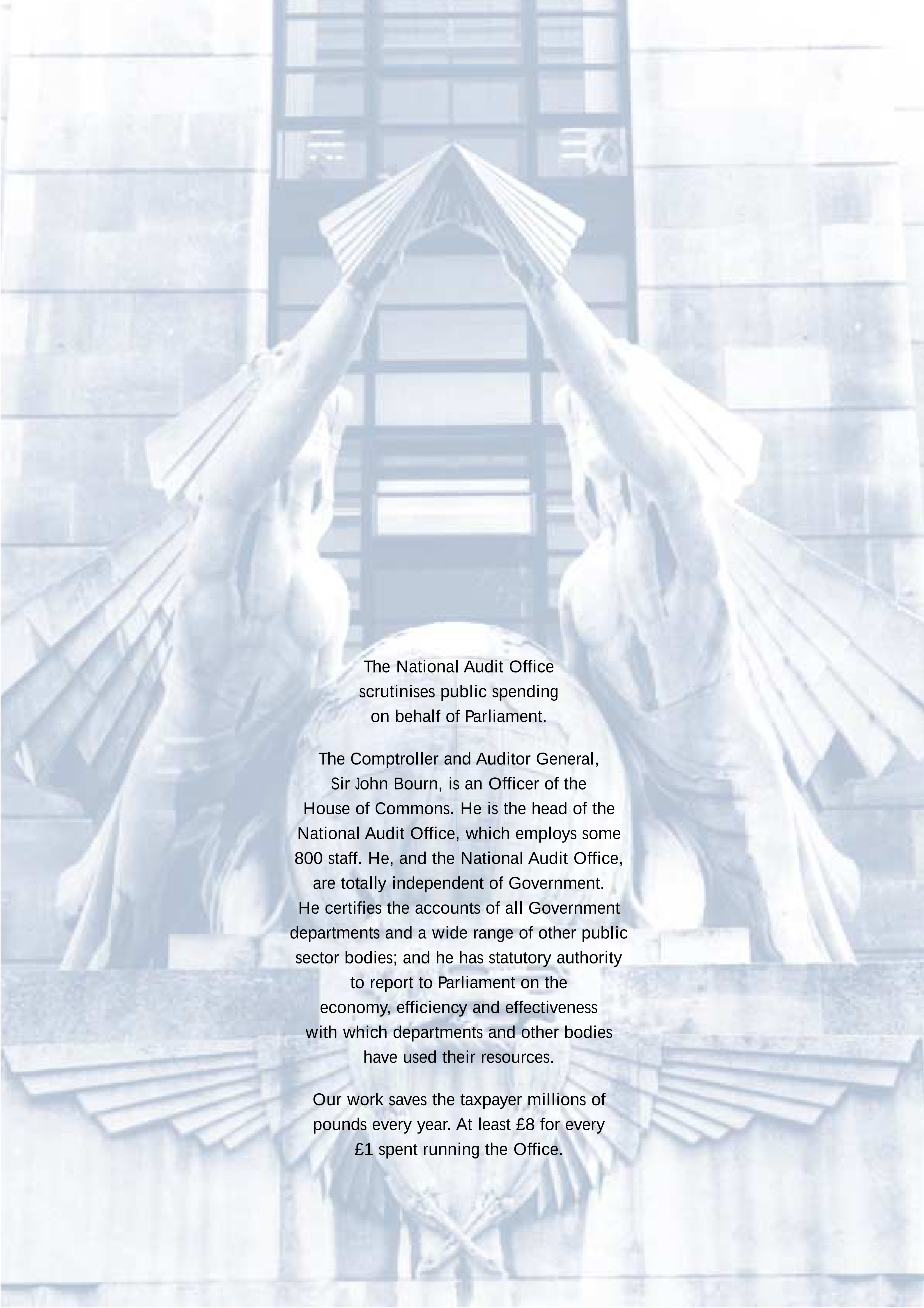
PFI: The New Headquarters for the Home Office

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 954 Session 2002-2003: 15 July 2003



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John Bourn	**National Audit Office**
Comptroller and Auditor General	**10 July 2003**

The National Audit Office study team consisted of:

Phil Airey, Heather Thompson, Sophia Collingwood, Hilary Milne and Jenny Davies

This report can be found on the National Audit Office web site at www.nao.gov.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Email: enquiries@nao.gsi.gov.uk

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Summary

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1 In March 2002, following a procurement that began in 1996, the Home Office signed a 29 year contract with Annes Gate Property plc (AGP)[1] for funding demolition of the old Department of the Environment building at 2 Marsham Street, design and construction of new headquarters accommodation on part of the site and provision of associated services. The Home Office expects to move into its new building in 2005 when it will begin paying AGP a monthly charge for the building and associated services amounting to £311 million (net present cost) over the life of the project. At the end of the contract in 2031, the Home Office will have the option of vacating or purchasing the building. The building will be able to accommodate up to 3450 Home Office central London headquarters staff including those employed by the Prison Service, an executive agency of the Home Office.

The Home Office will get what it wants from the deal

A replacement for inadequate existing accommodation

2 The Home Office reviewed its accommodation requirements in 1996, and concluded that there were deficiencies in its existing estate. By 2002, it occupied three leasehold and three freehold buildings in central London, mostly in poor condition and of inflexible design and internal layout. Although, under the Marsham Street PFI deal, the Home Office will be paying about £6 million more per annum than it had been paying for its existing estate in 2002, it considers that it will be worth paying more for better quality accommodation. Furthermore, the cost of running the estate is rising as a result of its condition and the Home Office has estimated that, in the long term, maintaining its existing accommodation would be more expensive than the PFI deal.

1 *A company owned by Byhome Ltd (which in turn is owned by Bouygues UK Ltd and Ecovert FM Ltd both of which are owned by Bouygues Construction S.A., a major international construction company based in France) and HSBC Infrastructure Ltd.*

An enabler of the Home Office business change strategy

3 The Home Office has identified how the new accommodation will help it achieve its business requirement to deliver an up-to-date, flexible workplace providing an efficient and effective IT platform and the range and quality of facilities expected of an employer of high calibre staff in central London. Although the Home Office is not due to move into its new accommodation until 2005, it needs to make good use of the time available and take steps early enough to secure the benefits and ensure that they are measurable.

4 The relationship between the accommodation project and Home Office and Prison Service IT projects is complex. The rapid change in information technology meant that determining a specification for the IT infrastructure proved difficult and the Home Office decided to delay agreeing the specification beyond financial close by 12 months rather than risk having to change it later. The IT specification was agreed on time and includes some technology enhancements. The cost of these enhancements is being negotiated with AGP but the Home Office is confident it will get a fair price. The IT programme is now on track but there is still some way to go. Although AGP will install the IT infrastructure, it will not be responsible for its maintenance. The Home Office, therefore, needs to examine other options for infrastructure maintenance and expects to source it in 2004.

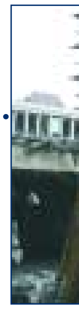
Alternative options considered were not so good

5 In 1998, the Home Office had obtained three competing bids to refurbish the existing estate, proposing the existing building at 2 Marsham Street as temporary accommodation during the refurbishment. AGP, however, made a developed and costed variant bid for a new building at 2 Marsham Street. This variant was attractive to the Home Office because it presented the opportunity to house all Home Office and Prison Service staff in a single building and avoided the business risk associated with moving out to temporary accommodation and back again. Another bidder, Central Accommodation Services Ltd, also put forward a variant bid proposing a new building at 2 Marsham Street. Further competition has indicated that the Marsham Street deal is better value for money than refurbishment.

6 The Home Office also identified other potential accommodation, but it was either too expensive compared to the Marsham Street deal or the location was considered unsuitable. Furthermore, it assessed the cost of procuring accommodation through leasing a building at market rent and paying separately for services as more expensive than the Marsham Street PFI deal. Deferment of the project would have delayed the business benefits and added to the costs because of the poor condition of the existing estate.

All central London staff cannot currently be housed in one building

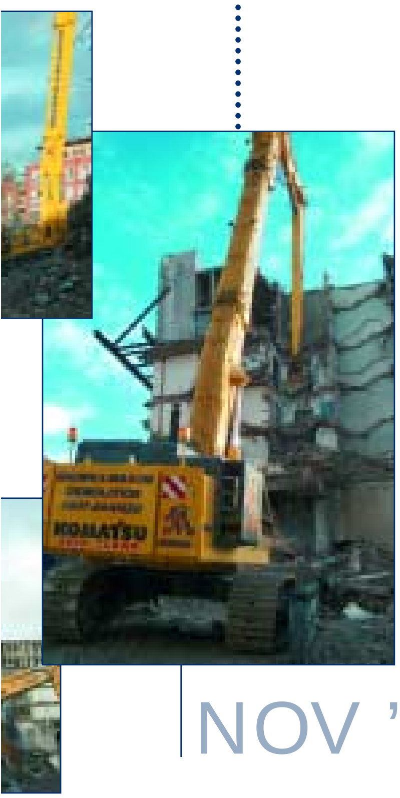
7 Since 1998 when the Home Office stated its requirement and invited Best and Final Offers, the Home Office has experienced significant growth in Home Office and Prison Service central London headquarters staff numbers from 3200 to 4900 at present. The new building will be able to hold up to 3450 staff. Current projections for 2005 are subject to review but if numbers remain constant, it will not be possible to accommodate all Central London Home Office headquarters staff, including those employed by the Prison Service, in 2 Marsham Street. A range of options for accommodating the excess are currently being considered aimed at ensuring numbers in Central London are no larger than necessary but there are no firm proposals at present.



OCT '02

pre-MAR ’02

APR ’02



NOV ’02

The Home Office got a good price for the Marsham Street deal

The Home Office ran a good competition

8 The Home Office requested further offers from all bidders to test the value for money of the variant bid to develop 2 Marsham Street and, in order to maintain competitive tension, it decided to contribute towards bidding costs. The Home Office’s bid evaluation showed that the competition was successful in producing two close but high quality bids and the Home Office considers that its decision to contribute to bidding costs was justified.

9 During the 20 month preferred bidder negotiation period, the price of the deal rose by 4.9 per cent. This increase reflects changes in scope, indexation changes and changes relating to the financing of the deal. In particular, the Home Office, supported by Partnership UK, negotiated with AGP for 50:50 sharing of any refinancing gains. In return, AGP was allowed a 1.1 per cent increase in its Internal Rate of Return, equivalent to a net present cost increase of £2.8 million. From its financial analysis using a Public Sector Comparator, the Home Office estimated that at financial close the deal cost would be lower than conventional public sector procurement of a new building and associated services.

Appropriate risk allocation was achieved

10 The new Home Office building will occupy around two-thirds of the site with the remainder being a separate development of mixed residential (including 25 per cent affordable housing) and commercial premises to comply with Westminster City Council planning requirements for the area. Although there are contractual safeguards protecting the Home Office, some residual risk relating to the commercial/residential development remains. The planning agreement stipulates that the final 25 per cent of the Home Office building floorspace cannot be occupied until completion of the commercial/residential site. However, AGP is sufficiently incentivised to complete all the required construction on time. During occupation, a payment mechanism incentivises the contractor to achieve availability and service levels.

11 The Home Office decided to dispose of its existing estate itself as the prices offered by the bidders for its freehold properties were not considered to offer good value for money. The prices offered by the bidders will, among other considerations, have reflected their assessment of the risk of changes in the property market. The extent to which this risk has already materialised is not clear but given recent decreases in the commercial property market in central London, it is possible that the value of the freeholds is now less than estimated by the Home Office at financial close in 2002. The gap in valuation was such that the Home Office still expects to get better value when the surplus buildings are disposed of.

12 The Office of Government Commerce considers cross-Government property strategy issues and will assist the Home Office with planning a property strategy to recycle or dispose of its surplus assets appropriately. The future of the remaining properties has not yet been decided but the Home Office and the Office of Government Commerce consider that retaining the freeholds in the Westminster area could offer better value for money for government as a whole rather than transferring the property to the private sector.

