PARLAMENT TA' MALTA

IT-TLETTAX-IL LEĠIŻLATURA

P.L. 2161

Dokument imqiegħed fuq il-Mejda tal-Kamra tad-Deputati fis-Seduta Numru 140 tat-3 ta' Ottubru 2018 mill-Ispeaker, l-Onor. Anġlu Farrugia.

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Performance Audit: An evaluation of Government's deal to design, build and operate the Malta National Aquarium

September 2018

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National Audit Office
MALTA

Performance Audit

An evaluation of Government's deal to design, build and operate the Malta National Aquarium

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List of Abbreviations

ANAO	Australian National Audit Office
BoQ	Bill of Quantity
CBA	Cost Benefit Analysis
DBPFOT	Design-Build-Part Finance-Operate-Transfer
DG Regio	Directorate-General for Regional and Urban Policy
DoC	Department of Contracts
ERDF	European Regional Development Fund
EU	European Union
FIDIC	International Federation of Consulting Engineers
GPD	Government Property Department
IAID	Internal Audit and Investigations Department
IRD	Inland Revenue Department
IRR	Internal Rate of Return
ISSAI	International Standards of Supreme Audit Institutions
IZVG	International Zoo Veterinary Group
JASPERS	Joint Assistance to Support Projects in European Regions
MEPA	Malta Environment and Planning Authority
MIP	Malta Industrial Parks Limited
MNA	Malta National Aquarium
MTA	Malta Tourism Authority
NAO	National Audit Office
NGO	Non-Governmental Organisation
PPCD	Planning and Priorities Coordination Division
PPP	Public Private Partnership
VAT	Value Added Tax
WACC	Weighted Average Cost of Capital

Executive Summary

Introduction

1. One of the major tourism projects undertaken in recent years was the Malta National Aquarium (MNA) in Qawra. This project constituted an expenditure of over €15.4 million, where 48.6, 8.7 and 42.7 per cent of funding emanated from the European Union (EU), Government and the private sector respectively. In addition, Government outlay included a 50-year rent-free concession of a site of over 20,000 square metres located on public land. The MNA commenced its operations in October 2013.

2. The audit objectives, outlined below, reflect the main criteria adopted to determine the degree to which this venture constituted value for money. To this effect, this review sought to evaluate the extent to which the:

   i. project contributed to Malta's tourism product;
   ii. direct financial benefits to Government replicate the public investment;
   iii. Contracts' clauses safeguard Government's interests and ascertain a balanced partnership in terms of project benefits; and
   iv. Malta Tourism Authority (MTA) is monitoring project implementation.

3. This Executive Summary includes extracts from MTA's feedback on this performance audit. A more detailed presentation of MTA's comments is included in the Report proper. Moreover, in view of their commercial sensitivity, while available to the National Audit Office (NAO), some statistics are not being reproduced in this Report.

Enhancing Malta's Tourism Product

4. The MNA complex established itself as an integral part of Malta's tourism product. To this end, this performance audit revealed that MNA operations have fulfilled predetermined and other generally accepted criteria related to a quality tourism product.

5. The National Aquarium project, which was part of the plan for the embellishment of Buġibba and Qawra, significantly overhauled the facilities available in the area by providing a high-end National Aquarium complex, housing a visitor attraction and educational facilities, a diving institute and various catering establishments providing ancillary facilities, together with a retail outlet and car parking facilities. The facilities also include freely accessible public areas such as the large plaza and games area. The project also included restoration of historic structures in the area. Additionally, the complex is regularly used as

an events venue, some of which directly attract visitors to Malta. Since the interest in the Diving Institute by this Sector's associations did not match expectations, in line with the concession Agreement, the Contractor now mainly utilises the Institute's facilities for other commercial purposes. The lack of interest in the Diving Institute deviates from the project's performance indicators.

6. Between 2014 and 2017, the number of visitors to the National Aquarium (tourists and local) of which more than two thirds were tourists, significantly surpassed the forecasted visitors. The foregoing considers two factors, namely that at the time of projecting visitor forecasts (2008/9) the tourism industry was experiencing a negative growth. Conversely, in subsequent years, the industry went through a significant growth where the National Aquarium visitors growth was double the increase in tourist arrivals.

7. The MNA complex is in itself a prime revenue generator in the area through various aspects, mainly employment as well as entertainment and catering activities. During 2016, the MNA employed 98 persons during the winter months, with this number almost doubling during the summer peak season. In turn, such employment contributed to the economy and influenced positively Government revenue generated through income tax and social security contributions.

Financial considerations

8. The permanent capital injected in the project by the three main contributors amounted to around €15.45 million (€6.6 million by the contractor, €7.5 million by the EU and €1.35 million by the Government) – this excluding the present value of the land foregone over the concession period. This performance audit estimates that such present value of land foregone varies between €2.6 million to €28.5 million, depending on the market value that is to be attributed to it. To this end, the NAO attributed an average value of €15.5 million, which represents the semi-commercial nature of the MNA complex. On the other hand, MTA contends that it is the €2.6 million, that is the lower value, which should be considered for the purpose of this exercise since it reflects the lack of previous market interest in the project.

9. While acknowledging the validity of MTA's argumentation, the NAO considers that the value of the site in question is better represented by an average value of €15.5 million attributed for such land. Consequently, the total capital injected in the project would amount to €31 million. On this basis, the proportion of capital forked out by the Contractor will amount to only around 21 per cent. Consequently, the major question lingers as to how sufficient was and is to be the return of capital to Government over the project period. Of relevance in this context is the need to improve systems to ensure the appropriate attribution to the valuation of public land concessions in various commercial, semi-commercial and non-commercial settings.

10. The better-than-expected performance from the MNA complex is mainly due to a positive outcome for tourism in Malta and the operator's ability to exploit business opportunities. To this effect, envisaged profits increased from 12.69 per cent quoted in the Cost Benefit Analysis (CBA) to 16.2 per cent estimated by MTA. However, as Government is not a beneficiary of revenues generated by the project, a financial imbalance was created in the returns attributable to Government and to the Contractor within the project period. MTA contends that revenues were not a priority, as Government was after the positive economic benefits to the project's locality.

11. While not necessarily clearly visible at the time of project commencement, such a financial imbalance could have been ratified through a much stricter claw-back clause. In this case, this could have entailed compensation for the land concession, which would have become chargeable or reinvested in the development of the Qawra / Buġibba area if company revenues far exceeded the original estimate. Thus, one could have ensured that within the 50-year Service Concession Agreement period, the Government would be more fairly entitled to a share of the financial benefits emanating from the project. Such circumstances present a better balance between the interests of the two parties where the Contractor bears the risks of adverse performance and Government would not just benefit indirectly through taxation, but also directly through revenues generated by the project.

The contractual framework

12. The MNA project's contractual framework comprises three main contracts. Firstly there is the Emphyteusis Agreement between Government Property Department (GPD) and MTA regarding the use of publicly-owned land. The second agreement relates to the co-financing Grant Agreement between the Planning and Priorities Coordination Division (PPCD) and MTA relating to the design and build elements. The third element of the contractual framework comprises the agreement between the Contractor and the Department of Contracts on behalf of the MTA with respect to all aspects of the 50-year concession and project delivery, including its operations. This audit found that, in cases, these three contracts do not comprehensively assure that Government's interests are fully safeguarded as follows:

    a. The 50-year concession to the Contractor for the operation of the National Aquarium complex is longer than the norm. A shorter contract period is seen as more advantageous to Government as it would have provided the latter the opportunity to review and re-negotitiate conditions to seek a better deal within a shorter time-frame. This 50-year concession was given following MTA's consultants' advice which considered that additional investment was required to maintain the relevant standards for the National Aquarium complex in later years. Nonetheless, World Bank guidelines outline that a concession is typically for a period of 25 to 30 years (i.e., long enough at least to fully amortise major initial investments). The International Federation of Consulting Engineers (FIDIC) Model and Joint Assistance to Support Projects in European Regions

(JASPERS) recommend a period of up to twenty years. In a similar vein, Public Private Partnerships (PPPs) which have already been undertaken in Malta were generally of up to a renewable 25-year period, even when the materiality involved exceeded the investment made with respect to the MNA project.

b. Rent payable by MTA, rather than the Contractor, for the transfer of land from the Government Property Department amounts to €25,000 annually, which will be constant throughout the concession. MTA contends that this value is purely symbolic to ascertain that Government retains the title over the land in question.

c. The use of public land for the actual National Aquarium constitutes only seven per cent of the total area in question. Supporting amenities constitute 26 per cent of the concession area. Another 67 per cent of the area is being utilised for outdoor recreational space, and in instances to host commercial events. Given that this is a rent-free concession and that government is not entitled to any direct revenue generated from this site for a period of 50 years, raises questions as to whether the contract has appropriately managed to balance the parties' interests.

d. The Service Concession Agreement does not appropriately define deliverables, as references to the final plan of the MNA complex are not included in an Addendum.

e. While the Service Concession Agreement was forward-looking to the extent that it included claw-back clauses, such provisions did not fully anticipate the potential of changing economic circumstances or tourism arrivals. To this effect, stricter claw-back clauses would have ensured a more balanced partnership between the parties involved in this venture.

