National Audit Office

Report
by the Comptroller
and Auditor General

Ministry of Defence

Delivering the defence estate

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Key facts

1.8%
percentage of UK land mass managed by the Ministry of Defence

£4.8bn
spend by the Ministry of Defence on its estate in 2015-16

30%
target reduction in the Ministry of Defence's 'built' estate by 2040

424,000	hectares of land and foreshore that the Ministry of Defence (the Department) owns or has access rights to in the UK as at 1 April 2016
30 million square metres	current size of the 'built estate'
55,000	the number of new homes to be built on land the Department releases between 2015 and 2020
£1 billion	amount the Department must make from land disposals between 2016-17 and 2020-21
£2.4 billion	overall financial benefit of delivering the Department's strategy for managing the defence estate (called the Footprint Strategy)
£8.5 billion	current estimated minimum shortfall in funding needed over the next 30 years to replace parts of the defence estate, according to operational lifespan and current condition and assuming successful implementation of the Footprint Strategy
£475 million	current estimated cost of the backlog of work to maintain the defence estate
£328 million	expected fees to be paid to the Department's strategic business partner over 10 years to improve management of the defence estate

Summary

Background

1 The Ministry of Defence (the Department) holds one of the largest estates in the country, accounting for approximately 1.8% of the UK land mass and valued at £31 billion. The defence estate is crucial to the country's defence capability. It includes land and also buildings such as offices, houses, storage units and training facilities (the 'built estate'). In 2015-16 the Department spent £4.8 billion (12%) of its budget on the estate, mainly on maintaining, building and upgrading the built estate.

2 Between 1987 and 2010 we reported five times on how the Department manages its estate, including its failure to align it with military need. Our past reports suggest that some of the reasons for this failure include a lack of agreement within the Department on the size, location and composition of the estate; poor management information on which to base decisions; and an inability to align the interests of different stakeholders. Additionally, most of the estate is in use and often cannot be disposed of without providing essential facilities elsewhere.

3 In 2011 the Department established the Defence Infrastructure Organisation (DIO) to manage the estate centrally. The objective was to cut costs, drive further rationalisation and create commercial opportunities for using the estate.

4 The government has set targets for the Department to reduce its built estate by 30% by 2040 and, as part of its Spending Review settlement, it must also make £1 billion between 2016-17 and 2020-21 by disposing of estate that it no longer needs. The Department is also the largest contributor to the government's objective of releasing land to build 160,000 new homes between 2015 and 2020, and has a target of releasing enough land to build 55,000 homes.

5 The Department has prepared a strategy for the defence estate for the period 2015 to 2030 which sets out its vision to deliver an estate "that is affordable and optimised to enable Defence capabilities, outputs and communities both now and in the future". The Department defines affordable as being able to fund the cost of sustaining an estate that enables it to meet its strategic commitments, at an acceptable level of risk to military capability.

6 Given the scale and complexity of the task it faces in regards to its estate, the Department recognises that it is not yet in a position to identify what an optimised estate should cost and then deliver it. Instead, it is focusing on rationalising its estate onto a smaller footprint that is more efficiently organised, more intensively used, with assets in better condition, and that enables it to meet the short-term targets it has been set.

Scope

7 This report assesses whether the Department is well placed to deliver the estate it needs to meet its strategic objectives, and has addressed the barriers to progress that we have identified in previous reports. In Part One we describe the defence estate, factors that influence how the Department manages it and the Department's vision for a more optimal estate. We then assess whether the Department:

- has a coherent strategy in place to provide a defence estate that meets defined military needs and is affordable within available resources (Part Two); and
- has an appropriate operating model in place to support its long-term strategy for the defence estate (Part Three).

8 Our study focuses on the UK estate managed by DIO because this accounts for most of the Department's spending on the estate. DIO's management of the overseas estate is not within the scope of this study.

Key findings

9 **The Department faces a huge challenge in maintaining its estate.** Because of long-standing pressure on its budget, the Department has carried out only essential maintenance on its estate since 2009. It only acts where the health and safety of those using the estate is at risk. As a result, there has been a steady decline in the overall condition of the estate. Increasingly, assets have needed to be replaced rather than repaired. In the longer term, this is more costly (paragraphs 1.8 and 2.6).

10 **The constraints on funding for its estate are leading the Department to make decisions that are poor value for money in the longer term.** Demand for funding significantly outstrips available budgets. To manage the estate within its budget, the Department has made decisions that subsequently offer poor value for money in the longer term, including the 1996 decision to sell and lease back the majority of Service Family Accommodation, which is now limiting the Department's ability to manage this element of the estate cost-effectively. The Department has adopted a portfolio approach of prioritised estate projects to try to achieve stability and certainty in what projects will go ahead and to focus its investment more effectively, similar to the approach taken to managing projects buying and supporting military equipment. However, the lack of contingency funds to meet unexpected costs and lack of certainty about future budgets undermine the Department's programme to invest in its estate (paragraphs 2.3 to 2.5 and 2.7).

