National Audit Office

Report
by the Comptroller
and Auditor General

HM Revenue & Customs

Managing the HMRC estate

HC 726 SESSION 2016-17 10 JANUARY 2017

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO, which employs some 785 people. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of £1.21 billion in 2015.

National Audit Office

HM Revenue & Customs

Managing the HMRC estate

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 9 January 2017

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

6 January 2017

HC 726 | £10.00

This report examines whether HM Revenue & Customs is well placed to deliver its new estates model, which meets its changing operational needs.

11334 01/17 NAO

Key facts

£269m
total running cost of the HMRC estate in 2015-16

30%
reduction in HMRC's annual estate running costs since 2010-11

£83m
expected reduction (31%) in annual running cost of HMRC's estate by 2025, compared with its current estate

£3.2bn	HMRC's latest estimate of its estate costs over the next 10 years
£588m	HMRC's forecast investment in its new estate
137	HMRC's offices planned to close by 2021
38,000	employees will need to move offices to regional centres, or leave HMRC
27%	reduction in the size of HMRC's estate since 2010-11
£354m	total savings achieved on its estate between 2010-11 and 2015-16
15 m^2	average space per person in HMRC's estate in March 2015 as outlined in HMRC's strategic outline case for its new estate strategy
8 m^2	target for average office space per person in the government estate by March 2018

Summary

1 HM Revenue & Customs (HMRC) has a strategy to redesign and significantly reduce its estate over the next 10 years. It plans to move from a current estate of 170 offices to 13 large regional centres, supplemented by four specialist sites and a headquarters in central London.

2 As of November 2016, HMRC had nearly 1 million square metres of buildings. It spends around £269 million each year running its estate to accommodate its 58,600 staff. It sublets 15% of its estate to other government departments.

3 HMRC has been reducing the size of its estate for six years. Across its whole estate, it has moved out of almost 300 buildings and cut its estate by 27%, reducing its annual running costs by £102 million and saving a total of £354 million since 2010-11.

4 HMRC has achieved more than half of this reduction by moving out of excess space under the terms of its STEPS (Strategic Transfer of Estate to the Private Sector) contract. STEPS is a 20-year private finance initiative (PFI) deal set up in 2001 with Mapeley STEPS Contractor Ltd (Mapeley). Under the deal, HMRC sold its freehold properties, which comprised two-thirds of its estate, to Mapeley for £370 million. HMRC immediately leased back the properties from Mapeley, with Mapeley providing facilities management and maintenance services. As HMRC has reduced its workforce over this period, it has moved out of some of these buildings each year. The remaining third of HMRC's current estate is managed under smaller PFI deals and individual leases with landlords.

5 We reported on HMRC's management of the STEPS contract in 2004 and 2009.[1] In our 2004 report, we identified significant risks with STEPS that HMRC needed to manage carefully. In 2009, we found that HMRC had not been managing those risks effectively, and it had not realised the benefits available from the contract. In particular, HMRC had not made all the savings possible by moving out of as many buildings as the contract allowed. We recommended that HMRC should have full access to Mapeley's financial data to give it a better understanding of Mapeley's profitability and that it should negotiate more effectively to achieve better outcomes through the contract.

1 Comptroller and Auditor General, *HM Revenue & Customs' estate private finance deal eight years on*, Session 2009-10, HC 30, National Audit Office, December 2009; and Comptroller and Auditor General, *PFI: the STEPS deal*, Session 2003-04, HC 530, National Audit Office, May 2004.

6 HMRC's strategic business case identifies three main reasons why it is seeking to move from a widely dispersed estate to regional centres:

- it considers a different estate is necessary to support the wider transformation of its business. It sees regional centres as offering the right infrastructure and working environment to enable new digital ways of working for its customers and staff;
- HMRC's programme will support the wider civil service agenda to move to shared government hubs, supported by a regional network of mini-hubs; and
- the end of the STEPS contract in 2021 provides an imperative for HMRC to act and an opportunity to reconfigure its estate on a large scale.