A good price for financing was obtained

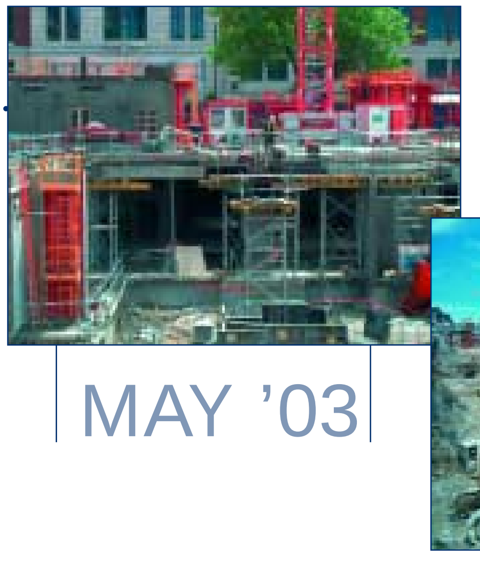
13 An innovative aspect of the financing structure is that AGP has retained the risk associated with potential changes in the value of the property at the end of the contract term. To reduce the cost of the Home Office's annual payment to AGP, the deal was constructed such that £100 million of debt is not repaid over the contract life. Instead it will either be paid off at the end of the contract if the Home Office chooses to buy the building (at the lower of market value or £137.5 million) or renewed if the Home Office does not take up this option. AGP are therefore retaining the risk that the market value of the site will not fall below £100 million in 29 years time and the Home Office has flexibility over its accommodation options at the end of the contract.

The deal has been co-ordinated with other departments' accommodation requirements

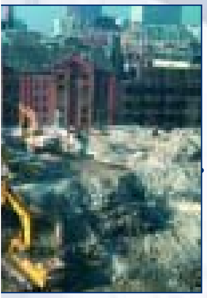
14 Until 1999, no other Government department had expressed an interest in taking over 50 Queen Anne's Gate or any of the other existing Home Office buildings. Therefore, the Home Office negotiated with the landlord of Queen Anne's Gate to terminate the lease at a price equating to a net present cost of £91 million. In 2000, however, to avoid such a large payment, the Office of Government Commerce identified the Department for Constitutional Affairs (formerly the Lord Chancellor s Department) as a suitable occupier for Queen Anne's Gate and Clive House in response to separate requests for assistance from the Home Office and the Department for Constitutional Affairs. In June 2003, the Department for Constitutional Affairs exercised an option to extend the lease on Queen Anne s Gate to allow for its refurbishment and it will become liable for the lease and the cost of running the building once the Home Office vacates.

FEB '03

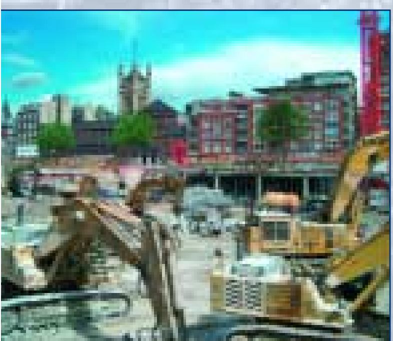
APR '03



MAY '03



MAR ’03



Recommendations

Recommendations for the Home Office

1 The Home Office has got what it wants from the deal at a good price and construction is now underway. It has, however, retained a number of risks that it must manage. In particular:

- The Home Office still owns the surplus property and in a market that is currently declining. It needs to continue to work with the Office of Government Commerce to achieve value for money for the Exchequer, whether this is by retaining freeholds for use by other government departments or by transferring the property to the private sector.
- Although good progress has been made in managing the interface between the accommodation and IT projects, there is still a lot to be done. For example, the Home Office still needs to finalise arrangements for maintenance of IT infrastructure in the new accommodation, undertake its procurement and negotiate arrangements for the move itself with the IT service providers. It will be very important to ensure that the IT infrastructure installed by the PFI contractor meets the specified quality standards before it is accepted and we support the Home Office's plans for a robust testing procedure involving all IT service providers.
- Projected staff numbers for 2005 are currently under review but it is likely that it will not be possible to accommodate all Home Office headquarters staff, including those employed by the Prison Service, in 2 Marsham Street as originally planned. The Home Office is currently examining options but there are no firm proposals at present. It needs to decide how it will accommodate the excess soon in order to determine the budgetary implications as well as manage staff expectations. There is a risk that any continuing uncertainty could mean that some staff might lose interest in the accommodation project and are not committed to their role in securing wider business benefits. It will be particularly important to ensure that staff who do not move to Marsham Street are reassured that alternative accommodation will be satisfactory. The Home Office is aware of this risk and is seeking to address the issue.

2 In the longer term, realisation of wider business benefits is key to the success of the overall accommodation strategy. While the Home Office is not due to occupy its new accommodation until 2005, the experiences of other organisations suggest that considerable time and resources will be required to ensure that the Home Office is ready for the move. The Home Office also needs to develop measures to demonstrate that it is achieving benefits. In particular we recommend that the Home Office:

- Continues to ensure that there is a fully-resourced project team in place to manage the move to the new building;
- Develops a strategy for making sure that staff are ready to move to their new accommodation including allaying concerns about the new working environment, piloting any new technology or working practices, providing any necessary training and resolution of storage issues;
- Identifies ways of developing performance indicators to demonstrate the achievement of business benefits resulting from the new accommodation and of establishing a baseline so that these benefits can be measured throughout the lifetime of the project;
- Continues to profit from the experiences of other organisations such as the Treasury and the Ministry of Defence in preparing for the move and securing business benefits. The Office of Government Commerce plays a role in sharing lessons across the public sector and the Home Office should use any further opportunities to learn from other departments and to spread good practice.

Recommendations for future PFI deals

3 The Home Office deal benefited from a good project team backed by good advisers. Shortly before financial close, the Home Office brought in a Senior Project Manager from another government department who was experienced in managing major construction projects, while retaining key staff. We recommend that a team with the right skills and experience is put together early on in the deal and where possible is retained after the contract is let in order to maintain continuity.

4 The Home Office was able to work with the Office of Government Commerce and therefore take account of the wider context of the Government's accommodation needs. The Department for Constitutional Affairs commitment to take over the Queen Anne s Gate lease will result in a saving to the Home Office and shows that there is an important role for the Office of Government Commerce to play in developing a structured long-term strategy for office accommodation in Westminster.

5 Departments should always allow bidders the opportunity to come up with new ideas such as the variant bid to redevelop 2 Marsham Street. Such suggestions should be tested thoroughly, for instance as the Home Office did by extending the competition and requesting Further Best and Final Offers from all bidders.

6 During Further Best and Final Offers and preferred bidder selection, the Home Office worked hard with AGP to reduce risk and therefore any premium for inappropriate risk transfer, and the extent to which prices were conditional and subject to later changes. Although having selected AGP as preferred bidder, it still took 20 months to reach financial close, the Home Office considers that the time spent driving out conditionality was worthwhile as reflected in the final terms of the contract and the relatively small overall increase in price between preferred bidder selection and financial close. Departments should seek to achieve an appropriate balance between reaching financial close quickly and reducing risk and price conditionality as the Home Office did here.

7 Departments should always ensure that the funding provided is competitive. In this case AGP competed part of the equity and subordinated debt financing for the deal, researched both bond and bank options for the senior debt and competed the reinvestment of the bond issue proceeds.

8 The use of residual value finance brought down the price of the annual combined payment. This form of finance may be appropriate to other PFI accommodation deals. We would expect departments and their advisers to have considered the merits of such a form of financing in future deals.

9 The Home Office negotiated an option, whereby in the event of an early termination of the contract by the Home Office, it could avoid the immediate payment of outstanding capital on the bonds and instead elect to pay over time. This would give it flexibility in its options if it needs to terminate the contract early and avoid a large cash outlay in one financial year. We recommend that when negotiating future PFI deals, departments consider whether this option could offer improved value for money.


MARSHAM STREET SITE PRIOR TO DEMOLITION

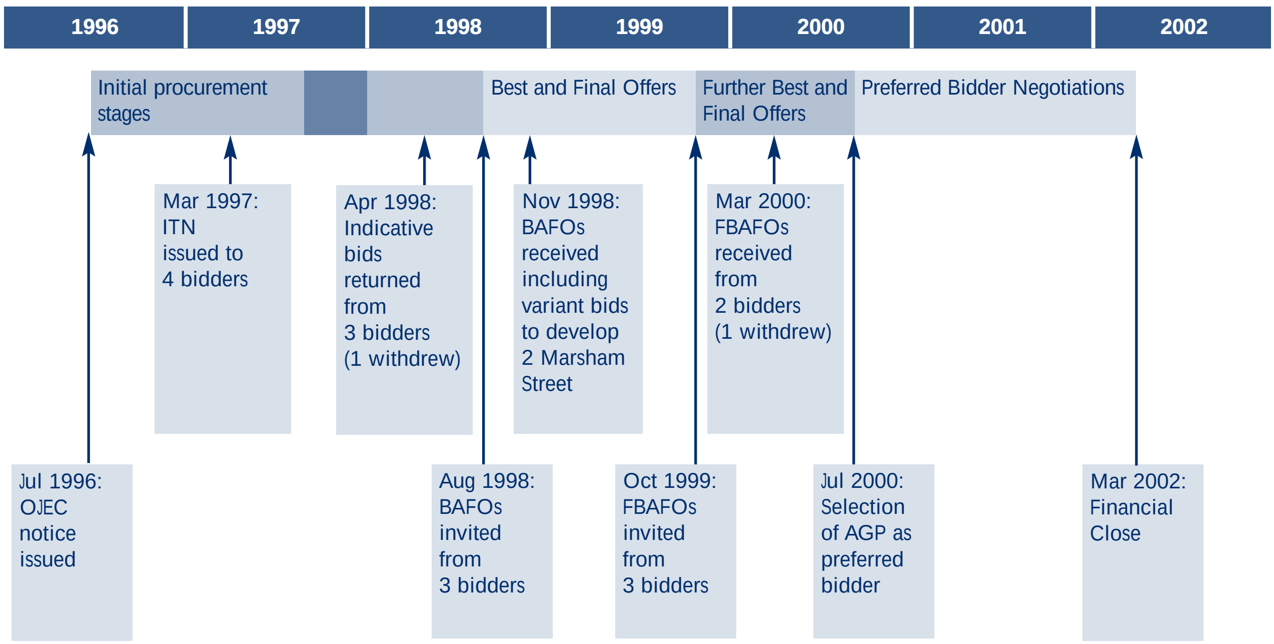
Part 1

The Home Office will get what it wants from the deal

This part of the report examines whether the Home Office achieved its objectives. It shows that the deal provides a replacement for the Home Office's inadequate existing central London accommodation and that the Home Office expects to secure wider business benefits from its new accommodation although it will not be possible to house all staff. The Home Office considered alternative options to the Marsham Street PFI deal but concluded that they would not offer as good value for money.

1.1 In 1996, the Home Office launched a review of its accommodation requirements in central London and concluded that there were deficiencies in its existing estate. The history of the procurement exercise that followed is shown in **Figure 1**. An Invitation to Tender stating the Home Office's accommodation requirements was issued to prospective bidders. In addition to bids to refurbish the existing estate, one bidder offered a developed solution proposing to redevelop the site of the old Department of Environment building at 2 Marsham Street, affording the opportunity to bring the Home Office and Prison Service staff together in a new headquarters building and avoiding the need to decant temporarily from its existing building while it was refurbished. The Home Office liked the strategic solution offered but the bid was not sufficiently developed so a further round of bidding was necessary. This solution, however, meant that the Home Office would have to surrender the lease of Queen Anne's Gate at a price equating to a net present cost of £91 million unless another government department took over the tenancy. In June 2003, the Department for Constitutional Affairs committed to take over the Queen Anne s Gate lease, exercising an option to extend the lease in accordance with a Memorandum of Understanding with the Home Office, thus saving the Home Office the cost of its surrender. (See Part 3)

1 History of the Home Office Central London Accommodation Project



The project was suspended between August and December 1997 following the General Election and in light of a parallel decision to suspend the procurement of refurbished headquarters accommodation for the Treasury

Source: National Audit Office analysis

1.2 Annes Gate Property plc (AGP) was selected as the preferred bidder in July 2000 and the deal was finalised in March 2002. The project involves the demolition, the design and construction of new buildings on the site, the relocation of up to 3,450 Home Office staff and the provision of support services for 26 years. The new building will occupy around two-thirds of the site with the remainder being a separate development of mixed residential and commercial premises to comply with Westminster City Council planning requirements for the area.

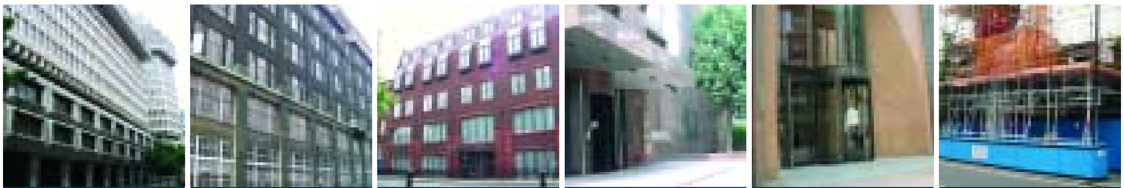
1.3 The demolition and construction work will be financed by AGP through the issue of £244 million of long-term debt to investors and £29 million in the form of equity. When the Home Office moves into its new building it will begin paying a monthly charge for the building and associated services amounting to £311 million (net present cost) over the life of the project. At the end of the project agreement in 2031, the Home Office will have a choice between either walking away from the deal or purchasing the building.