11 **There is a significant risk that the poor condition of the estate will affect the Department's ability to provide the defence capability needed.** The estate is an important element of defence capability, enabling the Armed Forces to train and undertake operations, and providing accommodation for personnel and their families. The Department's inability to invest sufficient funds may jeopardise the delivery of new and existing capabilities. The Department now faces a shortfall of at least £8.5 billion in its future funding for 'lifecycle replacement costs', based on the expected size and condition of its estate, over the next 30 years. As the estate's condition deteriorates, some parts may wholly or partially close. This will exacerbate other risks and could reduce operational readiness. Furthermore, poor accommodation for service families is affecting the morale and the recruitment and retention of service personnel (paragraphs 1.8 to 1.11).

12 **Plans to delegate infrastructure budgets to the Commands have risks which must be managed if the anticipated benefits are to be secured.** The Department believes delegating estate budgets to the Commands, as it has done with the budgets for equipment and staffing, will enable them to balance demands across their budgets to better tackle the risks of the estate failing. However, the Commands' underinvested in the estate when they previously held this budget prior to 2011, which is a significant cause of the problems the Department now faces. Also, the Commands' budgets are already stretched. The Department will consider the balance between the estate, equipment and people as part of its 2017 budget planning (paragraphs 3.24 to 3.26).

13 **The Department has now set out a plan that supports the delivery of military capability and makes a significant contribution to government targets.** After many years of limited progress in determining the size and shape of the estate it requires, in 2016 the Department set out a vision for its estate in 2040 that supports military capability, while meeting government targets. The Footprint Strategy sets out innovative plans for making a significant contribution to the Department's targets to reduce the size of its estate by 30%, release land for new housing and secure disposal receipts for reinvesting in the estate. The Footprint Strategy built on the Army Basing Plan announced in 2013, which set out a future basing strategy for the Army, including bringing back troops from Germany (paragraphs 2.9 and 2.20).

14 **The Footprint Strategy is based on assumptions and estimates and the Department expects that its plans will evolve over time.** The Department expects to refine the information on which decisions in the Footprint Strategy to keep, dispose and invest in the estate are based. In doing so it expects to reduce the estimated cost of re-providing essential facilities. However, if the Department fails to secure the disposal proceeds predicted, or costs increase, this could reduce the financial benefits of the strategy and cause potential funding gaps. The Department anticipates that more than 40% of disposal proceeds will come from disposal of a few sites in London, which are uncertain. The Department does not have enough funds to finance the strategy in full and is exploring other finance models, including Private Finance 2, which could be more expensive and less flexible than direct government financing (paragraphs 2.16 to 2.19).

15 **Successfully implementing the Department's Footprint Strategy will be extremely challenging.** The Department has set out at a high level how it intends to deliver the Footprint Strategy. However, at the current time its plans are untested and based on a number of assumptions. Many of the estate disposals, re-provisioning of essential facilities and personnel moves are interdependent. If the Department fails to keep to its timetable, or to achieve the forecast proceeds from disposing of sites or keep within its forecast for re-provision costs, there is a significant risk of long delays in implementing the overall strategy. Our case studies illustrate the many complications with disposing of the estate. Sustaining focus over the 25-year life of the strategy will be difficult, with yearly budgeting cycles and five-yearly strategic defence and security reviews (paragraphs 2.21 to 2.24).

16 **The risks to military capability from the estate will continue unless further actions are taken to address the shortfall in funding to sustain the estate.** Due to the scale and complexity of the challenges facing the Department, it was never the Department's intention that these would be fully addressed by the Footprint Strategy. The Department is aware that even after successful implementation of the Footprint Strategy, current assumed budgets will only allow for a partial reversal of the decline of its remaining estate and that there will be a gap of at least £8.5 billion in relation to the funding required to sustain the estate. As a result there will be continuing risks to its ability to support military capability. It is considering further proposals for reducing the cost of its estate and achieving a better balance between the estate, personnel and equipment it needs to deliver military capability. However, it has not yet set out a strategy for achieving an optimised estate that can be sustained at acceptable risk within planned funding levels (paragraphs 1.14 and 2.25 to 2.27).

17 **There were fundamental weaknesses in the Department's contracting with a strategic business partner.** The Department let a novel contract in 2014 to a private sector consortium, led by Capita, to become its strategic business partner running the organisation and helping it achieve savings which had already been removed from its budget. The Department failed to set contractual safeguards to ensure savings are achieved from operational improvements, which was the primary aim of the contract, rather than one-off cost-cutting. The key performance indicators regime set in the contract to measure DIO's performance has weaknesses. Around half of the contract's key performance indicators were not in place at the start of the contract. Also, the Department assessed that reported performance against the indicators did not reflect the Commands' perceptions of how DIO was performing (paragraphs 3.4 to 3.6, 3.9 and 3.10).