Monitoring

13. The contractual framework permits comprehensive monitoring of all aspects of the MNA complex. Moreover, MTA has a Monitoring Committee and is in receipt of audited financial statements and an annual report evaluating the extent to which project objectives and targets are attained to support its monitoring function. Nonetheless, MTA's monitoring coverage did not extend to all aspects of the design, build and operate Agreement as follows:

a. While the Monitoring Committee meets on a needs basis and at least annually, meeting minutes are not taken.

b. The concession Agreement, drafted on the FIDIC model template, considers a lump sum agreement for the design and construction of the MNA complex. Despite its advantages, this contract type reduces substantially the contractor's obligations on cost reporting, which ultimately impinges on the principle of transparency. Thus, the Contractor's

contribution of €6.6 million together with the development costs incurred by the other parties, which collectively amounted to €8.85 million, could not be conclusively verified by the NAO. MTA stated that the costs of the project were certified by the appointed independent architects. The process undertaken as part of this lump sum contract in the certification of payments has been reviewed and accepted by various audit bodies (both National and European). MTA, however, accepts that unfortunately the workings undertaken at various phases of construction were not included in the relative costings and certification reports. To this effect, MTA is pursuing the matter and trying to obtain such workings.

c. In line with the provisions of the Concession Agreement, the MTA and the Contractor were required to appoint jointly an Auditing Body to carry out independent and impartial audit during the Operation Service. However, this appointment materialised two years after the start of the MNA's operations. Furthermore, the scope of review agreed with the Auditing Body does not extend to a financial review based on the annual audited accounts.

Overall Conclusions

14. It is undisputable that the Malta National Aquarium is a quality tourism product and generally exceeded expectations on many counts. The question arises as to whether this joint venture involving EU, National and Private Sector funds, reflects a balanced partnership where risks and benefits are equitably shared between the two main players: Government and the Contractor of this design, build and operate project.

15. The first point relates to the parties' outlay. On the basis of NAO's attribution of value to the public land used in this concession, the balance tilts in favour of the Contractor as the operator's input to the project amounted to around one fifth of the total capital outlay. This state of affairs largely materialises because of Government practices where the value of land concessions does not reflect commercial or semi-commercial rates.

16. Lessons drawn from this performance audit for future joint venture projects relate to contractual clauses, in particular claw-back clauses. The Agreement covering this joint venture was innovative as it introduced claw-back clauses, however, these provisions were not strict enough to cater for changing circumstances over a period of 50 years. The importance of this issue has also been recognised at EU level, whereby in the past three years, the Commission has taken action to strengthen claw-back clauses to ensure that the concessionaire is not over-compensated throughout the concession period.

17. This performance audit acknowledges the value of lump sum contracts. However, NAO did not find evidence that Governmental entities involved in the evaluation of the Contractor's submissions at the tendering phase carried out comprehensive assessments to verify that the MNA infrastructure would equate to that noted by the operator. This issue mainly

resulted as the relevant workings undertaken by Governmental entities were not included in official documentation.

18. Similarly to other reports concerning joint ventures between Government and the private sector published by NAO, this Report showed that the sharing of benefits and risks of joint ventures between Government and the private sector was not always equitable. This is not, in any way, to be interpreted that private initiative or profits in such ventures are to be stifled. On the contrary, they should be encouraged to the full. Nonetheless, NAO believes that while there is scope for Government and the private sector to work further in tandem and to develop quality projects, the potential exists for a more balanced partnership in terms of risks and rewards.

Recommendations

19. At the strategic level, this performance audit identified a number of issues, which National Authorities[1] could consider for future projects involving land concessions as well as joint ventures between Government and the private sector. At the operational level, this study highlighted elements that if addressed, would further safeguard Government's position and ensure a more balanced partnership within this Service Concession Agreement. Within this context, NAO proposes the following recommendations:

At the **strategic** level:

a. When valuing public land identified for concession purposes involving commercial and semi-commercial operations by third parties, project evaluations by National Authorities are also to consider the opportunity costs to Government based on market values. This approach would produce a more realistic evaluation on project feasibility. This approach may include forecasts of future compensation value for concession, that is, such compensation will change depending on the market prices throughout the period of the Concession.

b. National Authorities are to draw up policies, which clearly illustrate the computation of the compensation element in cases of service concessions involving commercial activities. Such a policy should also provide clear guidance on the extent to which compensation for such eventualities are to be based on market values. A policy in this regard would eliminate subjectivity when attributing compensation values to public land.

c. National Authorities are to document the basis on which value is attributable to public land identified for transfer to third parties. As land is a highly priced resource, this

[1] National Authorities namely include those entities responsible for finance, contracts and land.

proposal aims to enhance good governance, particularly through the principles of transparency, accountability and value for money especially when such transfers are not subject to a Parliamentary Resolution.

d. In the same vein, National Authorities involved in evaluating service concession contracts are to document the basis on which concession periods are decided. To this effect, National Authorities are to document the respective weightings allocated to the key elements considered during the dialogue stage of tender evaluation, when determining the length of concession periods.

e. In line with EU developments over recent years, service concession contracts between Government and contractors are to include stricter claw-back clauses. This would be particularly relevant in situations of long-term agreements. Apart from obliging the contractor to keep investing in the project, such claw-back provisos could relate to compensation or obliging the contractor to contribute in the upgrading of the surrounding area. This type of claw-back clauses would ensure that Government does not benefit solely from the development of sites or areas but also partakes in the financial benefits reaped by the project.

f. At the tender evaluation stage, National Authorities involved in the awarding of lump sum contracts are to ascertain the feasibility of submissions through comprehensive validation studies, the results of which are to be included with official documentation. Such studies are to assess the reasonableness of bidders' claims of works to be undertaken and that rates quoted compare well to prevailing market prices. This approach would ensure that Government benefits from the advantages of lump sum contracts while mitigating its disadvantages.

At the **operational** level:

g. Malta Tourism Authority's Monitoring Committee is to document meetings' minutes. This is conducive to greater transparency as well as encourages continuity in the Committee's important function.

h. Similarly, MTA is to document the outcome of inspections carried out at the MNA complex. Documenting inspection results constitutes good governance.

i. MTA is to extend the scope of its audit of the MNA complex to include a more comprehensive review of the financial statements submitted annually by the Contractor. Such a review would be critical particularly in view of the claw-back contractual clause whereby the operator is to invest abnormal profits in the project. Moreover, a more in-depth financial review is desirable to monitor the returns being made by the different commercial outlets on the MNA site.

Chapter 1

Terms of Reference

1.1 Introduction

1.1.1 During recent years, the Ministry for Tourism in conjunction with the Malta Tourism Authority (MTA) has embarked on a number of projects with the aim of improving tourists' experience in Malta. One of the major projects, involving a capital expenditure of over €15.4 million is the Malta National Aquarium (MNA).

1.1.2 The Malta National Aquarium in Qawra commenced its operations in October 2013. The European Union (EU), Government and the private sector co-funded the project. This project spreads over approximately 20,000 square metres and comprises amongst others the public National Aquarium, a public garden at promenade level, a multi storey car park, facilities for local dive schools, catering facilities, a merchandise outlet and a tourist information kiosk. The project also includes a large plaza and games area which are open for free for the public. Furthermore, the project also included restoration of historic structures in the area.

1.1.3 Against this backdrop, the National Audit Office (NAO) conducted the performance audit: 'An evaluation of Government's deal to design, build and operate the Malta National Aquarium'. The aim of this audit was to evaluate whether the joint venture between Government and the Private Sector for the design, build and operate relating to the Malta National Aquarium,[2] constituted a good deal for Government.

Background

1.1.4 The need for Malta to have a National Aquarium first emerged in 1993 but the project ultimately materialised twenty years later. Until a few years ago, the Northern part of Malta, mainly the touristic areas of Buġibba, Qawra and St Paul's Bay, lacked in facilities being offered both for tourists as well as locals residing in and visiting the area, especially during the winter months. Throughout the years, there have been many interventions to try to revive the area from its decline.

[2] Throughout this Report, the terms 'Malta National Aquarium (MNA)', the 'National Aquarium project' and 'National Aquarium' are used interchangeably.

1.1.5 The project takeoff was delayed by the identification of an appropriate site and a sustainable financial operating model. Further hindrances emerged in the form of the prevailing slow growth in the tourism industry registered during the early 2000s in view of the global economic crises.

1.1.6 Figure 1 presents a summary of the National Aquarium project timeline since the initial stages in 1993 until the National Aquarium was fully operational in 2013.

1.1.7 Figure 1 shows that the Malta Tourism Authority (MTA) sought to ensure project sustainability through EU Funds. In September 2007, MTA submitted an EU Application, requesting assistance for the construction of facilities at Qawra Point, which included two marine visitor attractions and landscaped areas with seating and open sea views, together with a National Aquarium, a marine archaeology museum, a diving institute and a Greek theatre.

1.1.8 The original intention was for Government to develop the visitor attractions itself and subsequently lease it to a commercial operator or for a Government agency to operate the attractions. However, the project ultimately evolved into a Private Public Partnership (PPP) where the Department of Contracts (DoC) issued a public call for bidders interested in a Design-Build-Part Finance-Operate-Transfer (DBPFOT) arrangement in January 2009.

1.1.9 The tender highlighted that the Project was to be funded by the EU and MTA at a co-financing rate of 85 per cent and 15 per cent up to a maximum of €7,500,000 excluding Value Added Tax (VAT), for the design and construction, which would complement the Concessionaire's own funding. At this point, the tender did not clearly specify the amount required to be funded by the Concessionaire.