1.4 Demolition of the existing buildings on Marsham Street began in 2002 and the Home Office is expected to move to the new building in 2005.

The deal will provide a replacement for inadequate existing accommodation

1.5 At financial close, the Home Office and Prison Service occupied three leasehold and three freehold buildings in central London. Details of their condition, size and the number of staff accommodated are provided in **Figure 2**. The design and internal layout of the buildings is inflexible and most are in poor condition. In particular, Queen Anne's Gate requires refurbishment of both the plant and internal services and there are potential problems with the external building fabric. A 1993 study by the former Government accommodation department, Property Holdings, concluded that Horseferry House was incapable of future economic occupation. Although they are in better condition, the Home Office has calculated that Abell, Cleland and Clive House require some £28 million of work over the next thirty years. Grenadier House is a more modern building in better condition.

2 The Home Office's Existing Estate as at financial close (March 2002)



	Queen Anne's Gate	Horseferry House	Grenadier House	Abell House	Cleland House	Clive House
Headcount (in post)	1600	400	260	1450		490
Area (m2)	31,671	13,400	3,600	12,200	10,700	9,800
Condition	Poor	Very poor	Good	Requiring upgrading	Requiring upgrading	Requiring upgrading
Lease expiry date	2018	(freehold)	2015	(freehold)	(freehold)	2013

Total headcount: 4200

Total area: 81,371

NOTE

Since March 2002 both the staff numbers and the estate have changed. Clive House has been acquired by the Department for Constitutional Affairs and is currently being refurbished. The Home Office has acquired Allington Towers from the Treasury (accommodating 375 staff) and Ashley House from the Office of Government Commerce (accommodating 130 Home Office staff). See Figure 4 for total current staff numbers.

Source: Home Office

1.6 **Figure 3** shows that the Home Office will be paying about £6 million more per annum for its new accommodation under PFI than it had been paying for the existing estate at financial close in 2002. However, it considers that it will be worth paying more in return for greatly improved quality accommodation and new facilities. Furthermore, the annual cost of owning, operating and maintaining the existing estate is rising as a result of its condition and other factors, and are now estimated to be £45 million. Funding for essential repair and maintenance would have been expected to add substantially to the cost of running the existing estate in subsequent years.

The deal is supportive of Home Office business objectives

1.7 One element of the Home Office's business change strategy is to modernise corporate support and its accommodation project will be critical to achieving this. This section of the report examines the benefits the Home Office want to secure from its new accommodation in Marsham Street and the steps it is taking to ensure that these benefits are realised. It also examines the interface between the accommodation project and information technology, another key element of the modernisation strategy.

Modern office accommodation is expected to deliver business benefits

1.8 The Home Office identified a business requirement to deliver **an up-to-date, flexible workplace** providing an **efficient and effective IT platform,** and the **range and quality of facilities** expected of an employer of high calibre staff in Central London. The Home Office expected the new accommodation to help achieve these business requirements through:

- Modernisation through a flexible solution of three blocks integrated into a single well-designed Home Office building offering open and accessible offices with discrete and up-to-date security;
- Enabling greater business effectiveness and efficiency: consolidation of the Department from six buildings to no more than two closely associated headquarters buildings in 2 Marsham St and nearby;
- Accommodation designed to enable modern methods of working particularly team working, extensive exploitation of IT and high levels of business change and reorganisation;
- Contributing to sustainable development objectives by enabling the development of an innovative mixed use city centre site and by providing a building highly rated under BREEAM[2];
- Providing a better service to visitors and public by provision of fit for purpose fully serviced central conference and press facilities situated close to main entrance to enable good security with ease of access; and
- Assisting staff retention and morale by providing attractively designed but not extravagant staff facilities including new restaurant, workplace nursery, multi-purpose sports hall and recreational facilities.

3 Comparison between the cost of running the existing estate as at March 2002 and expected running costs under the PFI deal

Costs of running the existing estate[1] (£m)						
Rent	Capital Charge	Rates	Running costs	Capital costs	Other costs	**Total**
13.3	4.4	5.2	6.6	0.4	3.1	**33**

Cost of running the estate under the PFI deal[2] (£m)			
Unitary Payment	Rates	Mail and Messenger services[3]	**Total**
30.3	8.0	0.9	**39.2**

NOTES

1. These were the annual running costs as at financial close (March 2002).
2. This does not include costs of accommodating the excess staff.
3. Mail and Messenger services are not included within the PFI deal.

Source: National Audit Office analysis

2 *Building Research Establishment Environmental Assessment Method.*

1.9 The Home Office did not quantify the business benefits in terms of improved productivity or better quality outputs having concluded that accommodation change is linked to other cultural and business process change and separating any one of these changes from the other to measure their individual effects has no robust methodology. However, the Home Office will need to take steps to secure business benefits and identify ways to demonstrate that they have been achieved. This action is currently being planned and has backing from Home Office senior management. The experiences of other organisations suggest that considerable time and resources will be required to ensure that the Home Office is ready for the move. So far, the Home Office has taken the opportunity to learn from other Government departments such as the Treasury and the Ministry of Defence who are also undertaking headquarters accommodation projects and has sought to evaluate the benefits of open plan accommodation by running pilot projects.

The Home Office still needs to manage the interface with its IT projects

1.10 One of the business requirements identified by the Home Office is an efficient and effective IT platform and there is a close relationship between modernisation of accommodation and programmes to modernise information technology. At present the Home Office and the Prison Service have separate IT systems provided through two separate PFI deals and there are complex interfaces between these projects and the IT infrastructure in the new building. While the PFI contractor will be responsible for installing the infrastructure in the new building, it is not responsible for its maintenance. Procurement of provision of infrastructure maintenance is planned for 2004.

1.11 The rapid change in information technology meant that determining a specification for the IT infrastructure acceptable to the IT providers proved difficult and the Home Office decided to delay agreeing the specification beyond financial close by 12 months rather than precipitate a less than acceptable solution with the risk of having to change it again. This arrangement was reflected in the contract. A final specification was agreed on time and includes some enhancements. The cost of these enhancements is being negotiated with AGP but the Home Office is confident it will get a fair price. To proceed to financial close with one element of the specification outstanding is an unusual step but the Home Office considers that there have been benefits to this approach as it was possible to take advantage of developments in a rapid moving technology such as the 'electronic patch management'[3] concept, a technology that allows a more flexible management of IT provision.

1.12 The Home Office have identified a number of learning points for future projects:

- Robust and professional project management is required for a complex project with a number of interfaces. Initially, the interface between the accommodation project and the IT projects was not managed effectively, but in 2002 a working group was set up to provide leadership; and
- It might have been better if it had been clearer earlier who would be responsible for maintaining the infrastructure. The Home Office originally intended one or both of the IT providers to take responsibility and it only became clear at a later stage that IT infrastructure might have been better managed by the accommodation provider. By this time, AGP had already been selected as preferred bidder and was not prepared to take on responsibility for IT infrastructure maintenance. In competitive tension, AGP might have been more willing to do this, possibly by subcontracting the work to a specialist IT supplier.

3 This technology allows changes to individual's computer accounts to be made electronically and therefore remotely. Previously changes were made manually so the IT service providers required access.

1.13 The IT project is currently on track but there is still some way to go to ensure that the IT works when the building is ready in 2005. For example, the Home Office still needs to finalise infrastructure maintenance requirements and undertake the procurement, plan and negotiate arrangements for the move with the IT service providers and undertake infrastructure testing prior to the move. It will be particularly important to ensure that AGP delivers infrastructure that is acceptable to the Home Office, the IT service providers and the infrastructure maintenance contractor. Unlike the rest of the building, once the infrastructure has been accepted by these parties, the PFI contractor will no longer be responsible for it. The Home Office believes that the commissioning and handover arrangements have been carefully considered and fully reflected in the contract.

Alternative options considered were not so good

1.14 This section examines the Home Office's assessment of alternatives to the Marsham Street PFI deal. These included alternative accommodation options, deferment of modernisation and, redevelopment of the existing estate. The Home Office also considered whether a conventional lease and procurement of service provision would be better value for money than a PFI deal. None of the options were shown to clearly represent better value for money than the selected route.

Realistic alternative accommodation could not be identified

1.15 In its Invitation to Tender the Home Office stated its accommodation requirements rather than specifying a solution. This meant that it was left open to bidders to come up with any alternative accommodation options. At the later stage when the no-temporary decant solution was sought, the Home Office's property advisers had identified potential buildings in the vicinity with planning consent so the Home Office was aware that it may have the opportunity to explore these options. They were:

- Potential availability of a leasehold office building at Waterloo. This option was rejected by the then Home Secretary on the grounds that its location was unsuitable as it was too far from the Palace of Westminster; and
- Land Securities' proposed scheme at Stag Place. The main block was expected to be approximately four-fifths of the size of 2 Marsham Street and the rent was anticipated to be more expensive at £550-600 per m^2 per annum. It was also less convenient to the Palace of Westminster.

The Home Office did not consider relocating to outside central London. This was because of the need to remain geographically close to Ministers.

1.16 The Office of Government Commerce has expressed the view that at the time the Home Office were considering viable options, property rental values in central London were high. This meant that re-using existing government freeholds and leaseholds was more likely to provide value for money for the Exchequer than leasing or purchasing alternative sites. Nevertheless, the Home Office wanted to market test this and it was clear that bidders could have come forward with alternative solutions.

Deferment of modernisation was not value for money

1.17 The Home Office considered deferring modernisation until expiry of the Queen Anne's Gate lease in 2018 and in the meantime conducting a long-term plan of essential maintenance, repair and replacement works. Its analysis indicated that deferring modernisation would be more expensive than the cost of the Marsham Street PFI deal. Furthermore, this option would mean deferment of the modernisation benefits until 2018.

Redevelopment of the existing estate would not be as good

1.18 The Home Office received Best and Final Offers in 1998 from three bidders. All three submitted bids to refurbish the Home Office's existing estate and using the existing Government building in Marsham Street as temporary accommodation during the refurbishment. However, two bidders proposed an alternative solution at 2 Marsham Street. One of these put forward a designed and costed scheme that demonstrated the potential value for money of this option. The then Permanent Secretary indicated that he considered this an attractive opportunity worth paying more for (if that was necessary).

1.19 The Home Office also had concerns about the prospect of moving out to alternative temporary accommodation in Marsham Street and then moving back again. There was particular sensitivity because the Immigration and Nationality Department suffered problems with a decant from Lunar House into the Whitgift Centre in Croydon at around the same time in 1998. The Home Office considered that it was impossible to quantify the risks associated with the decant, but that it would cause up to three years' disruption at the same time as IT business re-engineering was taken place. Furthermore, using the old Marsham Street building as temporary offices was also seen as a risk given its poor condition and bad reputation.

1.20 The Home Office tested the value for money of the Marsham Street option through further competition by requesting Further Best and Final Offers from all three bidders. During preferred bidder negotiation on the Marsham Street deal, the Home Office continued to compare the bid to its estimate of the net present cost of refurbishment. At financial close this was £578 million (net present cost), compared to the £460 million for the Marsham Street PFI deal.

Alternatives to PFI did not clearly represent better value for money

1.21 Throughout the procurement, the Home Office benchmarked costs in the bidders' financial models against equivalent commercial costs as advised by external specialists. This analysis showed that while AGP's tendered costs for support services were on the high side, in overall terms, AGP's price of approximately £550 per m^2 per annum was in line with the cost of procuring more traditionally through leasing a building at market rent and paying separately for support services, furniture, fitting out and lifecycle maintenance. AGP moderated their support services costs without material reduction in service quality between selection of preferred bidder and financial close.

1.22 Our own analysis supports this - if anything, the Home Office appears to be getting a better deal than it may have done through a commercial rent and procurement of service provision. After stripping out service and lifecycle costs, the Home Office will be paying about £400 per m^2 overall per annum in rent. This compares well with March 2002 rental values in the Westminster/Victoria Street area of £500-600 per m^2 per annum.

1.23 The Home Office concluded that the PFI deal offered as good or better value for money than alternative routes. PFI can also provide other benefits that may not apply to traditional procurement by way of open market leasing:

- Greater scope for innovation and optimisation of the build to reduce service costs and improve operational performance;
- Involvement in the design and build so that the accommodation could be more tailored to Home Office requirements; and
- A more disciplined and transparent approach in that any changes to the design beyond financial close have to be carefully thought through and fully justified, reducing cost escalation.