7 HMRC's programme to rationalise its estate is one of 15 major programmes it is implementing concurrently to transform how it operates and administers tax. It aims to become "one of the most digitally advanced tax administrations in the world". HMRC's transformation is large and complex, and many of the programmes within it are interdependent. **Figure 1** shows the strategic aims of HMRC's transformation programme and how the plans for its estate support its wider objectives.

8 This report takes an early look at HMRC's plans for its new estate and the actions it is taking to implement them. First, we consider the strength of the strategic case for HMRC to move to regional centres. We then evaluate how well HMRC has managed the STEPS contract since our last report in 2009 and how effectively it is preparing for the end of the contract in 2021. Finally, we look at early indicators of the challenges HMRC faces in implementing its strategy and identify some of the risks it has to manage over the next five years.

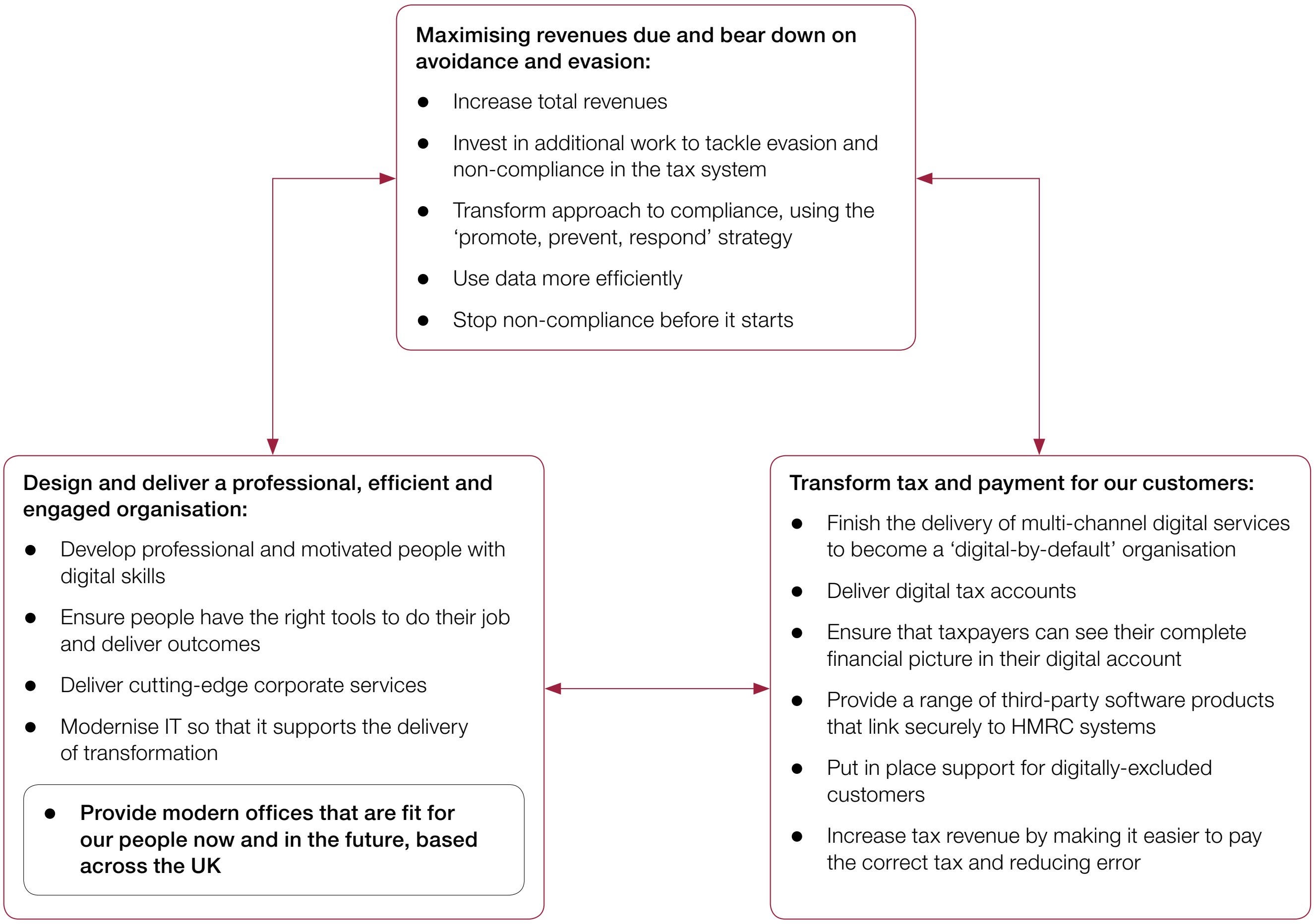
Key findings

On the strategic case for the move to regional centres

9 HMRC has concluded that moving to regional centres will provide the flexibility necessary to modernise and transform the way it works. HMRC has more space than it needs and much of it is in poor condition, which HMRC considers reduces morale and productivity. It has assessed that large regional centres will help it work more efficiently and flexibly with fewer staff, supporting collaboration, knowledge sharing and economies of scale. They should also give its employees more career options and help it to recruit high-quality graduates with the skills HMRC will need to change the tax system to a primarily digital service. HMRC's plans for regional centres are therefore integral to its strategic aims to increase tax revenue by bearing down on tax evasion and avoidance and to transform the service it provides to its customers (paragraphs 1.5 to 1.9, 1.14, and Figures 2 and 3).

Figure 1

HMRC's strategic aims and transformation



Source: National Audit Office analysis of HM Revenue & Customs' single departmental plan 2015–2020

10 **HMRC has assessed that the move to regional centres will mean substantially lower running costs in the long term.** While HMRC has reduced the size and cost of its estate over the last six years, the scale of the changes it could make has been limited by the terms of its long-running STEPS contract with Mapeley, which expires in 2021. In its November 2015 strategic outline case for moving to regional centres, HMRC estimated that it would continue to make savings over the next eight years as it leaves most of its existing buildings. Beyond 2024-25, it estimated it would achieve a sustainable reduction of between £80 and £100 million in the annual cost of holding and maintaining its estate (paragraphs 1.15 to 1.18, 2.11 to 2.13 and Figure 4).

