bidder on Package 1. Good progress has been made and the Ministry of Defence (MoD) anticipates committing to the final developmental phase in spring 2008, with a view to financial close a year later. Metrix also remains as provisional preferred bidder for Package 2. However, having concluded that there are insufficient efficiencies to move forward with a “Whole Programme Solution” for DTR, the MoD continues to consider a range of options for Package 2, from adaptations of the Metrix proposal through to conventional procurement.

We are shortlisted for the Building Schools for the Future (BSF) projects in Birmingham and Kent where the initial phases involve in excess of £200m of PPP capital expenditure. It is anticipated that the preferred bidders will be announced this financial year.

PPP market update

Following the integration of the of SMIF and IIC businesses last year, the acquisition of AMEC's Project Investments business has further strengthened our position at the forefront of the UK PPP market. We now have an unrivalled team engaged in the development and acquisition of new business opportunities.

Our portfolio and our underlying asset and capital management activities have made significant progress. We are in the process of establishing our own debt aggregation vehicle, which will reduce over the long-term the cost of capital in our underlying investments. The completion of a major school refinancing, together with a 29% reduction in insurance premia through our consolidated buying programme, were also notable achievements.

In April, we commenced the establishment of a new joint venture fund, aimed at bringing in third party investors alongside our own long-term investment in the venture. Once established, this will be the largest venture of its kind in the marketplace. UBS have been appointed as our advisers on this initiative, which is intended to release in excess of £750m of capital and provide us with a further ongoing source of capital that will support our new business platform. Notwithstanding the turmoil prevailing within the credit markets, we have made good progress and expect to achieve a first closing this year with a final closing before our financial year end.

During the period we completed the disposal of Meterfit, one of the non-core utility businesses we acquired as part of the SMIF transaction generating a profit on sale of £10.0m.