However, all central London staff cannot currently be housed in one building

1.24 While the deal is expected to provide the Home Office with the accommodation it needs to secure its business objectives, the Marsham Street solution initially led to the aspiration that all core Home Office and Prison Service staff could be housed in one building. Since 1998, however, there has been a significant increase in the number of central London staff. The forecast for 2005 is currently subject to review but it is very unlikely that it will be possible to house all staff in one building.

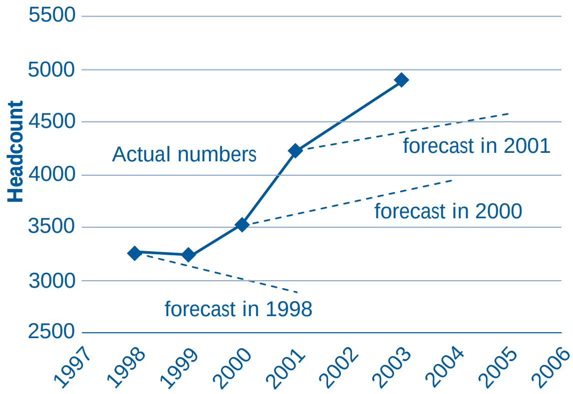
Forecast headcount has changed since conception of the project

1.25 When Best and Final Offers were invited in 1998, the Home Office estimated a reduction in its central London headquarters staff, including those employed by the Prison Service, from 3200 to 2920. This forecast reduction was expected to result from a downward pressure on pay and other running costs, outsourcing, efficiencies from streamlining of support services and efficiencies resulting from a change in working practices and culture resulting from modernisation initiatives and improvements in IT. **Figure 4 opposite** shows that the expected reduction did not occur; in fact, between 1998 and 2003, core Home Office and Prison Service staff numbers increased to about 4900. This includes vacancies being filled. The Home Office attributes this large rise to rapid increases in activity to meet increasing workload being put on the Department by Ministers and in the case of the Prison Service headquarters, by the rapid increase in the prison population.

1.26 Although the accommodation project team carried out annual surveys of business units the rapid rise in staff numbers made it difficult for them to maintain up-to-date information on current staff numbers and to forecast future headcount. This arose partly because the Home Office Human Resources function records and projects numbers on a nationwide basis whereas the accommodation project required forecasts for central London only. The project team recognised this was a weakness and began to reconcile Human Resources planning with their own projects from June 2001. The accommodation project also needed to take account of contractors and other non-payroll occupiers which the Human Resources figures did not include. The outcome of these difficulties was that Human Resources were forecasting expansion before the accommodation project was aware of it. Human Resources first started to forecast national staff increases in autumn 2000 but this was not picked up by the accommodation project until the following year.

4 Comparison of how actual staff numbers and forecast have changed over time

This graph shows that actual staff numbers have increased rapidly since 1999. The project team forecast in 1998 was for a drop in numbers



NOTE

The blue squares show points of assessment. For clarity changes between these squares are shown as straight lines. In practice the changes will have occurred in more complex ways.

Source: National Audit Office analysis

Options for accommodating the excess are being considered

1.27 In 2000, the preferred bidder was invited to provide for an additional 500 staff in the new building, resulting in a maximum capacity of 3450. Further expansion of 2 Marsham Street was not possible because of Westminster City Council's site restrictions and the Home Office considered that it would not be possible to find alternative accommodation capable of housing all core Home Office and Prison Service staff. At financial close, the Home Office expected to require additional accommodation for 750 staff. Current projections for 2005 are subject to review but it is unlikely that it will be possible to house all Home Office headquarters staff, including those employed by the Prison Service, in 2 Marsham Street as originally planned.

1.28 The Home Office has not yet reached a decision on how any excess will be accommodated. There are no firm proposals at present but various options are being investigated. The Home Office is progressing two initiatives intended to ensure staff numbers in central London are no larger than necessary. It is carrying out an efficiency study into the size of its headquarters and also contributing to the Lyons Review[4] on relocation of Government jobs out of London and the South-East. The Home Office expects that the results of these two studies will enable it to make final decisions on who occupies 2 Marsham Street by no later than mid-2004. Its view is that it needs to achieve an appropriate balance between having flexibility to accommodate increases in numbers and having too much space for too long. Over a 26 year contract, there is a possibility of staff reductions and of more flexible working allowing more staff to be based in a building than there are workstations or desks. At present, however, space per person in 2 Marsham Street is expected to be lower than for other government departments and industry benchmarks as shown in **Figure 5**.

1.29 The Home Office has told AGP which directorates will occupy floors in the new building and the Prison Service has confirmed that it will have about 1375 staff to accommodate in one of the three blocks. However, individual directorates have not yet decided which of their staff will be moving to Marsham Street or where they will be located. Until it is confirmed exactly which staff will be accommodated in 2 Marsham Street in 2005, the Home Office's plans to prepare staff for their new accommodation can only be provisional. It will be important to ensure that the business benefits of the move are secured and that staff who do not move to Marsham Street are reassured that alternative accommodation will be acceptable.

5 Planned Space per person in 2 Marsham Street compared to public sector benchmarks

	Net Internal Area (m^2) per person
2 Marsham Street	15.6
MOD Main Building Refurbishment[1]	19.0
HQ's all sectors[2]	18
DTI[3]	17

Source: (1) Report by the Comptroller and Auditor General, Redevelopment of MOD Main Building, HC 748 Session 2001-2002. (2) Gerald Eve: A study of Occupational Densities in the UK 1999. (3) Report by the Comptroller and Auditor General, MoD: Management of Office Space, HC 105, 1998-1999

4 *Sir Michael Lyons' ongoing review of departmental structures to examine the scope for relocating civil service and other public service staff from London and the south-east to other parts of the country, to improve cost effectiveness and achieve a better regional balance of Government activity.*

Part 2

The Home Office got a good price for the Marsham Street deal

This part of the report shows that the Home Office got a good price for the deal. A good project team ensured that a competitive procurement was held; the final contract allocated risk to those best able to manage it; and a good price was obtained for the financing.

There was a good project team backed by good advisers

2.1 The Home Office recruited good quality staff to the project team with relevant experience. The project director was an experienced property specialist and the project manager had worked previously on the PFI deal to redevelop the Ministry of Defence's Whitehall estate. A senior project manager was brought in from the Office of Government Commerce to focus on implementing the Project Agreement; this manager came from a construction background with experience in managing major projects. The winning consortium, AGP found it easier to work with members of the Home Office project team who had a detailed understanding of the technical and construction issues involved in developing the Marsham Street site.

2.2 Good quality advisers were employed by the Home Office following a competitive procurement process. **Figure 6** records the costs incurred by the leading advisers. In the context of the prolonged procurement process, we consider that the costs incurred were reasonable: the additional round of bidding required further input from the specialist advisers in terms of evaluating the revised bids; and delays in reaching final agreement with the preferred bidder over the right of light issue (see below) incurred extra costs. The Home Office required estimates from its advisers over each phase of work and presented monitoring reports on advisers' budgets and costs to the project board. The project was designated a Treasury Taskforce Significant Project by the Government in 1997 and was therefore supported by the Treasury Taskforce and its successor body, Partnerships UK throughout the period 1997-2002. The Home Office felt that the support from Partnerships UK, its legal advisers Berwin Leighton Paisner and financial advisers PricewaterhouseCoopers, was especially valuable in helping the transaction in its final stages to reach financial close.

6 Costs incurred by the Home Office accommodation project on professional advisers between March 1996 and January 2003

Advisers	Nature of Professional Advice	Total Cost (£m) to January 2003
PricewaterhouseCoopers	Financial	2.5
Berwin Leighton Paisner	Legal	2.6
Knight Frank	Property	0.6
EC Harris	Property surveyors	0.3
The Thomas Saunders Partnership	Architectural services	0.7
Turner & Townsend[5]	Monitoring Surveyor	1.3
	Other	1.1
TOTAL		**9.1**

Source: Home Office

5 *The monitoring surveyors costs have been incurred during the course of 2002/03: they are responsible for monitoring AGP's construction performance. Excluding their costs, the total advisers' costs for the procurement process was £8m.*

The Home Office ran a good competition

2.3 This section of the report examines the Home Office's competition for the Marsham Street PFI deal. It shows that the Home Office obtained two competitive bids after it requested Further Best and Final Offers from bidders to test the Marsham Street solution. The bid evaluation process, including comparison with a Public Sector Comparator was thorough and the Home Office ensured that there was little change in price during negotiations with the preferred bidder.

The Home Office considered that payment of bid costs for Further BAFO was justified

2.4 The Home Office requested Further Best and Final Offers from all bidders to test the value for money of the variant bid. In seeking a further round of bids, potential bidders were facing large additional costs in reworking their accommodation proposals. As a result, there was a high likelihood that competitive tension could be compromised if bidders were unwilling to incur these costs. The Home Office took advice from Partnerships UK and from its advisers and decided to contribute towards bidding costs. It proposed paying up to two thirds of costs incurred after 10 April 1999 subject to a £630,000 cap. One of the initial bidders dropped out of the competition since it was not prepared to develop proposals to redevelop 2 Marsham Street. As the two remaining bidders, AGP and CASL[6], put in two competitive bids, the Home Office considers that taking the exceptional decision to pay a contribution to bidding costs was justified although the amount to be paid to CASL is not yet finalised.

The Home Office carried out a thorough bid evaluation process

2.5 The Home Office's bid evaluation process included a technical evaluation (which included examination of the design, relocation strategy, support services and building management services proposals), property evaluation, finance evaluation and legal evaluation. In almost all areas, the scores between the winning and losing bidders were very close, as was the overall score, as shown in **Figure 7**. In evaluating the bids, the Home Office also invited comments from the Trade Union, an Independent Architectural Adviser and its accommodation user group. Their views were considered as part of the process of ensuring the proposals met the Home Office requirements and were not used in distinguishing between the bids. The selection process took the technical scores fully into account as well as other relevant factors including cost.

7 Further Best and Final Offers Bid Evaluation Technical Scores

	AGP (%)	CASL (%)
Total overall score	78.01	77.86

Source: Home Office

There was little change in price during preferred bidder negotiation

2.6 The price of the deal rose by 4.9 per cent over the 20 month period from selection of preferred bidder to financial close: the net present cost increased from £296.6 million (after adjusting for variations accepted by the Home Office at Further Best and Final Offers) to £311 million at financial close. **Figure 8 opposite** provides details of the price changes to the deal.

6 *The competing FBAFO bid was submitted by CASL, a consortium comprising Bovis Lendlease, Johnson Controls, Stanhope, Richard Ellis and Sumitomo Bank.*

8 Changes in Price from Further Best and Final Offers to Financial Close

	£m net present cost
AGP Bid at FBAFO (Adjusted for bid cost error and demand risk exclusion)	**296.6**
Scope Changes: Effect of 15% increase in staff numbers on capital expenditure lifecycle and service costs (£9.8m); Renegotiation of the payment mechanism (-£4.8m); Removal of the mail & messenger services when the Home Office decided to keep these in-house (-£8.3m); service cost changes (-£3.5m); and increase in purchase price for 2 Marsham Street (£6.5m)	-0.3
Indexation (from 15/2/01 to Financial Close)[7]:	13.4
Financial Changes: Refinancing (£2.8m); Extra negotiated Ambac structural fee (£0.6m); Financial market conditions - lower interest rate at financial close (-£7.5m); Other finance/tax/working capital (-£2.2m)	-6.3
Other Changes: Residential purchase price and adjustment (£2.4m); stamp duty (£1.7m); inflation reserve (£0.4m); timing of Marsham St payment (£1.3m); miscellaneous (£1.8m)	7.6
Total NPV at Financial Close	**311.0**

Source: PricewaterhouseCoopers

2.7 During the period in which the Home Office was negotiating the contract with AGP, the Public Accounts Committee held a hearing on the Refinancing of the Fazakerly Prison[8]. At the hearing, the Head of the Prison Service accepted that refinancing gains on future PFI contracts should be shared equally between the government department and the private sector partner. Having taken advice from the Office of Government Commerce and Partnerships UK, the Home Office decided that a 50:50 split of refinancing gains needed to be reflected in the Marsham Street contract although Office of Government Commerce guidance on sharing refinancing gains was not published until June 2002, after financial close.

2.8 Following tough negotiations, the final contractual agreement was that the Home Office would receive a 50:50 share of any refinancing gains. In return, AGP was allowed a 1.1 per cent increase in its Internal Rate of Return, equivalent to a £275,000 increase in the annual payment to the consortium. It is unclear at this stage whether a refinancing gain is likely and therefore impossible to comment on whether this increase in the annual payment was value for money. However, the approach taken by the Home Office was prudent; it reflected a warning that the Home Office had previously given to the Committee of Public Accounts at the hearing on the Refinancing of the Fazakerly Prison that there was a risk that in the future the Department might have to pay for a 50:50 share of any refinancing gains in any PFI contract it signed.

