

Thames House and Vauxhall Cross

**Report by the
Comptroller and Auditor General**

Thames House and Vauxhall Cross

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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.

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Comptroller and Auditor General

National Audit Office
7 February 2000

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Thames House and Vauxhall Cross

1 In 1992 and 1995 I produced classified reports to Parliament (in the form of memoranda) on the purchase and refurbishment of Thames House and on the purchase and fitting out of Vauxhall Cross - new buildings for the Security Service and the Secret Intelligence Service respectively. In accordance with the then arrangements for dealing with matters arising from my audit which involved the intelligence agencies, the memoranda were not published but were brought to the attention of the Chairman of the Committee of Public Accounts.

2 The Government has decided that these documents may now be published. I therefore append the three memoranda:

Appendix A - Purchase of Buildings for the Security Service and the Secret Intelligence Service (March 1992)

Appendix B - Refurbishment of Thames House (November 1995)

Appendix C - Fitting out of Vauxhall Cross (November 1995)

They are reproduced exactly as they were written and provided to the Chairman of the Committee of Public Accounts in 1992 and 1995 save for the replacement of a few words/figures with asterisks where the Government has decided that the information remains sensitive.

3 Based on the first of these memoranda, the Rt Hon Robert Sheldon MP, then Chairman of the Committee of Public Accounts, took evidence from the then Cabinet Secretary and the Accounting Officer of Property Holdings on 30 March 1993. In June 1993 he produced a report on the results of his enquiries. He wished to publish this report rather than simply make his views known to the Government. But the Government of the day refused publication as they deemed the matter secret. During his Chairmanship and since, he and his successor have continued to press for publication but successive governments refused to do so. Mr Sheldon's report is now reproduced at Appendix D, again with a few asterisks substituted where the Government considers the information remains sensitive.

4 By way of background, it may be helpful to explain the circumstances surrounding my audit at the time these reports were produced and the arrangements in place for the Chairman of the Committee of Public Accounts to deal with them.

5 In 1982 my predecessor provided the then Committee of Public Accounts with a note setting out the Comptroller and Auditor General's position in relation to the disclosure of classified information (9th Report of Session 1981-82, Appendix 1, paragraphs 11-12). He said that, formally, there was no restriction on the Comptroller and Auditor General's freedom to reveal any information which he considered relevant to his audit examinations. In practice, however, the Comptroller and Auditor General would not disclose in Reports to Parliament any information which was highly sensitive on security grounds. In such circumstances he would consult the Chairman of the Committee about the handling of such material. It was, and it remains, a matter for the relevant department and their ministers to determine and to defend the classification of material and the extent to which its release might be prejudicial to the national interest.

6 In January 1987, the then Chairman of the Committee (Official Report, 27 January 1987, cols 246-249) told the House of Commons about the Committee's arrangements for dealing with highly classified material. He said that the Comptroller and Auditor General would draw such matters to the attention of the Chairman who would make the enquiries himself that the Committee would make were it in session. He affirmed that these arrangements had been put before the Committee and that the Committee had accepted them.

7 The purchases and the early part of the refurbishment and fitting out of the buildings for the Security Service and the Secret Intelligence Service took place at a time when the existence of the Secret Intelligence Service was not officially acknowledged. At that time the Secret Services Vote, which provided for the salaries and expenses of the Security Service and the Secret Intelligence Service, was not subject to my audit. I relied solely on certificates provided by ministers under an arrangement agreed by the Committee of Public Accounts in the last century (1887 Report (HC 201) paragraphs 35-36). Since 1947, however, expenditure on stores and capital items, unless of an especially secret nature, had been met from votes open to my inspection, as recommended by the Committee of Public Accounts (4th Report 1945-46 (HC 172), paragraph 26). In practice, this was from votes maintained by the Foreign and Commonwealth Office and the Ministry of Defence and the civil estate votes.