1.1.10 Two bidders qualified for the tender dialogue phase. However, only one bidder, Ebcon-Global JV responded to the call 'Invitation to Dialogue' in January 2010. The proposed bid comprised a significantly larger facility with a wider scope (and related higher expenses) than had been originally intended by the MTA. Later that year, the EU Grant Agreement was signed, that is around three years after the initial submission of the EU Application.

Figure 1: The Malta National Aquarium timeline (1993 to 2013)

1993 - 1996

First steps taken by Government to establish a National Aquarium

Project discountinued as it was not feasible for private sector to take on alone

2003

Publication of the 'Qawra Coast Development Brief'

The brief identified a parcel of public land for the possible use of the National Aquarium project

2007

MTA submitted an EU Application to receive funds for the Aquarium project

The EU Application was based on a feasibility study. The EU Application requested assistance for the construction of facilities which included:-

- two marine visitor attractions;
- landscaped areas;
- an Aquarium;
- a marine archaeology museum;
- a diving institute; and
- a Greek theatre.

2009

The tender 'The Development of a Public Aquarium and Marine Attraction in Qawra' was published

Tender highlighted that the Project was to be funded by the EU and MTA at a co-financing rate of 85% and 15% respectively up to a maximum of €7,500,000 excluding VAT. The allocation was for the design and construction, which would complement the Concessionaire's own funding.

2010

During the Dialogue phase, the National Aquarium project scope was broadened.

Two bidders pre-qualified for the Dialogue phase. But only one bidder replied to this invitation. This bidder proposed a significantly larger facility with a wider scope (and related higher expenses) than had been originally intended by the MTA.

EU Grant Agreement signed

EU Grant Agreement provides assistance for the construction of facilities which included:-

- a marine visitor attractions;
- an Aquarium;
- ancillary facilities;
- souvenir outlets;
- kiosks;
- parking area; and
- a diving institute.

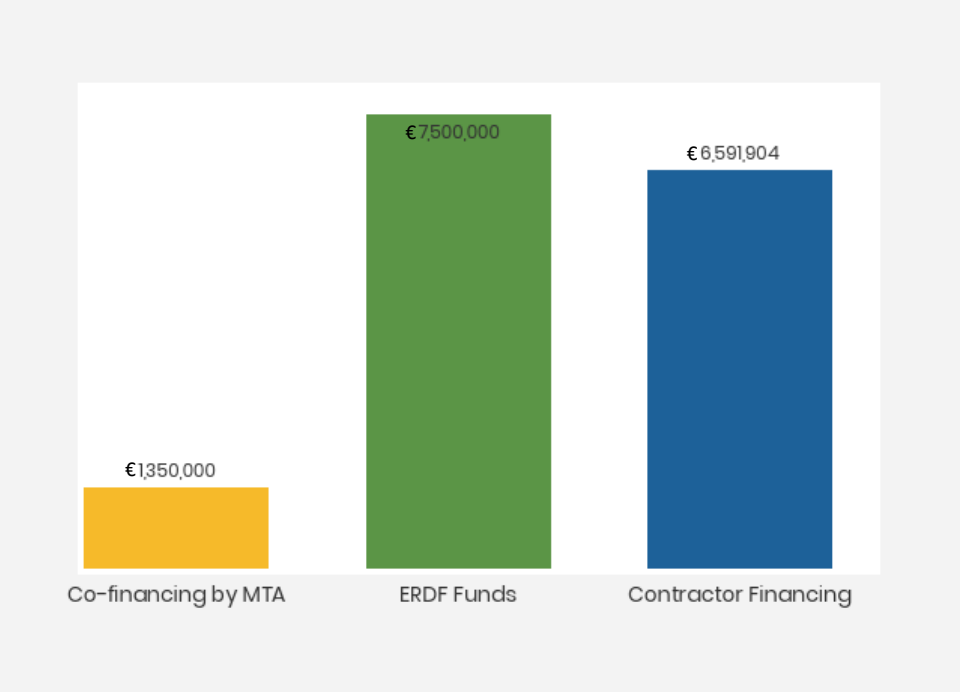
2011

The Aquarium Service Concession Agreement signed between the MTA and the Contractor

2013

Official opening of the National Aquarium Complex

Figure 2: Financial outlay for the National Aquarium



1.1.11 On 18 May 2011, the Department of Contracts issued the 'Letter of Acceptance' to Ebcon-Global JV. This letter formed part of the Service Concession Agreement signed between this Contractor[3] and the Malta Tourism Authority[4] on 12 September 2011. Figure 2 illustrates the funding sources of the accepted contract amount for the National Aquarium project of €15,441,904. This amount does not include the value of around 20,000 square metres of land housing the Malta National Aquarium.

1.1.12 In addition to the co-financed grant of €8.85 million, Government provided a public land concession with a footprint of over 20,000 square metres, upon which the contractor was to develop the infrastructure related to the whole of the National Aquarium project. The land concession arrangement involved that the Commissioner of Land, on behalf of Government, and the MTA sign a 65-years temporary emphyteusis deed at an annual rate of €25,000. Subsequently, MTA granted the concession for this stretch of land to the Contractor for a period of 50 years. MTA did not institute any compensation for the duration of this concession.

1.2 Audit Focus

1.2.1 This performance audit sought to assess whether the Service Concession Agreement between Government and the Private Sector concerning the MNA, constituted a good deal for Government. The main criteria adopted to determine the degree to which this venture constituted value for money are reflected in this audit's objectives. These sought to evaluate the extent to which:

[3] Ebcon-Global JV is the contract signatory and this consortium includes Elbros Construction Ltd, Ebcon Investments Ltd., Global Aquariums BV and Marinescape Projects Ltd. Marine Aquatic is the company responsible for running the MNA complex.

[4] The Department of Contracts signed the service concession agreement on behalf of MTA.

a. the project contributed to Malta's tourism product;
b. direct financial benefits to Government replicate the public investment;
c. contracts' clauses safeguard Government's interests and ascertain a balanced partnership in terms of project benefits; and
d. MTA is monitoring project implementation.

1.3 Methodology

1.3.1 The attainment of the above objectives entailed a number of methodological approaches. These included the following:

a. ***Adherence to ISSAIs***: The audit was carried out in accordance with the Standard for Performance Auditing, International Standards of Supreme Audit Institutions (ISSAI) 3000.

b. ***Documentation review***: The MNA Service Concession Agreement together with the seven subsequent Addenda was evaluated to establish whether the contract clauses safeguarded the parties' interests to the project. Furthermore, reviews of the EU Grant Agreement, the temporary emphyteusis deed, surveys, audit and inspections reports as well as statistics maintained by the respective Governmental entities were undertaken.

c. ***Semi-structured interviews***: Qualitative data provided to this Office through the various interviews undertaken were required to substantiate the various gathered information, mostly related to the National Aquarium Service Concession Agreement, the EU Grant Agreement, the Cost Benefit Analysis documents, and various correspondence. To this end, NAO interviewed key officials within MTA, the Planning and Priorities Coordination Division (PPCD), DoC and the Lands Authority.

d. ***Data analysis***: Analysis of data maintained by the MTA pertaining to visitors to the National Aquarium was undertaken. Such analysis highlighted whether MNA contributed towards Malta's tourism product and as an attraction to the local residents.

e. ***Financial analysis***: Analysis of the various Cost Benefit Analysis (CBAs) reports related to this project, together with reviewing of the Annual Reports, Financial Statements and any other financial records were undertaken. For this purpose, NAO engaged the services of a Financial Consultant to provide the required technical advice.

f. ***Econometric models***: The NAO reviewed the project appraisal models developed by MTA. These models evaluated Government's opportunity cost for the concession of public land utilised for the project. These evaluations also sought to benchmark the project's anticipated Internal Rate of Return with the expected Weighted Average Cost of Capital (WACC).

g. ***On-site visit***: NAO conducted a familiarity on-site visit to the Malta National Aquarium.

During this visit, officials from the MTA and representatives of MNA provided information related to this project.

1.3.2 During the course of this audit, NAO encountered the following limitations:

a. A lack of documentation relating to project design and construction costs incurred by the Contractor.

b. Cost Benefit Analysis undertaken by Government concerning the project did not comprehensively consider the opportunity costs involved in providing the land concession. Moreover, where such calculations were available, they did not consider the market value of the approximately 20,000 square metres of land involved in the concession.

c. NAO was not furnished with a breakdown of the various revenue streams generated by the project. The absence of such information hindered NAO from analysing declared revenues from the project as well as value for money analysis.

1.4 Report Structure

1.4.1 Following this introductory Chapter, the Report proceeds to discuss the following:

- Chapter 2 analyses whether the project contributed to Malta's tourism product. To this effect, the NAO reviewed the extent to which this project influenced Malta's tourism product and various related Key Performance Indicators.

- Chapter 3 evaluates the degree to which the direct financial benefits to Government emanating from the project replicate the public investment. This assessment considers the co-financing grant, the MNA financial statements, project appraisals as well as the anticipated terminal value of the project.

- Chapter 4 discusses the degree to which the Contracts' clauses safeguard Government's interests and ascertain a balanced partnership in terms of project benefits. The discussion will analyse the contract clauses against good practice criteria established by the Australian National Audit Office.

- Chapter 5 discusses the extent to which MTA monitoring is contributing towards the project's realisation. To this end, the Chapter focuses on the comprehensiveness of MTA oversight in terms of project development and operations.

1.4.2 The conclusions and recommendations emanating from this performance audit are included in this Report's Executive Summary on pages 9 to 11.