The cost of the PFI deal was lower than estimates of conventional procurement costs

2.9 In addition to its bid evaluation strategy and negotiation to ensure little net change in price during preferred bidder negotiation, the Home Office used a Public Sector Comparator to compare the costs in the PFI bid with estimates of costs under a conventional procurement. It also continued to use the previous Public Sector Comparator (which represented the cost of refurbishing the existing estate under conventional procurement) to compare the cost of the PFI deal with estimates of the cost of a public sector refurbishment option.

2.10 The Public Sector Comparator was based on an assessment of the likely costs of a hypothetical set of contracts to construct and operate 2 Marsham Street, including construction costs, lifecycle capital expenditure, operating costs and an assessment of the risks associated with these costs. In determining inputs and risk adjustments, the Home Office were advised by professionals with construction, accommodation services and property expertise.

2.11 The Home Office determined the net present cost of the Public Sector Comparator to be £494 million, £34 million greater than the cost of the PFI deal (£460 million including costs retained by the Home Office). The overall risk adjustment to the PSC was nine per cent. Further details about the Public Sector Comparator, including its inputs, its adjustment for risk, comparison with the PFI bid and its sensitivity to the assumptions used are provided at Appendix 2.

7 *When the FBAFO bids were submitted in May 2000, the bidders had to provide letters stating that their bid prices were subject to indexation, changes in financing costs and Home Office mandated changes. Indexation of costs was to commence from 15 February 2001 until financial close at an increase of 0.35% per month for construction costs and by reference to RPI for other costs.*

8 *PAC Report on the refinancing of the Fazakerly PFI prison contract, HC995-i), 1999-2000; pxx, paragraph 16 and p3, paragraph 27.*

Appropriate risk allocation was achieved

2.12 A key principle of the Private Finance Initiative is that risk should be allocated to the party best able to manage it. This section of the report examines how risk has been allocated on this PFI deal and where the Home Office has decided to retain risk, its reasons for doing so and its strategy for managing it.

There are safeguards to minimise the risk to the Home Office during construction

2.13 Planning Permission for the 2 Marsham Street site was given by Westminster City Council on the basis of a mixed development of the site of office accommodation, housing and other commercial development. The Home Office has contracted to sell the surplus land not required for its office development to AGP for £11 million for housing and commercial development in line with the planning permission but is not obliged to transfer the land until the development has reached certain key milestones. There are arrangements for termination of the land sale in the event that the residential/commercial development is badly delayed so as to frustrate the contract. AGP has subsequently sold its rights to this surplus land to a subsidiary company AGPRD (Annes Gate Property Residential Developments) established to carry out the residential development. A further agreement has been made whereby Galliard Homes Ltd will purchase the share capital of AGPRD once the surplus land development is completed.

2.14 A clawback arrangement has been put in place so that the Home Office can benefit from any increase in the value of the surplus land development. This arrangement means that:

- The Home Office will receive 50 per cent of any increase in the value of the site resulting from planning permission granted before 26 March 2012;
- The Home Office is entitled to a share of savings on specified costs; and/or
- The Home Office is entitled to an increasing percentage share over specified limits of aggregate sale proceeds.

2.15 The planning permission stipulates that the final 25 per cent of the Home Office building floorspace cannot be occupied until practical completion of the residential/commercial site. There is therefore a theoretical risk that the Home Office will not be able to fully occupy its offices if the residential/commercial site has not been completed. The Home Office considers that the risk of this scenario materialising is slight since Bouygues is carrying out the construction of both the office and surplus land developments and AGP is not entitled to receive any payment from the Home Office until it is able to occupy 100 per cent of the office space and the Independent Certifier has declared that the contract requirements have been met. The Home Office decided to retain this risk following legal advice that any contractual arrangement to mitigate this risk by permitting it to step in to complete the residential and commercial development would be very complicated and it had a number of other protections. In addition, Westminster City Council have sent a non-binding letter to the Home Office stating that planning conditions may be varied if necessary to overcome any problems associated with the above scenario materialising.

2.16 Variation bonds for £30 million were issued but not funded as part of the index-linked bond in order to provide potential funding for any construction cost increases:

- £10 million of these bonds would be sold to cover the costs of any Home Office initiated changes to the Marsham Street office building specifications. If these bonds are used, the Home Office has to compensate AGP with a higher accommodation and services payment.
- The remaining £20 million of the bonds would be sold if AGP's own costs are higher than anticipated. If these are used then AGP's equity returns will be diluted.

Planning risk has been adequately allocated but risks remain

2.17 The proposed new buildings at 2 Marsham Street may reduce the natural light to a small number of local properties. Despite uncertainties over the legal position, the Home Office decided to offer compensation on rights of light for public policy reasons. The Home Office concluded that placing this risk wholly with AGP could have meant that the project was unfundable, or at best would be much more expensive, and therefore it retained management of the risk. The Home Office has shared parts of the risk with AGP by price capping some of the costs of design changes and the delay consequences should there ever be any sustainable legal objections to the approved scheme.

9 Comparison of the prices offered by bidders for disposal of the freehold property with the Home Office's own estimates in 2000 as advised by Knight Frank

Property	AGP (£m)	CASL[1] (£m)	Home Office estimates at BAFO evaluation (£m)	Home Office estimates at financial close (£m)
Cleland House	9.75	9.40	16.4	23.3
Abell House	11.975	10.9	18.75	27.3
Horseferry House	12.025	12.00	16.3	17.7
Total Existing Freeholds	**33.75**	**32.3**	**51.45**	**68.3**

NOTE

1. These figures do not include 'overage' - a mechanism by which any excess profits from disposal of the property would be shared with the Home Office.

Source: Home Office/Knight Frank

The Home Office will dispose of its surplus buildings itself

2.18 The disposal of existing central London property assets has been retained by the Home Office. At the Further Best and Final Offers evaluation stage, the Home Office's property advisers considered that the prices offered by the bidders for the freehold properties (Abell House, Cleland House and Horseferry House) were not value for money as compared to the public sector comparator. **Figure 9** shows how the values compared. The Home Office took their advice and disposal of these assets was not included in the preferred bidder negotiations. The prices offered by the bidders will have reflected their assessment of the risk of changes in the property market. There have been value decreases in the commercial and residential property market in central London since March 2002 and it is possible that the value of the freeholds is now less than estimated by the Home Office in 2002. The extent to which this risk will materialise will not be clear until the properties are sold.

The payment mechanism is expected to incentivise performance

2.19 The contractor will only begin receiving payment for accommodation and services when the building is available for occupation and the Home Office has declared it fit for purpose. A payment mechanism has been designed to incentivise the contractor to achieve availability and service targets. Each month, the contractor's performance is measured against a set of weighted performance indicators and where there is a shortfall in performance, a deduction is made from the monthly payment. There are a number of additional measures that come into play if any shortfall in performance is sustained. More details about how the payment mechanism is expected to work are at Appendix 3.

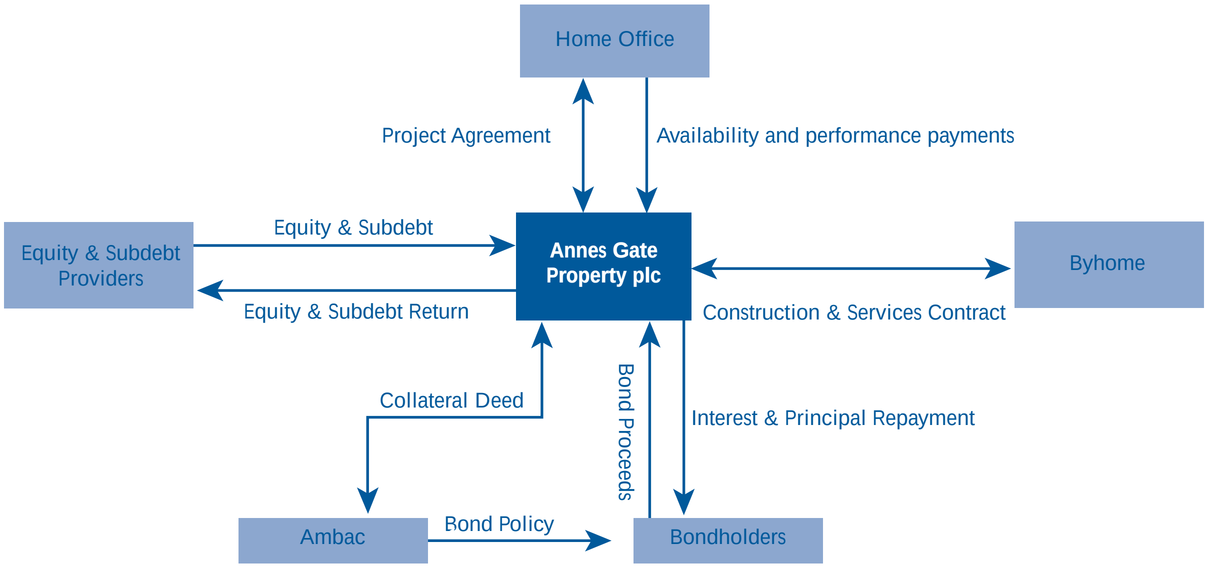
A good price for financing was obtained

2.20 In redeveloping the 2 Marsham Street site, the financing for the office development has been kept separate from the financing for the residential/commercial development. The latter development has been financed by a £45 million corporate loan from HSBC to AGPRD. This section examines the financing associated with the office development for the Home Office.

2.21 **Figure 10 overleaf** shows the structure of the deal. Anne's Gate Property plc consortium consists of HSBC Infrastructure Limited and Byhome Limited (Byhome is majority owned by Bouygues UK and minority owned by Ecovert FM during the construction phase and this will reverse during the operational period. Both are wholly owned by Bouygues Construction S.A.). Byhome's performance is also underwritten by Bouygues Construction SA. It is responsible for the construction of the office development and then the subsequent provision of building management and other support services directly to AGP, and indirectly to the Home Office within the building.

2.22 The bulk of the financing for the construction of the project comes from a bond issue in March 2002. Equity investment predominantly comes from secured loan stock (subordinated debt) provided by HSBC with a small amount of pure equity from both HSBC and Byhome. The amount of each funding source for the project is shown in **Figure 11 overleaf**.

10 The Structure of the PFI deal



Source: National Audit Office

11 AGP Funding Sources

Funding Source	Amount (£ms)	percentage
3.237 per cent Index-Linked Guaranteed Secured Bonds due 2030	144.22	48.5
5.661 per cent Guaranteed Secured Bonds due 2031	100.00	33.6
Equity: Subordinated debt (Secured Loan Stock)	28.5	9.6
Pure equity	0.64	0.2
Property disposal proceeds (Sales of surplus land to AGPRD)	11.00	3.7
Revenue during construction	2.86	1.0
Interest income (Predominantly through reinvestment of bond proceeds in a Guaranteed Investment Contract)	10.23	3.4
TOTAL	**297.44**	

Source: AGP Financial Model

Competitive financing

2.23 At Further Best and Final Offers, bidders were required to give bid quotes based on both bond and bank financing. The prices provided by the AGP and CASL consortia at that stage both suggested that a bond financed solution for the deal was going to be the cheapest option. On selection as preferred bidder, AGP continued to research both bond and bank options before firmly deciding on a bond financing solution in October 2000. The Home Office's financial advisers then continued to periodically monitor potential differences in price between bond finance and bank finance. At financial close, bond finance was estimated to be some £6 million cheaper than bank finance.

2.24 The bond issue proceeds were reinvested in a Guaranteed Investment Contract (GIC)[9]. Three bidders competed for the GIC and the winning bidder (Ambac) was selected on 19 March 2002 (the day before financial close) and undertook to maintain its discount against market rates overnight. The Home Office's financial advisers benchmarked the price against the market rates on the day of the bond launch (20 March 2002) to ensure that the rate continued to be competitive: their conclusion was that the rates quoted by the GIC provider were the best available market rates. The Home Office negotiated a 50 per cent share of any financial gains made by AGP should the assumed rate of inflation in the construction price during the development phase that is required by the bond insurers

9 *In a project involving a prolonged construction period, the borrower will be disbursing funds on project costs over a number of years. Since the proceeds from a public bond issue are normally received in a single tranche soon after financial close, any funds not immediately required by the borrower should be invested in a deposit instrument and released as and when required so as to minimise the overall cost of financing. A Guaranteed Investment Contract is one such instrument: it provides a single fixed rate of interest on a reducing deposit balance for a given period.*

(also Ambac) exceed the actual rate of inflation. The Home Office will receive 50 per cent of any gains arising but has no downside risk.