11 **HMRC has designed its strategy to support government's objectives to create government hubs that will be shared by government departments.** The government intends to modernise and rationalise the estate occupied by central government departments by moving civil servants to shared government hubs, allowing departments to collaborate more effectively and achieve economies of scale. The timing of HMRC's plans, created by its imperative to take decisive action before the end of the STEPS contract, place it in the vanguard of government's proposed move to shared hubs. It is working with the Government Property Unit (GPU) to ensure its new centres align with the locations chosen for cross-government hubs and meet the expected design standards (paragraphs 1.11 and 1.12).

On the management and the end of the STEPS contract

12 **HMRC's ability to achieve the outcomes it wants from its estate has been impaired by the STEPS contract.** Our 2009 report on the STEPS deal identified features of the contract which reduced its value for money, including the actions necessary for HMRC to understand the risks it would face should the contract end prematurely. HMRC has assessed that Mapeley's performance under the contract has fluctuated since then: while it had recovered from a low point in 2013-14, Mapeley's performance in 2014-15 remained below the quality standards HMRC had set. HMRC's payments to Mapeley for facilities management were reduced by just under £700,000 to compensate for Mapeley's underperformance in that year. This equates to around 2% of what HMRC pays to Mapeley annually for this part of the contract (paragraphs 2.3, 2.4, 2.7 to 2.10 and Figure 5).

13 **HMRC's regional centres need to be up and running and its estate plans settled before the end of the STEPS contract in March 2021.** HMRC's business case identified that if it stayed in STEPS properties beyond 2021, its rental and service costs would increase. Its aim is to occupy regional centres before this happens, and it has sought to make decisions about its choice of locations early in order to negotiate with Mapeley about the time frame for leaving existing buildings. Its aim to occupy regional centres quickly has meant in some locations having to balance the need to achieve timely occupancy against cost and quality (paragraphs 1.15, 2.14 and 2.17).