Chapter 2

Enhancing Malta's Tourism Product

2.1 Introduction

2.1.1 This Chapter shows that the Malta National Aquarium (MNA) complex established itself as an integral part of Malta's tourism product. To this end, this performance audit revealed that MNA operations have fulfilled pre-determined and other generally accepted criteria related to a quality tourism product. Within this context, this Chapter discusses the project's contribution to:

a. upgrade the Qawra area;
b. create a versatile tourism product;
c. conserve local marine life; and
d. generate economic activity.

2.2 The National Aquarium complex significantly upgraded the facilities in the Buġibba and Qawra area

2.2.1 Until a few years ago, the Northern part of Malta, particularly the touristic areas of Buġibba, Qawra and St Paul's Bay lacked in facilities being offered both for tourists as well as locals residing in and visiting the area, especially during winter months. Throughout the years, there have been many interventions and other attempts to revive the area from its decline.

2.2.2 The Qawra Coast Development Brief document was published in 2003, with another updated version published in 2007, with the aim of accommodating a number of leisure and recreation facilities to diversify in what was being provided in the area of Buġibba, St Paul's Bay and Qawra. The embellishment of the area was a high priority at the time.

2.2.3 As outlined in Paragraph 1.1.4 of this Report, the idea of developing a National Aquarium in Malta dates back to 1993, when there was a plan to construct a National Aquarium in Marsascala. However, location-wise, Marsascala was thought to be too remote, especially for tourists. Shortly after that, Qawra Point was identified as a possible location for this project since it was a touristic zone, which required investment to revive it. However, the project takeoff was delayed due to the lack of identification of a sustainable financial operating model.

2.2.4 The National Aquarium project, which was part of the plan for the embellishment of Buġibba and Qawra, significantly overhauled the facilities available in the area by providing

a high-end National Aquarium complex, housing a visitor attraction and educational facility, diving institute and various catering establishments providing ancillary facilities, together with a retail outlet and car parking facilities. The facilities also include freely accessible public areas such as the large plaza and games area. The project also included restoration of historic structures in the area. These facilities are in line with Government's strategic objectives for a significant upgrade and regeneration efforts in the Buġibba and Qawra area to sustain this locality as a tourism hub and reduce the seasonality element, which at the time was impacting adversely on available bed capacity.

2.2.5 Apart from offering a visitor attraction and various catering facilities, the complex is regularly used as an events venue. To this effect, large-scale events are held throughout the year, such as music festivals and parties, in and around the Café del Mar and its surrounding area, which are attended by party-goers from all over Europe. This venue also offers an outdoor area with a large pool deck as well as the surrounding bar and dining options within the complex. Moreover, three special events related to music festivals and a New Year's Eve Celebration were held in the MNA Pjazza since its opening in 2013.

2.2.6 Furthermore, the National Aquarium complex also includes a diving institute, where its main objective is to provide facilities for diving associations in Malta. In this regard, one of the key performance indicators aims to increase diving tourism. To this effect, the premises were used marginally by MTA for seminars. However, since 2014, such activities have declined considerably. Moreover, this audit did not encounter any documentation showing that these facilities were actually used by local diving associations. MTA contends that this situation materialised due to declining interest from local diving associations.

2.2.7 MTA contends that the foregoing needs to be viewed within the economic context prevailing at the time of embarking on the project, which was particularly influenced by the international economic crises. On a national level, this resulted in overall weak economic conditions with the country generally lagging in terms of long-term growth and employment prospects. A case in point relates to the negative growth in tourist arrivals between 2008 and 2009. This instigated an overall stagnant outlook for the tourism sector, which was in great need for upgrades and innovative interventions to improve product quality.

2.3 The National Aquarium is attracting foreign and local visitors

2.3.1 The ability to attract visitors to the National Aquarium is a criterion adopted for the purpose of this performance audit to determine the extent to which the facility constitutes a quality tourism product.

2.3.2 During 2015, more than half of the tourists stayed in St Julian's and in St Paul's Bay (including Buġibba and Qawra).[5] Furthermore, in the following year, the top two localities where tourists stayed longest were also in St Julian's at 25 per cent, followed by St Paul's Bay (including Buġibba and Qawra) at 23 per cent.[6] Although these figures cannot be solely attributed to the construction of the National Aquarium complex, but also to other development in the area and the positive outcome of tourists visiting the Island, it is clear that this project has had a major positive impact and has led to more visitors in Qawra and its surrounding areas.

2.3.3 Moreover, one of the indicators which form part of the European Union (EU) Grant Agreement refer to the targeted number of annual foreign visitors, which must be adhered to as part of the Agreement. An addendum to the Grant Agreement signed on 27 July 2016 revised this figure upwards by 50 per cent. This revised value reflects an estimate dated 21 March 2013 further to the Cost Benefit Analysis (CBA) as signed off by London Economics on 28 January 2013. It was noted that such a figure may be subject to changes in line with any revisions, which may be required to the CBA. It is to be noted that this Addendum was planned to be finalised by end June 2013. However, it was signed around three years later in July 2016. The Grant Agreement provisions are reflected in the Service Concession Agreement.

2.3.4 The total number of visitors to the National Aquarium (tourists and local) during the period 2014 to 2017 shows that the numbers are increasing.[7] Table 1 compares visitors and tourist arrivals against the relative projections. In view of their commercial sensitivity, these statistics are being expressed in percentage or index form rather than in absolute terms.

Table 1: Contractor's projections versus actual visitors to the National Aquarium (2014 to 2017)[8]

Year	Total visitors		Total tourists	
	Projected (index)	Actual (index)	Projected (index)	Actual (index)
2014	1.00	1.01	1.00	0.77
2015	0.92	0.95	0.97	0.86
2016	0.87	1.11	0.94	1.07
2017	0.81	1.24	0.91	1.34

2.3.5 Table 1 indicates that the National Aquarium complex had a positive impact on Malta's Tourism Product. Both the total number of visitors and tourists that visited the National Aquarium significantly surpassed the relative forecasts. Moreover, while the projections have forecasted a downward trend, in both scenarios a positive upward trend materialised. The foregoing has to be taken into perspective of the tourism industry. During the period,

[5] National Statistics Office (2016), Trends in Malta – 2016, page 85.
[6] National Statistics Office (2017), Regional Statistics Malta – Edition 2017, page 204.
[7] As the National Aquarium opened during October 2013, visitors for 2013 are excluded for this analysis.
[8] All calculations are based on the projected values for 2014.

2014 and 2017, 7.8 million tourists have visited the Maltese Islands. In this regard, Table 2 compares the percentage increase in the total number of inbound tourists with the increase of the number of tourists visiting the National Aquarium.

Table 2: Percentage increase in inbound tourism against percentage increase of tourists visiting the National Aquarium (2014 to 2017)

Year	Total tourists visiting Malta	Annual increase in tourists visiting Malta	Annual increase in tourists visiting the Malta National Aquarium
	No.	%	%
2014	1,714,533	n/a	n/a
2015	1,799,213	5	12
2016	1,988,447	11	25
2017	2,314,596	16	25

2.3.6 Table 2 shows that the National Aquarium percentage growth in visits by tourists consistently exceeded the percentage increase in inbound tourism. This implies that the National Aquarium is providing an alternative tourism product to tourists visiting Malta. Moreover, the above figures show that there is a high correlation between the total number of tourists visiting Malta and those visiting the National Aquarium. In this regard, the success of the National Aquarium is heavily dependent on the prosperity of the tourism industry.

2.3.7 This Section outlined that various statistics are available regarding the number of visitors to the National Aquarium. However, a detailed study with regard to the MNA's contribution towards the country's Gross Domestic Product, its impact on the marine environment and the educational activities provided to its visitors is not available. Furthermore, statistics available only related to visitors to the National Aquarium, and not to the rest of the complex such as the restaurants and other ancillary facilities.

2.4 The MNA as a leading entity for the local preservation of marine life

2.4.1 One of the main targets of the National Aquarium was the ability to provide an educational facility to raise awareness about the local marine environment, as well as a driving instrument to promote marine conservation. The MNA aims to be the leading entity for the preservation of the marine life and its environment. A number of projects in this regard were created through collaboration with various Non-Governmental Organisations (NGOs), with the aim of promoting awareness and education amongst children and adults alike.

2.4.2 Various public talks form part of the daily programme at the MNA in order to help promote awareness on essential issues such as littering, loss of species and conservation. The MNA has teamed up with a number of NGOs and organisations to help spread awareness of marine conservation and issues related to the local marine environment. Environmental conservation initiatives include work and projects with Sharklab, Birdlife, The Herpetological

Society, Malta Aquarist Society, Migrate LIFE+, fish4tomorrow and Dr Klown amongst others. Furthermore, the MNA is regularly involved in "Clean Up" initiatives alongside NGOs and other organisations.

2.4.3 From an educational aspect, various student visits are organised at the National Aquarium by local schools. To supplement student visits, a number of educational programmes in line with the Maltese National curriculum were prepared in collaboration with the iLearn Biology Team.

2.4.4 The NAO's analyses focused on the total number of local visitors during the period 2014 to 2017. This data also includes school children visiting the National Aquarium as part of school outings. However, a decreasing trend was registered in the total number of local visitors. During this period, the total local visitors[9] amounted to 31.7 per cent of the total visitors visiting the National Aquarium specifically for its main attraction. Table 3 illustrates, in index format the number of total local visitors for the years 2014 to 2017, together with what was originally projected by the bidder.