8 The Security Service Act 1989 (ss1(1)) acknowledged the existence of that Service but it was not until the Intelligence Services Act 1994 (ss1(1) and ss3(1)) that the Secret Intelligence Service and the Government Communications Headquarters were put on the same statutory footing. Before the latter Bill was introduced, the Prime Minister told the House (Official Report, Written Answers, 24 November 1993, col 52) that he intended that all the expenditure of the

Intelligence Agencies would be on a Single Intelligence Vote, which would be fully open to my scrutiny, apart from limited restrictions to protect the identities of certain sources of information and the details of particularly sensitive operations. If I needed to see such information for audit purposes I would apply to the relevant Minister. So far this has not been necessary.

9 The Intelligence Services Act and the Security Service Act made provision for the relevant Secretaries of State to make arrangements which allowed the agencies to release information to me. These arrangements made under the Act provide me with full access to the agencies' records, subject to the restrictions referred to by the Prime Minister. The arrangements also prevent me from divulging the information I have obtained and re-state that I should continue to consult the Chairman of the Committee of Public Accounts about the handling of National Audit Office reports dealing with highly classified material on the lines described to the House in 1987 (paragraph 6 above). It is this restriction which the Government has now lifted in relation to the reports here attached.

Appendix A

Property Services Agency/Cabinet Office

Purchase of buildings for the Security Service and the Secret Intelligence Service

Background

- 1 The Security Service and the Secret Intelligence Service are currently located in several buildings in central London, with disadvantages in terms of division of business. Furthermore some of the buildings are old and do not always lend themselves to present day requirements - for example, to information technology. The Services have therefore for some time been considering improvements and alternative accommodation.
- 2 In 1984 a survey was carried out of the Secret Intelligence Service's possible need for new accommodation. The report, in 1985, raised serious concerns about the security of their existing building; some protective measures were put in hand immediately but it was considered irredeemably insecure.
- 3 In 1986 a review of the Security Service's current estate of 319,000 sq ft in various buildings in different parts of London considered that accommodation in a cluster of small buildings or at a single location in the Westminster area would be preferable.
- 4 In the following period various alternatives were considered and ministers were consulted on a number of occasions. Security requirements, however, ruled out a number of buildings (eg where ground floor shops or residential accommodation formed part of a building or were a planning requirement). Sites outside central London and out of the south-east conurbation were explored but ministers agreed with both organisations that their headquarters needed to be within easy reach of certain government departments in Westminster/Whitehall and New Scotland Yard. Ministers also accepted that there was little scope for dispersal of staff or operations outside the London area.
- 5 The possibility of co-locating the organisations in one building was also considered on value for money grounds - though this was not an operational requirement. In the event, however, it proved impractical to find a building or

site of sufficient size in central London (forecast needs were for net areas of 406,000 sq ft for the Security Service and 350,000 sq ft for the Secret Intelligence Service). Ministers also agreed that there were strong security disadvantages in co-location.

- 6 This memorandum considers separately the purchases of the buildings eventually chosen: Thames House for the Security Service (paragraphs 7 to 33) and a building at Vauxhall Cross for the Secret Intelligence Service (paragraphs 34 to 59). It also considers briefly refurbishment and fitting out costs (paragraphs 60 to 63). On 1 April 1990 the responsibilities of the Property Services Agency for the acquisition of property on behalf of the government were transferred to Property Holdings, part of the Department of the Environment.

Thames House

- 7 Thames House, on Millbank, was owned by Imperial Chemical Industries Ltd. It comprised two buildings - North and South. Thames House North was part occupied by the owners. Thames House South was partly held by the Property Services Agency, as part of the Government's Civil Estate, on leases which expired in 1982; it was occupied by the Department of Energy.
- 8 As recorded in my Report of March 1990 on the purchase of a new building for the Department of Energy (HC 303, paragraphs 1.2 and 1.3), the owners offered new leases for Thames House South beyond 1982 which included an obligation on the tenant for repair and day-to-day maintenance. The Property Services Agency did not agree to these terms because the owners would not first carry out major refurbishment. After expiry of the leases the Agency took advantage of their rights under the Landlord and Tenant Act 1954 to renew the lease at a more favourable rent than the owners had offered. Anxious to redevelop the building, the owner initiated court proceedings which it did not activate until 1986. These proceedings were extinguished in January 1987 when the Agency signed a short lease for occupancy until December 1989 at the latest; this agreement ended the lessee's rights under the Landlord and Tenant Acts but provided for the owner to pay £3.3 million in compensation when vacant possession reverted.
- 9 The Property Services Agency had had discussions with Imperial Chemical Industries intermittently since 1980 about buying various freehold interests in Thames House but had been unable to reach agreement on price. The latest in this series of negotiations began in February 1987 when Imperial Chemical