14 **HMRC has significantly improved its management of the STEPS contract, achieving cumulative savings of £354 million since 2011.** It has responded to the recommendations of the NAO and the Committee of Public Accounts by using almost all of the allowances within the contract to move out of buildings. It has closed 160 buildings managed under the contract, and reduced the annual cost of the contract by £54 million (paragraphs 2.11 to 2.13 and Figure 6).

15 HMRC has also improved its working relationship with Mapeley and achieved a better understanding of the performance of the contract. In 2009, the NAO found that HMRC did not have full visibility under the contract of Mapeley's gains and losses, particularly on renegotiated leases that may ultimately affect its liabilities in the event of contractor default. The Committee of Public Accounts recommended that HMRC should insist that Mapeley provides much greater transparency about the financial performance of the contract and its profitability. Since 2010-11, HMRC has had open access to Mapeley's books, giving it a good understanding of the operational and financial performance of the contract (paragraphs 2.4 to 2.6, and Figure 12).

16 HMRC continues to manage the risk of the STEPS contract ending prematurely. We reported in 2009 that Mapeley's finances would continue to be finely balanced for the foreseeable future and profits would remain low for the lifetime of the contract. HMRC has continued to monitor and manage the risk to Mapeley's financial health since then, and has established a team to oversee the period until the end of the contract. Should the contract not run until 2021, some buildings within the STEPS estate would revert to HMRC's ownership and responsibility, potentially leaving HMRC with properties in poor condition that it no longer needs. In these circumstances, HMRC would be faced with the costs of maintaining and improving buildings it does not intend to stay in long term, and would need to manage the disposal of properties which might not have a ready market (paragraphs 2.16 to 2.20).

Early indicators of the risks and challenges HMRC faces in implementing its strategy

17 HMRC's original plan has proved unrealistic. During the transition to regional centres, HMRC must ensure that its service to taxpayers and its ability to collect tax revenue are not impaired. It has concluded that suitable property will not be available in some of its chosen locations within the time frame set out in its 2015 spending review settlement. HMRC now estimates it may lose up to 5,000 staff as a result of the move to regional centres. It will therefore need to recruit to its new centres and train new staff, while managing redundancies and the moves of existing employees and operations into new buildings. It has concluded that its original plans were over-optimistic about the availability of suitable properties and carried too high a risk of disruption to its business, as they involved moving or replacing too many staff too quickly, while delivering other major change programmes in parallel (paragraphs 3.7, 3.8, 3.14 and 3.15).

18 HMRC is reconsidering the scope and timing of its moves to some regional centres to reduce costs and delivery risks over the next five years. Since its spending review settlement in November 2015, HMRC's estimate of its estate costs over the next 10 years has risen by nearly £600 million (22%), more than half of which is due to higher than anticipated running costs for its new buildings. It has also identified that slippage in the timetable for some regional centres had led to an unmanageable peak of activity scheduled for 2019-20. HMRC is considering the actions necessary to reduce this peak and stay within the funding it has secured between now and 2020-21. It tells us that it will reach this decision shortly. (paragraphs 3.4 to 3.6 and Figure 8).

19 HMRC has reduced its estimate of the benefits of the programme and now expects them to come later. As some of the moves to regional centres will now happen later than HMRC had planned, it will be longer until HMRC starts to realise savings. In the long term, it still expects its new estate to reduce its running costs. It now estimates cumulative efficiency savings by 2025-26 of £212 million, reduced from the £499 million estimated in its strategic outline case in November 2015. By 2025-26, HMRC expects its annual running costs to be £83 million lower than they are now (paragraphs 3.12 and 3.13).

20 Changes to reduce costs and delivery risk could diminish the long-term value of the strategy. HMRC is now considering actions to reduce the costs and the risks of disruption over the next four years. It is looking at a range of options, including: changing the timetable for opening and filling regional centres; reconsidering the functionality, location and size of individual units to determine the best mix of staff to undertake some work; adding a transitional site in East London to ease the disruption in the South East; changing where to focus its recruitment effort; and reassessing how and when to introduce flexible ways of working. HMRC must manage the risk that such changes compromise its objectives to improve the engagement, morale and productivity of its workforce while achieving sustainable savings in the cost of running its estate in the long run (paragraphs 3.7 to 3.11).