Table 3: Local visitors to the National Aquarium (2014 to 2017)

Year	Local visitors Projected (Index)	Local visitors Actual (Index)
2014	1.00	1.69
2015	0.79	1.20
2016	0.70	1.21
2017	0.55	0.98

2.4.5 As can be seen from Table 3 above, the Contractor's projections envisaged a decline of local visitors for the period 2014 to 2017. On the other hand, while the projected decline in local visitors over time materialised, in absolute terms, the number of locals visiting the facility consistently surpassed the Contractor's annual projections.

2.5 The complex is a prime revenue generator in the area

2.5.1 Another criterion adopted by this performance audit to establish the degree to which the MNA complex contributed to the national tourism product related to the revenues generated by the facility. This review revealed that the MNA complex is in itself a prime revenue generator in the area through various aspects, mainly employment and catering activities.

2.5.2 During 2016, the MNA employed 98 persons during the winter months, with the number of employees nearly doubling during the summer peak season to 179 employees. In turn,

[9] As the National Aquarium opened during October 2013, visitors for 2013 are excluded for this analysis.

such employment contributed to the economy as well as influenced positively Government revenue generated through income tax and social security contributions.

2.5.3 Furthermore, the MNA complex has to date generated substantial revenue (see paragraph 3.3.4). As most of this revenue is subject to Value Added Tax (VAT), it is estimated that MNA complex operations generated around €5 million between 2013 and 2017.

2.5.4 The major events held at the MNA, such as "Lost and Found Festival", "SUNbreak Malta" and "Showers" attract tourists specifically from the party and music scene, leading to an increase in bed nights in the area, as well as the usage of catering facilities both within the MNA complex as well as other catering establishments in the locality.

2.6 Conclusion

2.6.1 This Chapter of the Report outlined that the MNA project fulfilled most of its strategic objectives apart from those relating to the diving institute. The project regenerated the Qawra area through the provision of alternative leisure facilities to both the locals and tourists.

2.6.2 The National Aquarium complex also diversified Malta's tourism product, whereby tourists mainly choose Malta as a sun and sea destination. Through its all year round facilities, the National Aquarium complex provided an additional facility to attract tourists not only during the summer periods but also in the shoulder months.

2.6.3 With the exception of the Diving Institute facilities, which did not attain projected targets, the MNA project is a qualitative addition to Malta's tourism product. Within this context, the next Chapter of this Report discusses the extent to which Government is reaping direct financial benefits in line with its outlay in the project.

Chapter 3

Financial considerations

3.1 Introduction

3.1.1 This Chapter discusses that the Malta National Aquarium (MNA) Service Concession Agreement necessitated the inclusion of stronger safeguards to allow for the possibility of changing economic scenarios in the long term. Determining the extent to which this concession constituted the best possible deal entailed, *inter alia*, evaluating whether the direct financial benefits to Government emanating from the project reflected the public investment.

3.1.2 Government's main outlays included the 20,000 plus square metre site at the Qawra area as well as its share of the co-financing element pertaining to European Union (EU) funding of €1,350,000. An additional €7.5 million in terms of EU funds supplemented this outlay. When considering the Contractor's contribution of €6,591,904, then, if one excludes the value of the land concession, it transpires that the EU grant constitutes 49 per cent of the investment within this project. Consequently, the EU funds granted for this project are an integral element of project costs irrespective of whether or not Government directly incurred them.

3.1.3 Directorate-General for Regional and Urban Policy's (DG Regio's) publication entitled "Guide to CBA of Investment Projects" 2008 outlines that evaluating a project's performance from the perspective of the assisted public and possibly private entities in the Member States entails focusing on the funds provided by the beneficiary ('after the EU grant'). These include those funds that should be made available as national public contributions, private equity, if any, and the need to pay back loans and interest to third party financiers. The rationale for this approach to developing a project's Cost Benefit Analysis (CBA) is that, for a given investment cost, the beneficiary (the 'owner' of the project) will need to sink less capital in it, because the EU taxpayer covers a share of the project costs. This is consistent with the scope of the EU grant itself in the framework of Cohesion Policy, which is to increase investment opportunities by a shift in capital needs.[10] The CBA submitted for the purpose of this project, generally, followed these principles.

3.1.4 Within the context of EU grant, this Chapter discusses the direct financial benefits reaped by Government in the following circumstances:

a. the 50-year rent-free land concession to house the MNA complex; and
b. benefits emanating from the MNA complex operations.

[10] European Commission Directorate General Regional Policy, 2008, Guide to CBA of Investment projects, page 45.

3.2 The 50-year rent-free concession implies that Government incurred a substantial cost when the foregone value of public land is taken into account

3.2.1 The public land upon which the MNA complex is developed is in a prime site along the Qawra promenade. This audit sought to determine whether Government has benefitted financially, or as a minimum, recovered the opportunity cost tied to this land. However, defining the value of publicly owned land, within the context of this audit, is not a straightforward endeavour.

3.2.2 The main challenge relates to the value of publicly owned land assigned by the Lands Authority (formerly the Land Department within the Government Property Department). In this case, the Authority transferred the land to the Malta Tourism Authority (MTA), which subsequently was utilised by the MNA contractor through to the 50-year rent-free concession. In past cases, where transfers occurred to other governmental entities embarking on projects of a social nature, or even to third parties (such as Ħal-Ferħ Complex), again for social purposes, prevailing practices have been that such land is not valued at market rates. Such valuations on a non-market basis, also occur whenever the Malta Industrial Parks Limited (MIP) transfer land to promote the development of industrial zones.

3.2.3 It is acknowledged that the above practices are intended to correct market failures or to promote businesses and, given such considerations, the rates used are set so as not to reflect market values. However, the question arising here is as to whether, in the determination of the opportunity cost associated with the land concession for the MNA project, the reduction in the market value is an element to be considered fully or at least partially.

3.2.4 In this transfer, the Lands Authority on the basis of the current development, fully embraced non-market practices, estimating the value of the land in question at €3.54 per square metre. This rate reflects the practices adopted to transfer public land to Government Departments.

3.2.5 On the other hand, the Lands Authority estimates that if it were to transfer this site directly to the Contractor and considering its current use, the emphyteutical rental charge would amount to €400,000 equivalent to €20.14 per square metre. Nonetheless, the annual rent charged to MTA for the site in question equates to €1.26 per square metre.

3.2.6 In a similar vein, MTA reiterated that the relevant rates should be the non-market business development ones at a mere €5.56 per square metre, this reflecting MIP rates. The MTA contended that this was particularly to be so in this case because the land was being allocated for business development purposes, and was also tied up to a specific use rather than generic commercial development.

3.2.7 Yet the project in question clearly includes commercial elements and may probably be best defined as a semi-commercial one. Within a fully commercial context, the Chamber of Architects and the Inland Revenue Department (IRD) estimate the rates to be €70 and €61.4 per square metre respectively. Furthermore, information maintained by the latter for the period 2013 to 2015, shows that for duty of the transfer of property purposes, even agricultural land, which probably approximates to the semi-commercial situation prevailing in this case, is valued at a relatively higher rate than the non-market one of €19.39 per square metre.[11]

3.2.8 The scarcity of land renders it as a highly priced resource. Determining the extent to which Government has benefitted financially from the use of this site by the MNA project raises a critical point. This relates to the grant of a long-term concession as against the immediate cash outflow of around €6 million, paid by the Contractor and therefore saved by Government. The extent to which the rent-free land concession balances the interests of the parties involved in the MNA project is to be considered within the context and circumstances influencing the evolution of this project. To this effect, the main influencing factors related to the diversification of the tourism product, which could be sustainable in the slow economic growth environment prevailing during 2008/2009 as well as to the granting of EU funds.

3.2.9 MTA, as the beneficiary, did not charge any rent to the Contractor, this possibly taking into account that such an immediate charge could have disincentivised project bidders and possibly influenced the level of EU grant. However, the Agreement did not even make an allowance for a claw-back involving compensation in the future in the case of a reversal of the prevailing economic scenario within the 50-year contract period, a reversal which already did actualise shortly after project commencement.

3.2.10 In estimating the opportunity cost to Government of the rent-free concession, one needs to take into account that ultimately, in practice, this was not an inter-departmental land transfer. Furthermore, the actual opportunity cost of such a concession hinges on the value placed on the foregone rental rate per square metre as aligned with market values. Table 4 illustrates such an opportunity cost taking varying basis.[12]

[11] The agriculture value of land nearly equates to the estimates proposed by the Lands Authority of €20.14 per square metre. However, applying the prudence concept, the rate of €19.39 was used.

[12] The estimation of square metre rates by the Lands Authority and MTA are based on site area of 19,858 and 21,583 square metres respectively.

Table 4: Cost to Government for a 50-year rent-free concession

	Rate per square metre €	Annual rental rate €	Present value of cost over a 50-year period at four per cent discount rate[13] €
Annual rental value reflecting the average charges for MIP sites	5.56[14]	119,922	**2,576,189**
Average Annual rental values of *agricultural land* in Malta based on IRD (2013 – 2015)	19.39	418,494	**8,990,173**
Average Annual rental values of *commercial land* in Malta based on IRD (2013 – 2015)	61.4	1,325,488	**28,474,377**

3.2.11 As shown above, this opportunity cost is tantamount to a minimum present value of around €2.6 million, this if one considers Malta Industrial Parks (MIP) site annual rental values. This rises to around €9 million if one considers agricultural land rates as per IRD and further up to €28.5 million if one considers commercial land rental values as per IRD. Consequently, the average rate when considering the minimum and maximum values quoted herein would amount to €15.5 million.

