National Audit Office

The Regeneration of the Greenwich Peninsula: A Progress Report

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SUMMARY

1 This report is a follow-up to the NAO's 2005 report on the *Regeneration of the Millennium Dome and Associated Land*.[1] The 2005 report examined the process for selling the Millennium Dome and associated land and the resulting deal. The sale was conducted under difficult circumstances following an unsuccessful competition to find a buyer solely for the Dome. We concluded that the resulting deal offered an integrated solution for the regeneration of the Greenwich Peninsula and offered the Government a sensible exit strategy from the Dome.

2 The Department for Communities and Local Government (the Department) has strategic responsibility for delivery of the Greenwich Peninsula regeneration and English Partnerships (EP), the Department's national regeneration agency, manages the delivery. The Greenwich Peninsula lies within the Thames Gateway region, which is also undergoing an ambitious regeneration and development programme. The NAO reported on the management of this programme in 2007[2] and made a series of recommendations to help the programme deliver its goals more effectively. Developments on the Peninsula contribute to Thames Gateway housing targets so EP collaborates with the Thames Gateway Executive where appropriate.

3 Under the Greenwich Peninsula project, EP manages a series of contracts agreed with its consortium partners, undertakes a broader role in fulfilling the original sale objectives, and manages wider relationships with other stakeholders. The objectives of the Greenwich Peninsula project are to: i) maximise the long-term receipts to the taxpayer from the development of land; ii) ensure that the development of the Peninsula proceeds without undue delay and along lines acceptable to EP in terms of achieving sustainable communities; and iii) ensure the development of the Dome as quickly as possible, securing its sustainable future.

4 It is four years since the project commenced and the regenerated Dome, now called The O_2, has been open for a year. The development is still at an early stage, however, and faces inherent risks and challenges which mean it is only possible to come to firm conclusions about early progress compared to the initial plans, rather than on the longer term outcomes. EP has to manage the risks over the lifetime of the project to ensure obligations are met and to achieve maximum benefit for the taxpayer. This report, therefore, looks at the evolving risks and how well they are being managed.

5 Our main conclusions are:

Value for money conclusion

6 To secure the redevelopment of the Greenwich Peninsula, the Government disposed of a mixed portfolio of assets including the Dome itself and the surrounding land. The Dome has become a highly successful entertainment venue and a beacon for a new community on the Peninsula. The wider redevelopment of the surrounding land has been less successful. Some commercial and educational developments are underway earlier than planned initially. The delivery of new housing has, however, fallen behind schedule. It will be difficult for the housing programme to recover the lost ground to meet original targets because the rate of building required to do so is very demanding. As a consequence of these delays, the taxpayer's likely return from the redevelopment has fallen significantly. The structure of the deal means that the delays have affected the taxpayer more than the private sector. The Government should consider whether future deals can be structured to align better the interests of the public and private sectors.

1 *The Regeneration of the Millennium Dome and Associated Land*, HC 178 Session 2004-05, 12 January 2005.
2 *The Thames Gateway: Laying the Foundations*, HC 526 Session 2006-07, 23 May 2007.

Progress of redevelopment

7 The Dome has become a highly successful entertainment venue. Strict contractual obligations on the Dome's new owners, AEG, meant that the Dome opened as The O_2 on time in June 2007. In the first six months of opening (24 June–31 December 2007) over 1.2 million tickets were sold for the O_2 Arena and 90 per cent of the annual target of 150 events in the Arena had been arranged. The O_2 was reported to be the most popular music venue in the world for 2007 according to industry figures for tickets sold for music events for the relevant period. The O_2 has also had a positive effect on local employment with 62 per cent of employees coming from the Thames Gateway. The O_2 has become a beacon for the new development.