2.25 AGP, as part of its internal funding arrangements, competed the subordinated debt financing for the consortium. CCF Charterhouse plc (subsequently taken over by HSBC Project Equity Investment) won the competition.

Bond issued when demand was strong

2.26 AGP got a very good price on the sale of bonds to finance the project when launched on 20 March 2002. On this day, demand in the markets for the AGP bond was strong. The financial advisers carried out a thorough benchmarking process on the bond prices, monitoring spreads in the market prior to launch to establish appropriate benchmarks. They concluded that the terms of the bond achieved on launch were satisfactory and represented best available in the market rates. There was not a premium to the spread on existing bonds being traded on the market. The spread achieved was 65 basis points for the index-linked bonds and 70 basis points for the fixed rate bonds. These spreads were the cheapest new issue in the market for 5 years. Partnerships UK considers that the cost of financing reflected the good financial structure developed for the project, the Home Office decision, as far as possible, to use "standardisation" - the standard PFI contract terms issued by Treasury Taskforce[10] - and a risk profile that was well understood in the market. Partnership UK agrees with AGP's advisers' view that the strength of the contractor, the track record of the sponsors to the bond, the central London location of the scheme, and the disciplined approach to the marketing of the bonds by the lead manager were also important influences. As well as this the bond launch was made easier by the absence of any major competitor for bond issues at the time. A planned utility securitisation had been pulled shortly beforehand.

Contractual terms acceptable to financiers

2.27 A residual value element to the financing structure was incorporated in the deal to bring down the annual cost of the Home Office s payment to AGP: a £100 million fixed rate bond will be repaid as a bullet payment at the end of the contract. The Home Office has the option at the end of the contract to buy the remaining leasehold on the office building at the lower of market value or £137.5 million (a bid item from AGP) or to vacate the site[11]. The Home Office will not have to pay more than £137 million to buy the building and so could, in a buoyant property market, achieve a substantial value for money gain. AGP had initially offered a £90 million residual value bond but agreed to increase it to £100 million during preferred bidder negotiations.

2.28 If the Home Office chooses to vacate the site, AGP would have to find new tenants and refinance the fixed rate bond. If the Home Office decides to buy the building, the proceeds received from the Home Office would be used to pay off the fixed rate bondholders. There is a speculative risk for AGP's shareholders associated with this fixed rate bond if the market value of the offices is less than the value of the outstanding bonds. To mitigate this risk, and ensure that fixed rate bondholders are compensated in full at the end of the contract, a cash trap mechanism has been put in place. From 2022 onwards there will be a monitoring of the potential residual value of the site at the end of the contract. Any assessment of value being less than £100 million will lead to money being set aside into a residual value fund to ensure that bondholders are compensated in full. Shareholder returns will, as a result, be reduced.

2.29 In the event of termination of the contract by the Home Office, bondholders would normally receive the capital outstanding on the bonds or, if higher, their market value at the time. On this deal, the Home Office and its advisers negotiated an option whereby, in certain termination circumstances, the Home Office could elect to pay over time. This would mean that if the Home Office needs to terminate the contract, it would avoid an immediate cash call on its budget. Instead, the interest and capital re-payment profile for the bonds would be maintained.

10 Partnership UK's predecessor.

11 The Home Office must decide whether or not to buy or vacate the site two years and nine months before the contract ends.

Part 3

The deal has been co-ordinated with other departments' accommodation requirements

This part of the report examines how the Home Office deal fits in with management of the wider central London civil estate. It shows that the Department for Constitutional Affairs will benefit from the deal through use of the Home Office's existing estate, and that this has saved the Home Office the cost of surrendering the lease on Queen Anne s Gate.

A replacement tenant for the existing estate was found

3.1 The proposed redevelopment of 2 Marsham Street meant that the Home Office needed to vacate both its leaseholds at Queen Anne's Gate and at Clive House. However, the lease at Queen Anne's Gate of £11.5 million per annum was not due to expire until 2018. Between 1996 and 1999, it was not clear how Queen Anne's Gate or other surplus Home Office buildings could be re-used and the Home Office was unable to identify potential replacement tenants. It therefore negotiated with the landlord an option to terminate the lease at a price equivalent to a then net present cost of £91 million. The Clive House lease, which was due to expire in 2013, was valued as an asset since the rent was minimal at £30,000 per annum.

3.2 In 2000, Property Advisers to the Civil Estate (subsequently the Office of Government Commerce property division) identified the Department for Constitutional Affairs (formerly the Lord Chancellor s Department) as a suitable occupier for Queen Anne's Gate and Clive House in response to separate requests for help from the Home Office and the Department for Constitutional Affairs. Queen Anne's Gate and Clive House are suitable accommodation opportunities for the Department for Constitutional Affairs because they will be available when its existing leases expire. In June 2003, the Department for Constitutional Affairs committed to taking over the Queen Anne s Gate lease, saving the Home Office the cost of its surrender. The Department for Constitutional Affairs will become liable for the lease and for the cost of running Queen Anne s Gate once the Home Office vacates the building in 2005.

3.3 The timing of Queen Anne's Gate's availability fits in with the Department for Constitutional Affairs need for accommodation and there will be some leeway if there is a delay to the construction of 2 Marsham Street. The Department for Constitutional Affairs currently plans a two year refurbishment of Queen Anne's Gate following the Home Office's departure from the building in 2005. However, if there are delays to the Home Office vacating Queen Anne's Gate, the Department for Constitutional Affairs can defer its relocation until 2009 when its lease on its current headquarters building expires. Clive House has already been vacated by the Home Office and its refurbishment for the Department for Constitutional Affairs started in 2003.

The best way to secure value for money from disposal of the remainder of the current estate has not yet been decided

3.4 The future of the remaining properties has not yet been decided but the Home Office and the Office of Government Commerce are continuing to work together to ensure that best value for money is achieved from their disposal. The Home Office and the Office of Government Commerce both consider that retaining freeholds in the Westminster area could offer better value for money for Government as a whole rather than transferring the property to the private sector but that this would need to be tested as there is considerable demand from both the public and private sectors for office and residential space in the Westminster area. It is possible that the Home Office may need to retain some of its existing space as on present trends it is unlikely that all staff will be accommodated at 2 Marsham Street, but there are no firm proposals to do so at present. As noted earlier in this report the Home Office is progressing several studies which will confirm the numbers of staff that it considers it necessary should be employed in London in the longer term.

Glossary

Basis point	1/100th of 1%. A measure normally used in the statement of interest rates; 100 basis points equals 1%.
Best and final offers	The final bids made in the competition between private sector bidders.
Bond	A form of interest bearing security issued by governments, companies and other institutions - usually a form of long-term financing.
Bond issue	A method of borrowing by which debt is raised from a wide variety of individual or institutional investors. Bonds usually carry a fixed coupon payable by the issuer (borrower) to the bondholder (investor) and have a predetermined repayment date.
Conventional procurement	A procurement for a contract in which the public sector customer, using Government finance, pays the contractor as the works progress. Such projects are fully paid for on completion. The public sector retains the risk that the assets will not be delivered on time or to budget. The provision of services, operation and maintenance of the resulting assets are dealt with in separate contracts.
Discount rate	The percentage rate applied to cash flows to enable comparisons to be made between payments made at different times. The rate quantifies the extent to which a sum of money is worth more to the Government today than the same amount in a year's time.
Equity	The value of a company or project after all liabilities have been allowed for. The equity is owned by the shareholders.
Financial models	Spreadsheets designed to show the financial outcome of a particular set of estimated costs, revenues and fixed and capital charges for delivering a service over time.
Funding competition	A process whereby the financing for a project is obtained after a competition involving several potential funders rather than being provided by an incumbent funder retained by the project consortium appointed as preferred bidder.
Invitation to negotiate	A document giving detailed information about the services to be provided and the proposed PFI contract and inviting bidders to submit bids for the contract.
Invitation to tender	A formal communication to selected suppliers
Key Performance Indicators	The detailed standards of performance the authority requires a contractor to provide.
Life cycle capital expenditure	Expenditure to maintain the fabric of the building including the replacement of building components, plant and equipment.
Market testing	The re-tendering on the market of services to test the value for money of that service.
Net Internal Area	A measure of the size of the floorspace which is calculated by adding the area taken up by the primary circulation (main routes by which people walk around the building, including emergency escape routes) to the Net Usable Area (the floor space available for locating desks, equipment and storage cabinets).
Net present value	The net present value of the contract price represents the amount that would have to be invested at the start of the contract to fund the expected future cash payments which an authority will be required to make to the contractor.
Open Plan	Workspace where there is unobstructed access (i.e. no doors or full-height partitions) between the working area (usually desks) and the main circulation route through the building.
Preferred bidder	A bidder selected from the shortlist to carry out exclusive negotiations with the Department.

Private Finance Initiative	A policy introduced by the Government in 1992 to harness private sector management and expertise in the delivery of public services, while reducing the impact of public borrowing.
Public sector comparator	A benchmark against which value for money is assessed. It is typically a cost estimate based on the assumption that assets are acquired through conventional funding and that the procurer retains significant managerial responsibility and exposure to risk.
Refinancing	The process by which the terms of the funding which was put in place at the outset of a PFI contract, are later changed during the life of the contract, usually with the aim of creating refinancing benefits for the consortium company. Refinancing may be possible where the risk of a project has reduced due to, for example, the construction phase of a project being successfully completed.
Repayment period of loan	The date by which the last instalment of principal is due so that the loan is repaid in full.
Residual value	The value of an asset at the end of its useful economic life.
Senior debt	The debt that is ranked highest in terms of claims on project cashflows and therefore carries the lowest risk that it will not be repaid.
Subordinated debt	Debt over which senior debt takes priority. In the event of bankruptcy, subordinated debt lenders receive payment only after senior debt is paid off in full.
Termination liabilities	The amount of compensation payable by the department to the consortium' banks in the event of premature contract termination. Depending on the circumstances of the termination, the compensation may be lender liabilities or the residual value of the contract.
Value for money	Achieving the optimum combination of whole life cost and quality to meet customer requirements.

Appendix 1 Study scope and methodology

Study Scope

1 The objective of this study was to examine the value for money issues surrounding this high profile PFI deal to provide central London headquarters accommodation and associated services for the Home Office. We used an issue analysis approach to design the scope of the examination and nature of the evidence required. That is, we set a series of high-level audit questions that we considered necessary to answer to assess whether or not the deal had been worthwhile. For each of the top level questions, we developed a subsidiary group of questions to direct our work and analysis. The top-level questions we set were:

- Was the Home Office clear in its objectives?
- Did the Home Office apply effective procurement processes?
- Was the best available project solution selected?
- Are there adequate arrangements for managing the solution reached?

Study Methodology

2 We collected information from a number of sources in order to obtain evidence that would allow us to answer the above questions. In particular we undertook a wide-ranging review of documentary evidence provided for us by the Home Office and its advisers. We also interviewed key staff within the Home Office as well as other parties and stakeholders. Further information on how the interviews we undertook were used to address the issues, is provided in **Figure 12 overleaf**.

12 Interviews undertaken by the National Audit Office during its examination

Interview	Issues Examined
The Home Office and its Advisers	
Home Office (Accommodation project team, HM Prison Service, Information Technology working group, Trade Unions)	Option appraisal Procurement process and commercial strategy issues Contract management after financial close Modernisation strategy; achievement of wider business benefits Information Technology Property strategy Staff numbers
PricewaterhouseCoopers (Home Office financial advisers)	Public Sector Comparator Financing Payment Mechanism
Knight Frank (Home Office property advisers)	Property strategy
Berwin Leighton Paisner (Home Office legal advisers)	Legal issues
Partnerships UK	General procurement and commercial strategy issues financing
Private Sector Partners on the deal	
AGP	bid process and commercial strategy contract management after financial close
HSBC (equity funding)	procurement process financing
Royal Bank of Canada (bond arranger)	financing
Other Government Departments	
Department for Constitutional Affairs	property strategy
Office of Government Commerce	Option appraisal Property strategy Achievement of wider business benefits

Appendix 2 Public Sector Comparator

1 A Public Sector Comparator (PSC) is an estimate of what the project would cost if traditional procurement methods were used but still meeting the performance standards expected from the private sector deal over the life of the contract. The PSC is normally used to determine whether private finance offers better value for money than traditional procurement.

2 The PSC for the Home Office accommodation project was originally developed in 1998 when the envisaged solution was refurbishment of the existing Home Office estate. The financial advisers on the project, PricewaterhouseCoopers, were responsible for development of the second PSC which represents the whole life cost of central London accommodation at 2 Marsham Street under a conventional procurement process.