21 HMRC has yet to define fully how regional centres will support better customer service and more efficient and effective compliance activities. HMRC has signed the contract for its first regional centre in Croydon, but faces a demanding timetable to occupy the site as it plans in 2017. HMRC's move to regional centres will require good coordination across HMRC to ensure that everyone involved in the moves understands what is expected of them. It must therefore clarify what changes in working practices are necessary to support digital services and its future compliance model, and coordinate its design of regional centres to achieve these outcomes (paragraphs 1.9, 1.10 and 3.19 to 3.22).

22 HMRC must manage the risk that it locks itself into long-term property deals which limit its flexibility to change its future business model. HMRC is now implementing its third major change programme since the merger of the Inland Revenue and HM Customs and Excise in 2004. While the move to regional centres is consistent with its wider transformation plans, it should not assume that the business model it designs now will remain its optimal state indefinitely. HMRC therefore needs to weigh the cost of property deals against the benefits of having the flexibility to make future changes. It has not negotiated any break points in the 25 year leases it has signed so far for regional centres in Croydon and Bristol. HMRC aims to provide flexibility through a mix of lease terms across the estate, maintaining the ability to sublet to other parts of government, and by working with the GPU to provide for future flexibility in the design of cross-government hubs (paragraphs 3.26 and 3.27).

23 HMRC's decisions and what it learns from the relocations are critical to the success of the government's plans to reconfigure its estate. HMRC's decisions about the buildings it will occupy will affect the choices other departments will have. It is early days in implementing HMRC's move to regional centres, but important that HMRC takes stock of what it learns over the next few years, both to optimise its own decision-making and to inform the plans of the GPU and other government departments (paragraph 1.14).

Conclusion on value for money

24 It is important to see HMRC's estate strategy in two ways. First as a major programme in its own right, and second, as a component in HMRC's wider business transformation. From the standpoint of the estate strategy itself we can conclude that the handling of HMRC's STEPS contract has improved, and is more likely to deliver value for money though significant risks remain. As far as the new programme is concerned, HMRC has already recognised that its original plan was unrealistic and it is considering how it can adjust the scope and timing of the programme to reduce the cost and delivery risk. It is, of course, better management practice to recognise cost underestimates early and to consider options for recovery early as well. However, we think it important for HMRC to step back and consider the benefits afforded by the wider business transformation, and whether they might be reduced or placed at risk by cutting back on, or delaying, the estate plans, before going ahead.

Recommendations

25 HMRC is seeking to implement an ambitious estate strategy alongside 14 other major programmes designed to transform the way it administers the tax system. Many of these programmes are interdependent. It is inevitable that not every aspect of the transition to regional centres will run smoothly and HMRC must learn as it goes and respond proactively as issues arise. It should:

a Improve its control of the costs of the new regional centres. HMRC needs to be realistic in re-forecasting costs and guard against optimism bias. Given the inherent uncertainty in the property market, it should plan for the worst case rather than risk basing its plans on optimistic assumptions. It should put in place an adequate contingency for the programme of regional centres as a whole to make it resilient to emerging cost increases.

b Plan in detail how the infrastructure it is putting in place through regional centres will support the ways of working its business aspires to. HMRC has yet to demonstrate how in practice the regional centres will help its employees provide a better service to customers while increasing the efficiency and effectiveness of its compliance work. It should prioritise engagement with its business to identify what features of the new estate will be most important to support working practices that will deliver the outcomes it is seeking.

c Put in place a process to learn lessons by analysing the costs and benefits of occupying and operating regional centres. HMRC should be clear how it will establish whether it is achieving the benefits it expects from its regional centres once they become operational, and at what cost. It should identify and apply good practice from its occupation of the Croydon regional centre in 2017, and evaluate how its forecasts of the timetable, costs and benefits were affected by events. It should build a framework to compare the performance of the regional centres by identifying each centre's annual running costs, service levels and business outcomes.

d Build in flexibility to respond to future changes in technology and working practices. In negotiating property deals for the regional centres, it must therefore balance cost considerations against the benefits of retaining flexibility to make future changes to its estate.