8 Progress on new housing has been delayed. Although the deal was signed in 2002, it only became unconditional in 2004. The start of house-building on the site – which is the majority of this development – has been delayed by two years compared to the original 2002 forecasts which formed the basis of the deal (see paragraph 2.7). Under these plans, the first land was to be sold for development in June 2005. Conditional land sale agreements were exchanged in September 2006 with the first sale taking place in July 2007 when all conditions were satisfied. MDL now acknowledges that the original plans were overly optimistic and that the development is more difficult to deliver than originally thought.

9 It will be difficult for progress to catch up with the original plans. MDL's 2008-2011 forward programme involves a greater rate of building than originally anticipated. MDL has also changed its strategy towards greater direct development. While this approach has potential to put progress back on track, MDL will have to commit more of its own resources to the project, and the accelerated building rate will demand a greater commitment of time from EP and Greenwich Borough Council. To date the parties are seeking to manage the demands of planning processes, but their ability to deliver construction on site to an accelerated timetable is unproven. And the planned increase in development is constrained by the market's ability to absorb additional supply of housing. All these factors together increase the risk of the project not being able to achieve its target contribution of 4,250 housing units to the Thames Gateway regeneration programme by 2016.

10 MDL and EP have taken advantage of opportunities to bring forward commercial and educational developments earlier than planned. This means that a mixed-use community, which is an important basis for creating a sustainable community, will be present early on in the project. Furthermore, the project scored well against fourteen (out of our 20) key criteria for a sustainable community which means that there is potential for one to be created on the Peninsula.

Forecast financial returns to the taxpayer

11 The financial model used to estimate returns is out of date. The financial return to the taxpayer from such a long term land deal is inherently uncertain and is affected by factors including the timing of development and economic conditions. As a result, it is important that EP regularly assesses the impact of changes on expected taxpayer returns by using an up-to-date financial model. The current best estimate derives from a financial model which is now out of date in that it does not reflect the current phasing and timing of development. EP and MDL have been working since end 2006 on a new more sophisticated financial model for estimating the return, but are still in the process of agreeing it, because of the complexity of the model and the contracts on which it rests.

12 Current estimates of the taxpayer's expected return from the deal, though unreliable, show a reduction of £45–60 million compared to initial forecasts. Subject to the caveats in paragraph 11, the current best estimate shows a forecast reduction of between £45–60 million (depending on assumptions about the appropriate discount rate) from the forecast net present value of £216.4 million calculated at the outset of the deal. While it is impossible to be precise about the reduction in value based on the current financial model, delay to the housing development has eroded financial returns, since the present value of future income is lower when received later in time compared to income received earlier because of the time value of money and the greater risks involved.

13 The structure of the deal means that delays have a greater impact on the current estimated returns to the taxpayer than those of the private sector. The terms of the contractual agreements mean that the bulk of EP's returns are generated later in the deal. Delay, therefore, has had a proportionately greater impact on EP than on MDL. EP receives minimum land value payments upfront and most of its profits later in the life of the agreement. In negotiating the deal, EP weighed the arguments for deferring or advancing its share of the profits. Deferring its share would mean that EP benefited if property values rose over the life of the agreement. Advancing its share, by contrast, would mean that EP was less exposed to downturns in property values and delays. EP judged that deferring its profit share was in the interests of the taxpayer, taking into account expected changes in property prices and the need for all parties to have confidence in each other's long term commitment. Without formal levers in place to accelerate the pace of development, EP has, however, had to rely on its influencing and brokering skills to ensure that the project is as profitable for the taxpayer as was first anticipated.