3.2.12 MTA recognises the wide discrepancies associated with land valuation. The Authority maintains that for the purpose of determining the foregone value of the public land in question brought about by the 50-year rent-free concession, it considers that the use of the lower land value noted in the preceding paragraph is more appropriate. This stance is justified as it reflects the lack of previous market interest in the project. The Authority reiterated that by not making use of the lower value for such an assessment, will give a skewed image of the project. While acknowledging MTA's argumentation, the NAO considers that the value of the site in question is better represented by a value, which reflects the semi-commercial use of the site in question.

3.2.13 Within this context, Table 5 reflects the model developed by MTA, which was originally based on the annual land rental rate foregone pertaining to MIP. This is here being extended to include the above rates based on both agricultural and commercial land in Malta as per IRD (2013 – 2015). A consistent discount rate of four per cent was employed, this representing the Government opportunity cost of capital. This exercise excludes the EU grant component to avoid distorting the financial impact of the land rental element on the net financial benefits or losses to Government.

[13] A discount rate of four per cent was employed since this represents the opportunity cost of capital, defined as 'the expected return forgone by bypassing other potential investment activities for a given capital'.

[14] The rental value of €5.56 considers MTA's categorisation of the site into proportions of 63 and 37 per cent of productive and non-productive land. To this effect, the applicable MIP rates would be €2 and €11.65 per square metre respectively.

Table 5: Net benefits or losses to Government through the 50-year rent-free concession

	Annual rental value reflecting the average charges for MIP sites €	Average Annual rental values of *agricultural land* in Malta based on IRD (2013 – 2015) €	Average Annual rental values of *commercial land* in Malta based on IRD (2013 – 2015) €
Opportunity Cost of Resource:			
Annual rental value per square metre (See Table 4)	5.56	19.39	61.4
Foregone annual rental revenue	119,922	418,494	1,325,488
Present value of cost over a 50-year period	**(2,576,189)**	**(8,990,173)**	**(28,474,377)**
Financial Outcome for Government from Project:			
Co-financing Outlay by Malta Government	(1,125,000)	(1,125,000)	(1,125,000)
VAT revenue from EU-funded component	1,147,500	1,147,500	1,147,500
Net Financial Cost	**22,500**	**22,500**	**22,500**
Asset Creation Value to Government from Project:			
Value of asset at end of first 50-year period for 40 years	20,138,202	20,138,202	20,138,202
Present Value of Asset transferred after 50-year period	**2,833,699**	**2,833,699**	**2,833,699**
Net direct gain (+ve)/loss(-ve) to Government	***280,010***	***(6,133,974)***	***(25,618,178)***

3.2.14 As shown in Table 5, taking into account the revised rent values and keeping constant all other variables, the net losses to Government increase from a quasi-breakeven position to a maximum net loss of around €26 million.

3.2.15 A related issue concerns the rate of €5.65 per square metre, which was taken into account by the MTA in arriving at the original quasi-breakeven point of €280,010. MTA derived such a rate by considering that two thirds of the land in question has a minimal value (estimated at €2) on the basis that this proportion of the site does not generate any revenue to the project. However, this is contentious as it excludes the following:

a. that the 63 per cent portion of land deemed as unproductive is complementary and forms an integral part of the project;
b. that all such land formed part of the concession; and
c. that over the 50-year concession, certain circumstances may change with the Contractor developing more revenue generating amenities on site.

3.2.16 It may be argued that the negative outcome outlined in Table 5 could be partly or fully compensated by other possible financial benefits emanating from this project, such as higher tourism earnings and employment. Yet there is no evidence that such additional benefits could not have also emanated from alternative uses of Government resources.

3.3 The MNA complex is generating revenues in excess of projections

3.3.1 Financial statements submitted by the Contractor in terms of the concession Agreement shows that the MNA complex is increasing its revenue substantially. The generation of revenues is not only a critical element to project sustainability but it is also an important consideration from the Government's point of view on two counts. The first point relates to the potential benefits to Government through this increase in revenues during the 50-year duration of this Service Concession Agreement. Secondly, revenues influence the value of operations, which will eventually become Government's responsibility once the concession is terminated after the agreed timeframe.

3.3.2 To this end, this performance audit sought to ascertain how such revenues compare to projections made at the project's planning phase. The main sources of data utilised in this exercise pertained to the audited financial statements for 2011 – 2017 submitted by the Contractor and the CBA commissioned by MTA and concluded in 2013. The latter presented operational projections following completion of the MNA's construction phase.

3.3.3 MTA workings show that MNA cash flows were generally on an upward trend. From the commencement of operations in 2013 up to end 2017, revenues increased by 21 per cent. In accordance to the same MTA workings, such revenues are expected to reach €1,160,000 by end 2022. Although such workings show that, the rate of growth will slow and eventually stop, over a 50-year period revenues would remain substantial and reflect a healthy business.

3.3.4 From the Contractor's perspective, the growth in revenues generated by the MNA complex was reflected by a steady increase in the rate of return on capital employed. In 2013, this indicator stood at 7.1 per cent and by 2017 increased to 28.2 per cent. Even when considering that 2017 was an exceptional year for the tourism industry, such trends augur exceptionally well for the future of this concession. Using the same figures provided by MTA, and assuming that all net profits after tax will be reinvested in the project, the return on capital employed still remains high ranging from 17.1 to 23.5 per cent.

3.3.5 Other indicators continue to highlight the strong financial performance of the MNA complex, namely the Internal Rate of Return (IRR), the project's payback period and the net present values of cash flows. Table 6 shows the actual performance of the MNA complex.

Table 6: Actual performance of the MNA complex

	Actual
IRR	16.2%
Payback	8 years
Net Present Value of Cash flows	€1,343,630

3.3.6 This Section of the Report continues to highlight the strong financial performance of the MNA Complex. This implies that at the end of the concession period, it is likely that Government will receive the MNA amenities together with a healthy business. The term 'likely' is being used since a 50-year concession period is considerable and subject to various externalities.

3.3.7 The main point of contention remains that, throughout the duration of the concession, Government will not benefit financially from the MNA's healthy business. Admittedly, the Agreement provides for revenue claw-back clauses, which is an innovative provision in contracts of this nature. But the main beneficiary would still be the Contractor since increased investment within the same site will continue to generate revenues, which Government will not be entitled to. Moreover, the claw-back clause as applied in this case may not be fully effective as the MNA complex might eventually reach its expansion saturation point and further growth may then not be feasible or even possible any longer. Such a situation arises since the claw-back clause restricts investment to the MNA site only and does not consider that funds are directed towards the further development of this locality or the local community. In view of the foregoing, MTA contends that revenues were not a priority, as Government was after the positive economic benefits to the project's locality.

3.4 Conclusion

3.4.1 The permanent capital injected in the project by the three main stakeholders - that is the Government, the Contractor and the EU – amounted to around €15.45 million (€6.6 million by the Contractor, €7.5 million by the EU and €1.35 million by Government) – this excluding the present value of the land foregone over the concession period. As stated earlier, such present value of land foregone varies between €2.6 million to €28.5 million, this depending on how much market value is to be attributed to it. Adding an average of €15.5 million for such value, the total capital injected would amount to €31 million. On this basis, the proportion of capital forked out by the Contractor will amount to only around 21 per cent. Consequently, the major question lingers as to how sufficient was and is to be the return of capital to Government over the project period. Of relevance in this context, is a major lesson to be learned for future projects: this relates to the need to improve systems to ensure the appropriate attribution to the valuation of public land concessions in various commercial, semi-commercial and non-commercial social settings.

3.4.2 Another imbalance was created in the returns attributable to Government and to the Contractor within the project period. While not necessarily visible at the time of project commencement, such a position could have been averted by a much stricter claw-back clause wherein, for example, part of the rental value foregone, would have become chargeable or reinvested in the development of the Qawra / Buġibba area if company revenues far exceeded the original estimate. Thus, one could have ensured that within the 50-year Service Concession Agreement period, the Government would be more fairly entitled to a share of the financial benefits emanating from the project. Such circumstances present a better balance between the interests of the two parties where the contractor bears the risks of adverse performance and Government would not just benefit indirectly through taxation but also directly through revenues generated by the project. In any case, the application of stricter contract clauses is the second major lesson to be learned in the allocation of future projects.

Chapter 4

The contractual framework

4.1 Introduction

4.1.1 The aim of contractual provisions is to define parties' responsibilities as well as safeguarding signatories' interests. Within this context, contractual clauses are deemed critical to the realisation of project objectives, including those related to deliverables and value for money. This performance audit revealed that in the long-term, in cases, contractual provisions were not conducive to a balanced Service Concession Agreement.

4.1.2 The Malta National Aquarium (MNA) project's contractual framework comprises three main contracts. Firstly, there is the Emphyteusis Agreement between the Government Property Department (GPD) and the Malta Tourism Authority (MTA) regarding the use of publicly owned land. The second agreement relates to the co-financing Grant Agreement between the Planning and Priorities Coordination Division (PPCD) and MTA relating to the design and build elements. The third element of the contractual framework comprises the Agreement between the Contractor and the Department of Contracts (DoC) on behalf of the MTA with respect to all aspects of the 50-year concession, project delivery, including its operations. The latter is considered as the main Agreement since it generally encompasses the contractual conditions established by the other two contracts. Figure 3 refers.