18 The Department failed to transform DIO prior to contracting with the strategic business partner, which limited the benefits of the contract. The Department's intention was to first transform DIO and then contract with a private sector partner to bring in new management with specialist skills to deliver the savings the Department could not achieve on its own. However, the Department failed to deliver the transformation it expected to before the partner joined DIO, including putting in place an effective operating model supported by a single IT system. This failure has affected the partner's performance and created complexity in relation to the Department's ability to hold the partner to account for its performance. It also meant that the strategic business partner took on an organisation that was less capable, and therefore presented greater risks that DIO could be improved as per the contract (paragraphs 3.7, 3.8, 3.11 and 3.12).

19 Although there have been some improvements, the strategic business partner's performance has not met all expectations and has not made a notable difference in transforming DIO to better meet the needs of the Commands. The Department recognises the partner's success in turning around some of DIO's troubled programmes and developing the Footprint Strategy. But the partner has not met all milestones or performed adequately against agreed key performance indicators. The Department also considers that the partner has failed to manage certain key contracts adequately or improve internal controls effectively, and that many stakeholders across defence have lost confidence in DIO's ability to deliver the requirements of the Commands. The Department acknowledges that some factors have been outside the partner's control, including the underfunding of the estate and decisions that the Department has taken in the past. The Department paid the strategic business partner £90 million between June 2014 and July 2016 (paragraphs 3.13 to 3.17).

20 The Department does not yet have an overall model for managing the estate effectively. In 2011 the Department undertook large-scale change of how the estate was managed. It believed that both creating DIO to centrally manage the estate and prioritising the Commands' estate needs would improve its management and enable it to cut costs. In 2014 it made further changes by contracting with the strategic business partner to manage DIO and upskill staff. However, the overall model for managing the estate has not worked. Roles and responsibilities are unclear, governance arrangements are confused and DIO still does not have the skills and capabilities it requires. The Department is undertaking a fundamental review of how its estate is managed and the role the private sector will play. Further change, coupled with poor staff morale within DIO, may lead to delays rationalising the estate and could compound the risks to military capability from infrastructure (paragraphs 3.18 to 3.35).

Conclusion on value for money

21 The Department has started to improve its management of the defence estate. It has recognised demand for funding significantly exceeds budgets. Past actions it took to live within its means are now leading to increased costs overall and creating risks to military capability. In response the Department has developed a strategy which identifies the estate it needs and the 25% of its estate it can dispose of by 2040 to reduce costs. However, the success of much of this strategy is uncertain. There is a risk that anticipated financial benefits will not be realised and that long delays and gaps in funding will emerge. The strategy and current funding levels also allow only for a partial reversal of the decline in the condition of the remaining estate. The Department has not yet set out how it will fully address the significant challenges it faces sustaining the whole of its estate and the resulting risks to military capability.

Recommendations

22 The Department should:

a **Develop a more comprehensive view of the estate liabilities that will remain following the implementation of the Footprint Strategy, including what it will need to spend sustaining the entire estate.** Until the Department improves its visibility of its future commitments, and how these will be affected by the Footprint Strategy, it cannot target available funding to achieve optimal value for money from its estate.

b **In light of the above, undertake a detailed review to assure itself that it has optimised the strategic balance of investment between the estate and other elements of capability, such as personnel and equipment, at the departmental and Command level.** In the absence of this, there is a significant risk that the poor condition of the estate could jeopardise the delivery of military capability.

c **Develop detailed plans that set out how the Department will close the gap in funding to sustain the estate to an acceptable level of risk to military capability.** The Department is aware that even after successful implementation of the Footprint Strategy, it will not be able to afford to sustain its remaining estate and that this will present continuing risks to its ability to support military capability.

d **In the longer term, the Department should work out what the estate should cost in the context of the military capability it needs to deliver its strategic commitments and a plan to achieve this estate.** The Department's current approach aims to better align its estate with available resources in order to meet government targets and as a first step towards achieving optimal value for money. The Department is not yet in a position to identify what an optimised estate should cost and then deliver it.

e **Engage early with stakeholders critical to delivery of its Footprint Strategy, including local authorities, the Department for Communities and Local Government and the Cabinet Office.** Greater certainty about the Department's future plans provides an opportunity for it to address complications relating to disposals in advance of their scheduled delivery date.

f **Work with HM Treasury to identify financing options for the Footprint Strategy which do not place significant restrictions on the Department in relation to its future use of the estate.** The Department is considering the cost and flexibility of alternative financing options.

g **Provide clear information to Parliament on how it is managing the complex risks to delivery of its Footprint Strategy.** It should do this by reporting regularly both on progress to date and projected performance against its long-term strategy and medium-term implementation plan. Regular reporting will help the Department sustain focus on the strategy and enable Parliament to monitor its progress.

h **Ensure that, whichever overall operating model it decides upon to implement its estates strategy, responsibility and accountability for managing the estate are aligned and those who use the estate are incentivised to do so cost-effectively.** Without clear lines of accountability it will be difficult to improve the Department's performance in relation to its management of the estate.

i **Put in place strong safeguards, prior to delegating estate budgets, to ensure that the Commands give the estate the attention it requires and that they have the incentives, information and skills they need to manage their estate assets and budgets effectively.** Delegating the estate budget to Commands should put them in the best position to make difficult trade-offs but would create a risk that they will under-invest in the estate in favour of equipment and staff.