How the Public Sector Comparator was used

3 The PSC was used to compare the costs in the PFI bid with estimates of costs under a conventional procurement but it was recognised that the overall evaluation needed to consider the wider benefits of the solutions. The Home Office also continued to use the previous PSC (which represented the cost of refurbishing the existing estate under conventional procurement) to compare costs of the PFI deal with the public sector refurbishment option.

Basis of the Public Sector Comparator

4 The PSC was based on an assessment of the likely costs of a hypothetical set of contracts to construct and operate 2 Marsham Street, including construction costs, lifecycle capital expenditure, operating costs and an assessment of the risks associated with these costs. In determining inputs and risk adjustments, the Home Office were advised by professionals with expertise in construction, accommodation services and property.

5 The PSC also includes costs that would be retained by the Home Office in either the conventional procurement or the PFI scenario, such as revenue from disposal of the existing estate, running costs for the existing accommodation before occupation of 2 Marsham Street and business rates. It was necessary, therefore, to add these costs to the PFI bid unitary payment stream to allow a like-for-like comparison between the PSC and the cost of the PFI solution. However, the costs added to the PFI solution have been adjusted to reflect savings expected to accrue under PFI. The Home Office assumed that the construction period would be longer under conventional public sector procurement as the PFI timetable was considered ambitious. Under PFI, savings in the running costs of the existing estate and revenue from disposal of the existing estate, would be generated earlier.

Comparison with the PFI deal

6 **Figure 13** compares the risk-adjusted net present cost[12] of the PSC with the net present cost of procuring accommodation through PFI, in each case including those costs to be retained by the Home Office under either scenario. **Figure 14 opposite** shows how the costs of individual components of the PSC, have been adjusted for risk.

13 Comparison between the Net Present Cost of the PFI deal and the Public Sector Comparator

	Public Sector Comparator	PFI transaction
Unitary Payment Stream (NPC)	N/a	311
Conventional procurement costs including risk adjustment	494	149[13]
Total	**494**	**460**

Source: National Audit Office

12 *The net present cost represents the amount that would have to be invested at the start of the contract to fund the expected future cash payments. In this case, it is calculated as the total of the amounts payable expressed at 2002 prices and discounted at six per cent per annum to the start of the contract. At the time the comparison between the PSC and the private sector bid was made, use of a discount rate of six per cent was in accordance with the Treasury's guidance.*

13 *Costs which have been retained by the Home Office are included in the Public Sector Comparator and have been added to the cost of the PFI solution to allow a like-for-like comparison. However, the costs added to the PFI solution have been adjusted to reflect savings expected to accrue under PFI. The Home Office assumed that the construction period would be longer under conventional public sector procurement as the PFI timetable was considered ambitious. Under PFI there would be savings in the running costs of the existing estate because of its earlier vacation and the earlier revenue from its disposal.*

14 Risk adjustment to the Public Sector Comparator

Component	NPC (£m)	Risk adjustment to the PSC
Property (including site acquisition, disposal of surplus land and residual value)	-21	**Total risk = 7% (£1.5m)**
Construction costs (including development, pre-operating and insurance costs)	-199	**Total risk = 5% (£9.1m)** Risks associated with demolition, foundation construction, unforeseen problems with the site, design cost overrun, time overrun, furniture cost assumptions and inflation assumptions were identified.
2 Marsham Street running costs	-107	**Total risk = 27% (£28.9m)** Quantified risks included predicting the costs of a service, service standards not being met and the potential impact of market testing on indexation rates.
Pension and redundancy costs	-3	
Cost of running existing buildings (including rent) until 2 Marsham St is ready for occupation	-87	N/a
2 Marsham Street running costs not included in PFI bid	-14	
Rates for existing buildings and for 2 Marsham St	-108	N/a
Property Strategy (sale of surplus buildings)	49	**Total risk = 7% (£3.5 million)** Estimated by Knight Frank
Operating insurance	-4	**Total risk = £4 million**
	-494	**TOTAL RISK = 9% (£47 million)**

Source: National Audit Office analysis

7 Overall, the Home Office determined that the PSC is £34 million higher than the cost of procuring accommodation through PFI. In examining the adjustments made for risk, we note the following points.

- The relatively low risk adjustment (£9.1 million or five per cent) to the construction costs reflects the view that the construction of 2 Marsham Street was not expected to be particularly technically demanding. Most of the risks relate to those associated with the demolition and unforeseen problems with the site.
- The PSC running costs include a high risk adjustment (£29 million, 28 per cent). The Home Office's evaluation of AGP's bid noted that running costs were high compared to the competing bid but took the view that the PFI bid as a whole was value for money and that it was not possible to cherry pick individual elements. At selection of preferred bidder, the running costs were reduced in detailed negotiations of the payment mechanism, without material dilution of service quality.
- It is not government policy to insure its buildings but the Home Office decided to include the cost of basic insurance and the cost of insuring the building against latent defects as a surrogate for risk. This is in accordance with general recommendations on constructing PSCs which suggests commercial insurance may be used as an approximation of the value of risk borne by the Government.
- The total risk adjustment in the PSC is £47 million (nine per cent). However, this calculation includes the element of the PSC which is for costs retained by the Home Office in either case. The risk adjustment to the element of the PSC which equates to the PFI payment stream is £42 million (12 per cent).

Sensitivities

8 The Home Office compared the cost of the PFI solution to a single PSC figure, rather than a range to reflect the uncertainty associated with the PSC costs. To determine the PSC's sensitivity to its risk adjustment, a simulation[14] was carried out which determined a standard deviation of £7 million, 15 per cent of the total risk adjustment and 1.5 per cent of the total value of the PSC.

9 In addition to the modelled risk adjustments, the Home Office also identified other sensitivities that could affect the comparison between the PSC and the cost of the PFI solution including the cost of surrendering the Queen Anne's Gate lease, impact of changes in interest rates on the cost of financing the PFI deal, impact of changes in property values and risks associated with compensation claims for rights of light. The Home Office concluded that while the 2 Marsham Street solutions carried more risk, in all but the least likely, worst case scenarios, the analysis showed that the PFI bid was the cheapest solution.

14 *In order to adjust the PSC for risk, minimum, maximum and most likely values were assigned to the inputs where there was judged to be risk. A mean adjustment was then calculated for each risk in the PSC and a simulation package (Crystal Ball) was used to model the total risk in the PSC and the uncertainty associated with the calculation, expressed by the standard deviation.*

Appendix 3 The Payment Mechanism

1 As an incentive for the PFI contractor to provide the required level of service, the Home Office has designed a mechanism to determine how much the contractor should be paid each month, depending on the level of performance obtained compared to contractually agreed criteria.

The combined payment

2 The Home Office will pay the PFI contractor an annual sum of £30.2 million less deductions for poor performance. This Accommodation Services Charge is paid in monthly instalments along with a Monthly Usage Payment for services which are dependent on the volumes used, e.g. laundry, catering. The total of these two payments is the Monthly Combined Payment, as shown in **Figure 15**.

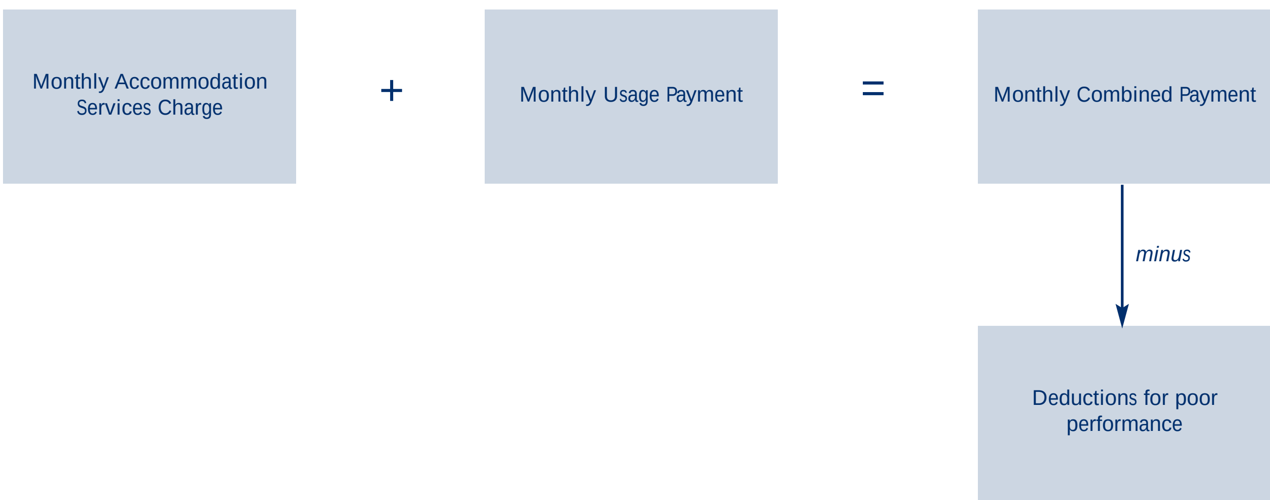
Figure 16 overleaf shows the mechanism for making performance deductions and for reporting performance levels to the Home Office.

How the performance deductions are calculated

3 Performance deductions fall into two categories as demonstrated in Figure 16. Firstly, a performance deduction will be made when accommodation is actually unavailable. Each area of the building is weighted according to its importance (critical, normal or low) and unavailability is penalised according to weighting. Accommodation will be declared unavailable when contractually specified standards of temperature, humidity, noise, light and fresh air are not met. If none of the accommodation is available, the Home Office will not pay anything to the contractor.

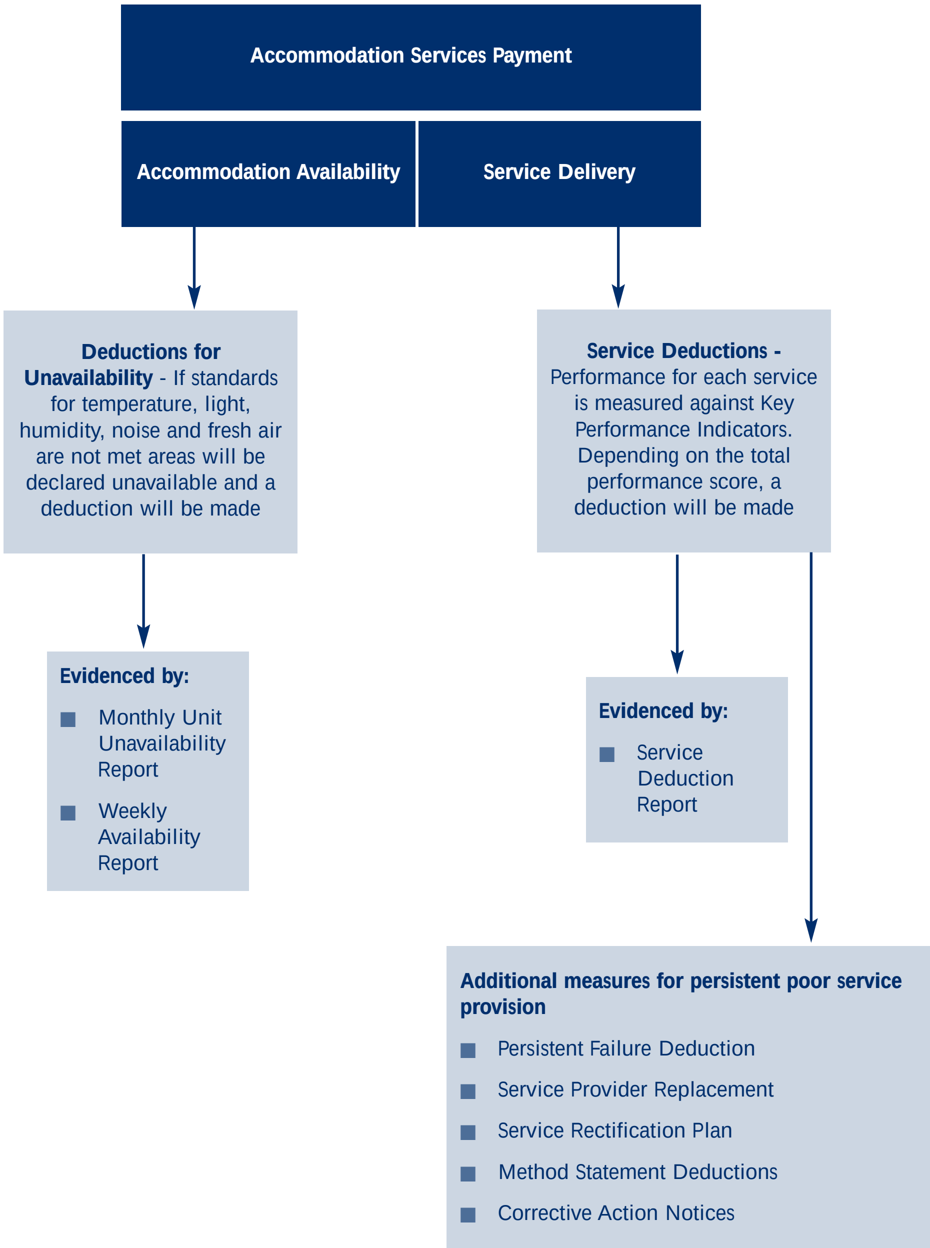
4 Secondly, performance deductions are made when contractually agreed service levels are not met. Individual services are grouped into 'bundled services' and weighted according to proportion of the total service cost. Performance delivery for elements of each service is measured against key performance criteria and scored. Individual scores for each element feed into a service score for each bundled service and an overall score which is used to calculate a performance deduction percentage figure.