Figure 3: The contractual framework

4.1.3 This audit found that, in cases, these three contracts do not comprehensively assure that Government's interests are fully safeguarded. To this effect, this Chapter discusses the extent to which contractual clauses within the three agreements embrace good practice guidelines and principles, which adequately safeguard Government's interests.

4.2 Contractual provisions did not always ensure a balanced Service Concession Agreement

4.2.1 This Section of the Report evaluates the three agreements through the clauses stipulated in the Service Concession Agreement between MTA and the Contractor. This approach is being adopted since the latter contract generally invokes the clauses in the other two agreements involved in the MNA project. This Report will clearly outline when referencing does not relate to the Concession Agreement.

4.2.2 This performance audit analysed the extent to which contractual clauses adequately safeguarded Government interest. At the outset, the NAO assessed whether contractual provisions therein embrace best practices advocated in the guidelines developed by the Australian National Audit Office (ANAO) entitled: "Developing and Managing Contracts – Getting the right outcome, achieving value for money". Table 7 refers.

Table 7: Embracing best practices contractual causes

Best practices contractual clauses	Status		
	Appropriately included	Not appropriately robust to safeguard Government's interest	Omitted
Termination	X		
End date		X	
Penalties	X		
Payments	X		
Access and disclosure	X		
Assistance provided to the contractor		X	
Confidential information	X		
Conflict of interest	X		
Contract variations	X		
Dispute resolution	X		
Insurance	X		
Intellectual property rights	X		
Key personnel	X		
Liabilities and indemnities	X		
Securities and guarantees	X		
Sub-contracting	X		
Transition arrangements	X		
Warranties and fitness for purpose	X		
Deliverables		X	
Benefit Sharing[15]		X	

[15] https://www.fhwa.dot.gov/ipd/pdfs/p3/model_p3_core_toll_concessions.pdf as at 20 August 2018.

4.2.3 Table 7 shows that the Concession Contract generally refers to the issues that would be expected in this type of agreement. Nonetheless, within this contract, a number of clauses do not fully embrace the best practices guidelines referred in paragraph 4.2.2. In such instances, the Contract does not appropriately safeguard Government's interests.

End dates of concessions are not fully conducive to value for money

4.2.4 The ANAO guidelines argue that it is a good practice for all contracts to specify an end date. In contracts, which include an option for extension, the end date will generally be a date beyond which any contract extension option can no longer be exercised. Moreover, these guidelines note that end dates, in themselves, must be conducive to value for money. The end dates within the MNA Contract raise two value for money related concerns, which will be discussed in the ensuing paragraphs.

Concession to Contractor given for 50-year period is deemed to be longer than the norm for similar type of projects

4.2.5 The MNA contract stipulates that the concession to the Contractor for the operation of the National Aquarium complex was given for a period of fifty years. At tendering stage, the clause for the operation period in the tender document was flexible, whereby tenderers were asked to state the number of years that they intended to operate the complex for prior to transmitting the whole operation to the Government at the end of the concession.

4.2.6 The selected Contractor outlined a fifty-year concession period, and although various discussions ensued, including with Joint Assistance to Support Projects in European Regions (JASPERS), this time period was finally agreed to and granted to the Contractor. This concession was given on the basis that additional investment was required to maintain the relevant standards for the National Aquarium complex in later years. However, such a period is considered to be excessive on several counts:

a. A shorter contract period is seen as more advantageous to Government as it would have provided the latter the opportunity to review and re-negotitiate conditions to seek a better deal within a shorter time-frame.

b. The World Bank outlines that a concession is typically for a period of 25 to 30 years (i.e., long enough at least to fully amortise major initial investments).

c. Public Private Partnerships (PPPs) which have already been undertaken in Malta were generally of a duration of up to a renewable 25-year period. In some cases, the materiality of the previous PPPs embarked upon significanly exceeded the investment made by the Contractor with respect to the MNA project.

d. The International Federation of Consulting Engineers (FIDIC) model suggests a 20-year period rather than a longer period.

e. JASPERS suggest a 15 to 20 year period, up to a maximum of 25 years for smiliar types of projects.

The transfer of land housing the MNA project to the MTA is subject to a non- reviewable standard rate for a maximum period of 130 years

4.2.7 The transfer of land from the GPD to MTA to house the MNA project in 2011 was affected through a temporary emphyteusis against a yearly and temporary ground rent of €25,000 for sixty-five years, which can be extended by a further sixty-five years. This rent is paid by MTA and not the Contractor. Furthermore, the amount paid for ground rent will be constant throughout the sixty-five years. MTA contends that the rental value due by the Authority to the GPD is purely symbolic to ascertain that the title of the land remains within a Governmental entity.

Government assistance included the rent-free land concession for 50 years

4.2.8 The ANAO best practices guidelines note that Governments often provide contractors with assistance to facilitate the delivery of goods or services. In this case, GPD transferred 19,858 square metres of land to MTA for constructing a National Aquarium with ancillary facilities at a cost of €25,000 per annum for 65 years. In turn, MTA granted a fifty-year period to build and operate the MNA project, at no cost, while retaining ownership rights.

4.2.9 MTA contends that a rent element for the land concession was omitted from the Concession Agreement as the direction at the time was that Government should not be seen to be generating revenue from such a project in view that the operator will be implementing and managing the project. Even more so, given the specific sector and its commercial sensitivity.

4.2.10 Another contentious issue regarding the concession of this land arises since the National Aquarium itself constitutes only seven per cent of the total area in question. Supporting amenities constitute 26 per cent of the concession area. Moreover, another 67 per cent of the area is being utilised for outdoor recreational space. It can be argued that these proportions are a requirement to facilitate the regeneration of the area. However, given that this is a rent-free concession and that government is not entitled to any direct revenue generated from this site for a period of 50 years, questions arise as to whether, in this case, the contract has managed to balance the parties' interests.

The Contract does not appropriately define design related deliverables as references to the final plan of the MNA complex are not included in an Addendum

4.2.11 A critical function of a contract is that it clearly defines the agreed deliverables. In this case, generally accepted practices dictate that the Agreement refers to the agreed development plans together with the relative specifications.

4.2.12 As the main objective of the Service Concession Agreement was to engage the Contractor to, *inter alia*, provide the project design, once such a task was completed, best practices demand that the parties would sign an addendum to the Agreement. This would enhance the clarity of deliverables, facilitate the monitoring of contract implementation and enable the contract to serve as the primary source of reference in cases of litigation.

4.2.13 MTA contends that the overall project proposal was approved in principle at evaluation stage. The Design Phase was concluded with the Proposed Plans that were approved by the MTA and later by the Planning Authority and the Construction Phase was concluded with the satisfactory certification of the architects in charge. The inclusion of an Addendum to reflect the final design was never envisaged by the Contract because it is not a modification but a mere conclusion of a phase anticipated in the Contract. While acknowledging MTA's standpoint, this Office emphasises that all deliverables, including project design, are to be included in a legally binding agreement, in this case an Addendum to the project. Including the project design in an addendum, would not only constitute best practices but would clearly delineate the legal obligations of both parties.

Contractual claw-back clauses did not anticipate the substantial increase in tourist arrivals and the level of revenue generated by the MNA

4.2.14 A concession implies that contract signatories share both the risks and benefits emanating from the project. At the end of the Agreement, Government will be entitled to any title or interest over the Site, any Permanent Work, Plant, improvements, buildings, or any (other) property which is immovable in terms of articles 308, articles 309 and 310 of the Civil Code (Chapter 16 of the Laws of Malta), within, on, under, adjacent to or surrounding the Site.

4.2.15 The Agreement also stipulates that, during the operation of the National Aquarium complex, as well as throughout any extension granted after the concession period, any revenue is the exclusive property of the Contractor, and improvements to the site have to be carried out in case of excess revenue. Nonetheless, this Agreement has a number of claw-back clauses intended to be invoked in the case of abnormal revenue generation by the Contractor. To this effect, the Agreement stipulates that in the event that revenue calculated cumulatively for periods of five years each shall exceed the amount of agreed projected revenue by at least 100 per cent, then the contractor shall carry out improvements to the site reflecting such excess revenue.

4.2.16 However, one notes that, in the case of re-investment, no guidance is available in the Agreement outlining in what to invest, except that such improvements should take place within the site. These contractual provisions, however, safeguard Government's interests only up to a certain degree for the following reasons:

a. Up to the termination of the Agreement, any improvements through capital investment to the MNA complex are to the immediate and sole long-term advantage of the Contractor. Benefits due to Government would become apparent after the termination of the Agreement when Government becomes entitled to the title and all interests over the Site. Given the long period involved, there cannot be any certainty or guarantees relating to the project's viability in 50 years' time.

b. Theoretically, there could be a point whereby further investment within the MNA complex would not be required since growth would have reached saturation point. Within this context, it is not understood why clauses relating to further capital investment by the Contractor was restricted to the MNA complex, when the project scope was much broader and included the Qawra / Buġibba / St Paul's Bay areas.

c. Throughout the duration of the Agreement, the contractual provision, which names the Contractor as the sole beneficiary of revenues, leads to a situation where Government is not afforded the status of an equal partner within the concession. This favourable contractual bias towards the Contractor becomes more apparent when considering the rent-free land concession and that claw-back clauses do not extend to invoke the payment of compensation in cases of abnormal revenue generation. This situation becomes more pronounced when considering that the claw-back clauses within the contractual framework did not anticipate the significant spike in tourist arrivals in recent years and the material revenues generated through the MNA project.