14 EP has started to clarify the detailed operation of profit sharing arrangements on the O_2 Arena. EP is entitled to financial returns from The O_2 Arena and Waterfront. Following commercial advice in 2002, EP did not take these potential returns into account when appraising the deal. The Committee of Public Accounts recommended in 2005 that Departments should attempt to quantify the likelihood and nature of such upsides to help maximise potential additional benefits to the taxpayer. EP considers that undertaking this exercise before now would not have provided meaningful data as The O_2 has only been operational since June 2007 and nor would the timing of the exercise impact on the level of its profit share entitlement which is governed by legal agreements. EP has begun to agree with AEG the practicalities of accessing information and calculating the profit share. The legal agreements provide for full access to the records and accounts of the tenant company, an AEG subsidiary, through which The O_2 business is wholly conducted. The legal agreements also contain protection provisions to ensure intra-group costs are validated and relevant records and accounts are provided. EP does not, however, have explicit legal access to the records and accounts of the AEG Group and it is not clear whether it will be difficult in future to access all relevant information to scrutinise and, if necessary, challenge the allocation of costs.

Governance, accountability and risk management

15 The Department seeks to hold EP to account for the delivery of this project. The delivery of housing under the project contributes to the Department's and EP's corporate targets. The Department is responsible for holding EP to account and, given the high profile of this particular project, reviews progress with EP twice yearly.

16 EP's ability to influence and work in partnership with other stakeholders is key to the delivery of its targets. EP can influence the quality and profitability of the project but, as in other regeneration deals of this nature, the contract for the redevelopment of the Peninsula contains few levers for EP to control the pace of delivery, particularly where development would not be economically viable because of high cost to value ratios. In general, where public sector land is sold for housing and a rate of development above the market level is required, the developers will reflect this increased risk in the cost they are willing to pay to purchase the land or may be reluctant to accept the risk at all.

17 There is no single forum for all stakeholders to coordinate their input into the project. There are regular forums, principally a Project Control Group, consisting of representatives from EP and MDL, which meet regularly to review progress and discuss operational issues. EP has also facilitated bilateral relationships with different parties to address various challenges (see Case Study, p.16). But there is no strategic forum, involving all of the project's principal stakeholders, with responsibility for ensuring that the long-term vision of creating a sustainable community is realised. EP and the Department agree that it would be sensible to establish such a forum and are in the process of doing so.

Recommendations

18 On the basis of the study's findings, the National Audit Office recommends that:

Progress of redevelopment

a **EP should conduct a full analysis of the factors which contributed to the delay to the project.** EP has started this process and should put in place a protocol for dealing with factors should they arise again in the future, whilst recognising that the process of commercial negotiation within the open market place cannot always be controllable. For example, in light of the delay to residential development EP has refined its standardised documentation for negotiating with third party developers. This now requires MDL to report any variations required.

Forecast financial returns to the taxpayer

b **EP should agree explicitly with AEG how it will access profit share information and calculate its financial returns by the end of 2008**, which will be 18 months after the opening of The O_2. This access should include the relevant records and accounts of the AEG Group, which would give EP assurance that the taxpayer will receive a fair and timely return from the activities of The O_2 Arena and Waterfront.

c **EP should implement the PAC recommendation to Departments to develop an estimate of the total expected return from this project.** Now that The O_2 is open this should include its share of profits made from the Arena and the Waterfront.

d Within a long-term deal, change is inevitable and this will have an impact on the returns to the taxpayer. **EP should ensure that the new financial model allows for an understanding of the impact of change on the value of its interest in the Peninsula land-based deal**, particularly where it is involved in approving changes. In these situations, it should review the balance between its returns and those of MDL and ensure that that these are in accordance with the legal entitlement.

Governance, accountability and risk management

e **The Department and EP should set up a strategic forum involving the project's principal stakeholders.** Such a forum should have the means of examining at regular intervals that the project is on track to achieve its vision. The forum should consider the Greenwich Peninsula project in the wider context of delivery within the Thames Gateway and should involve at a minimum the Department, EP, MDL, AEG, Greenwich Borough Council, the Greater London Authority, Transport for London and the Housing Corporation. The Department and EP have accepted this recommendation.

f **The project should be subject to robust and external accountability arrangements.** While the Department has established specific oversight arrangements for this project, the Department's level of oversight should be enhanced, particularly in terms of challenging and achieving milestones. The Department has accepted this recommendation and is taking steps to implement it.