15 Calculation of the Monthly Combined Payment



Source: National Audit Office

16 Mechanism for making performance deductions to the Accommodation Services Payment



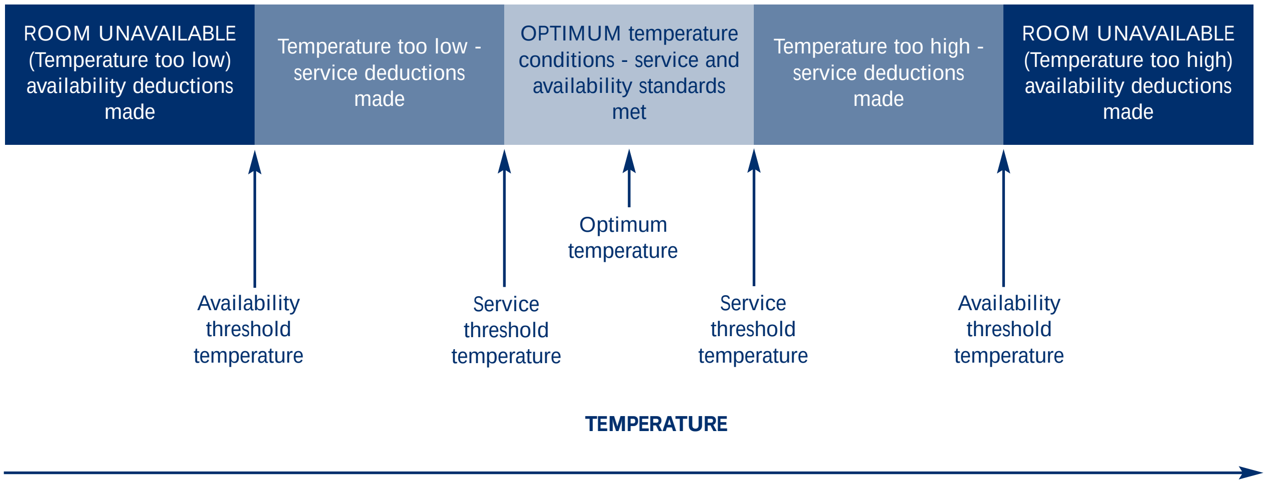
Source: National Audit Office

5 Poor performance in some services could result in either a service deduction or an availability deduction but it is not possible for the contractor to be penalised twice. For example, **Figure 17 opposite** shows that if the temperature of a particular room was too high or too low, it would be scored against the Key Performance Indicator for temperature and an appropriate deduction would be made. However, if temperature rose above a specified threshold, the room would be declared unfit for purpose and would be unavailable. In that circumstance, a higher penalty would be levied as an availability deduction.

6 The contract also contains additional measures to discourage on-going poor performance. These are:

- **Service Rectification Plan** - if there is persistent poor service in a category, the Home Office can require the contractor to produce an improvement plan;
- **Service Provider Replacement** - consistently poor scores in the same bundled service allows the Home Office to oblige AGP to replace the relevant service provider;
- **Persistent Failure Deduction** - successive months of poor performance will result in increased deductions for the same performance shortfall;

17 Circumstances in which either a service deduction or availability deduction is made



Source: National Audit Office

- **Method Statement Deduction** - deduction from the combined payment will be incurred if the contractor varies the specified method of service delivery for a period that is longer than has been agreed;
- **Corrective Action Notices** - the Home Office can step-in and carry out services itself if, after being served notice, the contractor fails to perform. The contractor will then have to pay costs and expenses which exceed the proportion of the combined payment relating to this service.

While, taken on their own, these additional measures are not necessarily novel to PFI, the Home Office considers that in having all these tools available, it has a robust mechanism for incentivising performance.

7 AGP will be responsible for performance measurement in accordance with monitoring methodologies in the contract that set out how each Key Performance Indicator will be measured, how often it will be measured and how this will be reported to the Home Office. Figure 16 shows the evidence that has to be provided. The Home Office can inspect any monitoring carried out by the contractor and can ask to examine audit material. If the Home Office finds that the contractor has not been fulfilling its performance measurement obligations, it can monitor performance itself, at the contractor's cost.

Appendix 4 Allocation of Risk

This appendix provides details of the risks that have been retained by the Home Office, the impact if the risk materialises and the action the Home Office has taken or is taking to manage the risk.

Risk	Impact if risk materialises	Mitigation/management of the risk
IT infrastructure specification would become out of date because of developments in technology	Updating a contractually agreed specification may result in an extra cost to the Home Office	■ The Home Office deferred finalising the specification until the latest possible date, 12 months after financial close. That date has now been met although negotiations over the price of enhancements are ongoing.
The PFI contractor is responsible for installing the IT infrastructure, but not for its maintenance. There is therefore a risk that it will not be incentivised to ensure that the infrastructure meets quality standards	Potential maintenance problems and associated costs outside the PFI deal	■ The Home Office intends to examine options for maintaining the infrastructure this year and undertake any procurement in 2004. ■ The Home Office plans to have a robust testing procedure to ensure that the infrastructure is only accepted by the Home Office, IT suppliers and the IT infrastructure maintenance provider if it meets set standards.
Business risk associated with a double decant - original proposals to redevelop the existing estate would have necessitated the Home Office moving out into temporary accommodation in the existing building at 2 Marsham Street and then moving back again	Disruption, risk to business continuity	■ One of the reasons why the Home Office considered the 2 Marsham Street new build option attractive, and eventually proceeded with it, was that it avoided this double decant. Nevertheless it is not clear what the Home Office would have done to mitigate the business risk associated with a double decant if the new build option had not arisen.
Risk that it will not be possible to house all staff in one building	Requirement to identify accommodation to house the excess and associated cost	■ It first became clear that the Home Office was forecasting increases in staff numbers beyond the 2920 expected when BAFOs were invited in 2000. The preferred bidder was invited to provide for an additional 530 staff in the new building, bringing the total that can be accommodated to 3450. ■ Actual numbers are now 4900 and although the projection for 2005 is currently under review, it is likely that there will be a significant excess to be accommodated. Options are being considered but at present there are no firm proposals.
A related risk is that until the projected staff numbers for 2005 is clear, the Home Office may need to amend its announced plans for which directorates are allocated floors in the new building. This could result in a delay to any plans the Home Office has to prepare the staff for its new accommodation and associated changes in working practices. It may also slow down migration to the new building if final numbers become clear too close to completion	Could be difficult for the Home Office to secure business benefits	■ The projection for 2005 is currently under review and expects to report in July 2003. ■ It is not clear what the Home Office are currently doing to manage staff expectations in this respect. Up to 1400 staff may not be accommodated in the new building - at the moment it is not clear who they will be or where they will be accommodated. ■ These issues are being considered by Home Office top management.
Risk that the contractor will not deliver quality services	Home Office would not be getting what they wanted from the deal	■ The contractor will only begin receiving payment when the building is available for occupation and the Home Office has declared it fit for purpose. The Home Office designed a payment mechanism to incentivise the contractor to achieve availability and service levels and this was the subject of considerable negotiation at preferred bidder stage. The payment mechanism includes a number of additional measures that come into play if there is any continuing shortfall in performance.

Risk	Impact if risk materialises	Mitigation/management of the risk
Risk that full occupation of the office building in 2 Marsham Street cannot take place due to residential/commercial development not being complete.	Under the planning permission, the Home Office could not fill the final 25 per cent of floorspace. The Home Office would have to seek alternative accommodation.	■ The Home Office consider that this likelihood is remote since Bouygues is responsible for the construction on both the office and the residential/commercial development. Failure to complete on time and allow full occupation of the office building would result in the AGP consortium (of which Bouygues is a member) foregoing receipt of the Combined Payment. The monoline insurer, Ambac, is entitled to step-in rights and complete the residential/retail development if AGP do not meet a 'longstop' date for completion of this development. ■ The Home Office have received a non-binding letter from Westminster City Council stating that planning conditions may be varied to allow full occupation even if the residential/commercial development is not complete to the required extent.

Reports

Reports by the Comptroller and Auditor General, Session 2002-2003

The Comptroller and Auditor General has to date, in Session 2002-2003, presented to the House of Commons the following reports under Section 9 of the National Audit Act, 1983:

Agriculture

Reaping the Rewards of Agricultural Research ....HC 300
Fisheries Enforcement in England ....HC 563

Cross-Government Reports

The Invest to Save Budget ....HC 50
Using call centres to deliver public services ....HC 134
Progress in making e-services accessible to all - encouraging use by older people ....HC 428
Developing effective services for Older People ....HC 518
Improving service delivery:
- The Veterans Agency ....HC 522
- The Forensic Science Service ....HC 523
- The Food Standards Agency ....HC 524
- The role of Executive Agencies ....HC 525

Getting the evidence: Using research in policy making ....HC 586-I
Getting the evidence: Using research in policy making An international review on Governments' research procurement strategies.......................................HC 586-II
Purchasing and Managing Software Licences ....HC 579

Culture, Media and Sport

Community Fund: Review of grants made to the National Coalition of Anti-Deportation Campaigns ....HC 519
Film Council: Improving access to, and education about the moving image through the British Film Institute ....HC 593
Progress on 15 major capital projects funded by Arts Council England ....HC 622
The English national stadium project at Wembley....HC 699

Defence

Major Projects Report 2002 ....HC 91
Ministry of Defence: The Construction of Nuclear Submarine Facilities at Devonport ....HC 90
Through-Life Management ....HC 698

Environment

Protecting the Public from Waste ....HC 156
Warm Front: Helping to combat fuel poverty ....HC 769

Europe

The European Court of Auditors report for the year 2001 ....HC 701

Housing

Improving social housing through transfer ....HC 496

Inland Revenue

Tackling Fraud against the Inland Revenue ....HC 429

Law, Order & Central Institutions

Community Legal Service: the introduction of contracting ....HC 89
New IT systems for Magistrates' Courts: the Libra project ....HC 327
Modernising procurement in the Prison Service ......HC 562

National Health Service

Facing the Challenge: NHS Emergency Planning in England ....HC 36
Innovation in the National Health Service - the acquisition of the Heart Hospital ....HC 157
Safety, quality, efficacy: regulating medicines in the UK ....HC 255
Ensuring the effective discharge of older patients from NHS acute hospitals.....................................HC 392
Safer Place to Work: Protecting NHS staff from violence and aggression ....HC 527
A Safer Place to Work: Improving the management of health and safety risks to staff in NHS trusts ......HC 623

Overseas affairs

Maximising impact in the water sector ....HC 351

Public Private Partnership

The PFI Contract for the redevelopment of West Middlesex University Hospital ....HC 49
PFI: Construction Performance ....HC 371
PPP in practice: National Savings and Investments' deal with Siemens Business Services, four years on ......HC 626
Northern Ireland Court Service PFI: The Laganside Courts.....................................HC 649
The Operational Performance of PFI Prisons ....HC 700
PFI: The New Headquarters for the Home Office ....HC 954

Regulation

The Office of Fair Trading: Progress in Protecting Consumers' Interests...HC 430
Department of Trade and Industry: Regulation of weights and measures......................HC 495
The New Electricity Trading Arrangements in England and Wales ....HC 624
The Office of Telecommunications: Helping consumers benefit from competition in the telecommunications market ....HC 768

Social Security

Tackling Pensioner Poverty: Encouraging Take-up of Entitlements ....HC 37
Department for Work and Pensions: Tackling Benefit Fraud ....HC 393
Improving service quality: Action in response to the Inherited SERPS problem ....HC 497

Transport

Highways Agency: Maintaining England's Motorways and Trunk Roads..................................HC 431

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