4.2.17 MTA contends that the better-than-expected MNA performance is, in good part, due to a positive outcome for tourism in Malta and the ability of the operator to make a success of the project. These considerations cannot be used to derive a negative judgement on the original Agreement, especially when such contract was sufficiently forward-looking to require periodic investments to maintain asset value, and even further investment in terms of a surplus revenue claw-back to further valorise the asset.

4.2.18 While acknowledging the context, foresight and ensuing benefits of such claw-back clauses, the situation portrayed above provides ample evidence that future contracts recognise the importance of compensation elements. Over the past three years, EU practices have also evolved to provide more realistic claw-back mechanisms.

4.3 Conclusion

4.3.1 This Chapter has shown that most of the contractual provisions were drafted in line with good practice. Nonetheless, some contractual clauses within the three agreements governing the MNA project do not appropriately safeguard Government's long-term interests.

4.3.2 In instances, this performance audit raised questions on the extent to which the granting of this 50-year rent free land concession will prove favourable to Government. Despite the claw-back clauses therein, the contractual framework further impinges on value for money issues as Government will not receive a share of revenues or other benefits generated by the project throughout the 50-year concession period. Potentially, this situation becomes more aggravated for Government as the Contractor is obliged to invest abnormal profits within the complex thus generating further revenues to the same operator. To a great degree, this situation has arisen, as, at the time of drafting the Concession Agreement, the upward economic trends, as well as the substantial increase in tourist arrivals in recent years were not anticipated. This Report has already discussed the financial implications of the foregoing in the preceding Chapter.

4.3.3 The next Chapter discusses another criteria adopted for this audit. To this end, the discussion therein focuses on the extent to which MTA, as a party to this venture, is appropriately monitoring the implementation of the contractual framework.

Chapter 5

Monitoring

5.1 Introduction

5.1.1 The Malta Tourism Authority's (MTA) monitoring function extends to all the Malta National Aquarium (MNA) project phases, namely the design, construction and operational stages. Effective monitoring ascertains contractual compliance, enables the early detection of issues, which may have a bearing on the performance of the project as well as ensuring that Government's interests remain appropriately safeguarded throughout the Service Concession Agreement. This performance audit, in cases, identified shortcomings, which influenced the level of MTA's monitoring function of the MNA project. Within this context, this Chapter discusses the following:

a. MTA's monitoring mechanisms in place;
b. Confirmation of the development cost of the MNA complex;
c. The appointment and scope of work of the Auditing Body; and
d. Financial monitoring.

5.2 MTA, generally has the appropriate monitoring mechanisms in place as stipulated by the contractual framework

5.2.1 MTA's monitoring mechanisms comprises various levels of review. To this effect, MTA has a Monitoring Committee to oversee the whole operations of the National Aquarium project. Moreover, the Service Concession Agreement between MTA and the Contractor gives the former accessibility to the premises and other operational documentation.

The service concession agreement provides for the appropriate level of MNA project monitoring

5.2.2 Clause 4.8 of the Concession Agreement stipulates that, through the European Union (EU) funding Grant Agreement, MTA has physical and operational documentation access to ascertain that the project's performance indicators are achieved. Moreover, the Contractor is obliged to furnish MTA with the relevant information for updating the cost benefit analysis required for the calculation of the co-financing rate pertaining to EU funding.

5.2.3 The Concession Agreement also provides for the undertaking of an audit of the MNA's financial statements. Clause 4.2.5 stipulates that the Contractor is obliged to provide MTA the annual audited financial statements within 14 days that they are submitted to the Malta Financial Services Authority.

5.2.4 Through clause 10.3, the Concession Agreement provides for the appointment of an Auditing Body to audit and monitor the performance of the MNA project. To this effect, the concession Agreement stipulates that the parties shall equally incur the costs associated with the engagement of the Auditing Body.

5.2.5 The Concession Agreement also provides for monitoring in terms of health and safety at the MNA complex. The Contractor appointed International Zoo Veterinary Group (IZVG) to inspect the complex and report accordingly in terms of Addendum 7 of the Concession Agreement.

The Monitoring Board within MTA meets annually and on a needs basis but does not maintain minutes

5.2.6 A governance structure in the form of a Monitoring Committee exists within MTA to oversee the whole operation of the National Aquarium project. The members forming the Monitoring Committee consists of MTA representatives together with an architect and a lawyer. The Monitoring Committee holds informal discussions, and meetings are held whenever the need arises. Nonetheless, an annual meeting is held to discuss the outcomes of the published Annual Report and Financial Statements of the Marine Aquatic Limited.

5.2.7 MTA confirmed that initially minutes to the meetings by the Monitoring Committee used to be held, but the Committee did not pursue this practice. As at the time of drafting this Report, MTA did not furnish NAO with details pertaining to meeting dates and attendees of the Monitoring Committee.

5.3 MTA has not presented NAO with detailed documentation to support project cost certification

5.3.1 The concession Contract, drafted on the International Federation of Consulting Engineers (FIDIC) model template, considers a lump sum agreement for the design and construction of the MNA complex. The advantage of a lump sum agreement particularly relates to fully transferring the risks associated with these tasks to the contractor. A case in point pertains to the exclusion of variation costs, which would have been incurred by Government.

5.3.2 On the other hand, a lump sum agreement reduces substantially the contractor's obligations on cost reporting, which ultimately impinges on the principle of transparency. Nonetheless, Government entities can mitigate this situation, if at the design evaluation stage, the Evaluation Committee verifies the cost information submitted by the contractor.

In the absence of detailed Bills of Quantities (not a requirement through a lump sum approach), such a task is rendered more problematic. Nonetheless, validation checks can still be undertaken by determining the volume of works to be undertaken and assuming prevailing market prices. However, documentation presented in the report compiled by the Evaluation Committee does not refer to such an exercise.

5.3.3 MTA contends that the Contractor prepared detailed costings relating to the construction of the MNA complex for bank loan purposes. As at the time of drafting this Report, MTA had not furnished this Office with such documentation.

5.3.4 MTA also noted that its appointed architects certified that works were completed in accordance with the agreed design and specifications. To this effect, MTA note that the architect's certification also relates to the value of the project. MTA maintains that such certification draws on the architects' judgment in accordance with their professional warrant. While acknowledging the rationale of such arguments, the matter could have been conclusively resolved if MTA was privy to the workings undertaken by the appointed architects.

5.3.5 The process undertaken as part of this lump sum contract in the certification of payments has been reviewed and accepted by various audit bodies (both National and European). MTA, however, accepts that unfortunately the workings undertaken at various phases of construction were not included in the relative costings and certification reports. To this effect, MTA is pursuing the matter and trying to obtain such workings.

5.4 MTA delayed the appointment and is not fully exploiting the review capabilities of the Auditing Body

5.4.1 In line with Article 10.3 of the Special provisions of the Concession Agreement, the MTA and the Contractor were required to appoint jointly an Auditing Body to carry out independent and impartial audit during the Operation Service. However, the following circumstances materialised:

a. MTA appointed the Auditing Body in 2015 that is more than two years following the commencement of the project's commercial phase. The delay in appointing the Auditing Body breaches contractual provisions, namely Addendum 3. According to the MTA, such a breach of contract was due as both the Contractor and the MTA were still settling down after the opening of the National Aquarium.

b. The Auditing Body's scope of work is not exhaustive. In the circumstances, the Auditing Body's work focuses on operational indicators as outlined in Schedule X of the concession Contract and does not extend to the interpretation of the annual audited financial statements submitted by the Contractor.

5.5 MTA's financial monitoring does not extend to analysis of MNA's audited financial statements

5.5.1 As outlined in paragraph 5.2.3, financial monitoring of the MNA complex includes audited financial statements. These audited statements are prepared by a firm appointed by the Contractor and referred to MTA in accordance with Clause 4.25 of the concession Agreement. However, MTA's financial monitoring of the MNA complex is subject to the following issues:

a. MTA is not aware of revenue generated by specific streams as the audited financial statements present a global total of revenues generated by the various facilities within the MNA Complex. This implies that MTA is not in a position to:

   i. compare between the projected and actual revenue by different streams as expressed in the Cost Benefit Analysis (CBA) submitted by the Contractor and MTA.
   ii. undertake financial monitoring of the different amenities within the complex.

b. As the MTA monitoring team does not include expertise related to financial matters, the coverage of financial monitoring becomes somewhat limited. These circumstances arise as MTA's financial monitoring does not extend to the company's financial structure and subsequent inter-company transactions and the gearing ratio.

5.6 Conclusion

5.6.1 MTA's monitoring function is critical to the effective implementation of contract provisions as well as safeguarding Government's immediate and future position in this venture. To this effect, the contractual framework permits comprehensive monitoring of all aspects of the MNA complex. However, MTA's coverage does not extend to all aspects of the design, build and operate Agreement.

5.6.2 As shown in this Chapter, limitations in the scope of the monitoring function led to a number of implications. Firstly, such a situation transgressed on transparency and accountability issues associated with contract implementation. Secondly, these circumstances influenced timely interventions for corrective action. Thirdly, such a situation has a direct bearing on Government's position as a partner in this venture, particularly with respect to financial and operational performance of the complex. This materialises since Government would not always be adequately informed on the progress of a key element of Malta's tourism product.

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