# PFI: The New Headquarters for the Home Office

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# Summary

**In this section**



**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

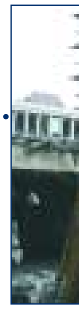
**2** The Home Office reviewed its accommodation requirements in 1996, and concluded that there were deficiencies in its existing estate. By 2002, it occupied three leasehold and three freehold buildings in central London, mostly in poor condition and of inflexible design and internal layout. Although, 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.

OCT ’02

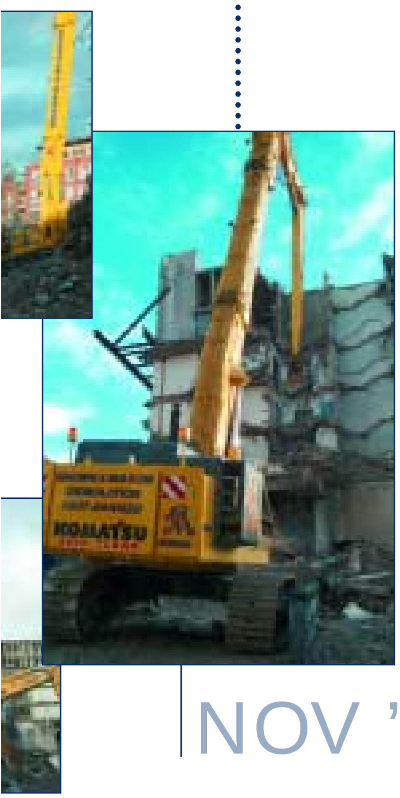
**6** The Home Office also identified other potential accommodation, but it was either too expensive compared to the Marsham Street deal or the location was considered unsuitable. Furthermore, it assessed the cost of procuring accommodation through leasing a building at market rent and paying separately 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.

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.

FEB ’03

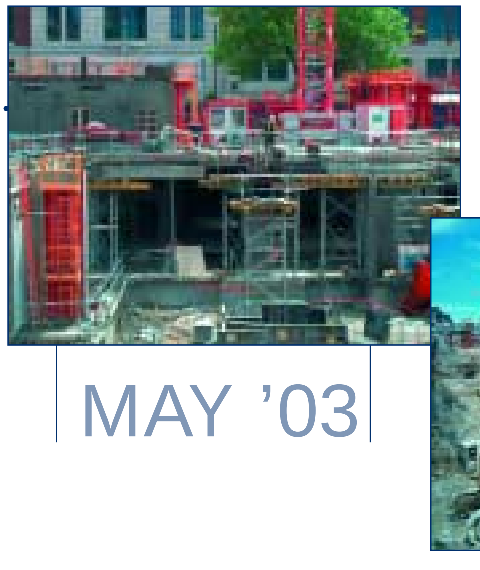
### A good price for financing was obtained

**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

APR ’03

**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.



MAY ’03