Industries made a fresh approach. At that time the Agency had no firm plans for the building. In early March, to offer ministers a basis for comparing the cost of a number of options for rehousing the Security Service, they made a rough estimate, without the benefit of a survey, of the cost of acquisition and refurbishment of the North and South buildings to a basic office standard - which they indicated might be of the order of £100 million (at 1987 prices). Ministers were attracted by the prospect of acquiring more freehold property for the Government Estate but considered the price was too high when they had no specific occupant in mind. Recognising the strategic advantages of a building in close proximity to Whitehall, however, they agreed that negotiations could continue.

- 10** The Property Services Agency identified a number of potential occupiers and proceeded with tentative negotiations for Thames House South only, suggesting in June that an offer, if approved by ministers, might be in the region of £45 million. Imperial Chemical Industries indicated that this would be a competitive offer but not the highest. They pressed for formal offers, agreeing to extend their deadline until two weeks after the 1987 General Election, and asked the Agency to confirm their bid, converting it to one for both buildings.
- 11** The Property Services Agency estimated that a competitive bid for the freehold of the whole of Thames House, subject to contract and survey, would need to be of the order of £75 million to £80 million; and their provisional estimate of the cost of refurbishment to a basic standard was a further £60 million or so. The Agency advised ministers that the increase in estimated price since March was because of revised costings based on more detailed survey data, the upward movement of the commercial property market and the presence of competitors forcing up the price. They considered that a bid in line with the sums previously discussed (paragraph 9) would be unrealistic and stand little chance of success. Ministers were not prepared to seek colleagues' approval for a higher offer in the short time available between the General Election and the owner's deadline, particularly as no occupier had been identified; they decided it would not be right to bid for the property at that time.
- 12** The Agency therefore advised Imperial Chemical Industries in June 1987 that they were unable to proceed. Shortly afterwards the owners agreed the sale of both buildings to Berkley House for £75.6 million: this comprised a deposit of £11.3 million (on which Imperial Chemical Industries paid interest to Berkley)

and payments of £28.3 million and £36 million due on the expected vacant possessions of the North and South Buildings in August 1988 and December 1989 respectively.

- 13** In August 1987 the new owners approached the Property Services Agency asking if they would like to take up a tenancy in Thames House. This approach coincided with the Security Service concluding that a proposed development on another site was unsuitable for their needs. As Thames House seemed suitable for the Service's special requirements, the Property Services Agency expressed interest. In November 1987 Berkley offered Thames House on a minimum 25 year lease for a starting rent of £19.5 million a year or for freehold purchase at £150 million (or £300 million refurbished), agreeing not to negotiate with others before the end of the month. The Property Services Agency considered this opening offer excessive. Nevertheless, they continued to believe that the building would be suitable for the Security Service if it could be obtained at a realistic price and they sought ministerial approval to negotiate. Ministers expressed their concern at the speed with which decisions had to be taken but, as no firm financial commitment was sought at that stage, agreed.
- 14** Thames House was considered suitable by the Security Service. The total usable floor area was adequate for their needs with a surplus of about 70,000 sq ft available for other Government departments. They expressed a strong preference, for security reasons, for the acquisition of the freehold.
- 15** In December, after detailed negotiations with Berkley, the Property Services Agency sought ministerial approval to purchase of the freehold, which they saw as significantly cheaper than leasehold. Ministers agreed to the building being purchased at a price up to £80 million on condition that expenditure was incurred before 31 March 1988.
- 16** Although no firm decision had been taken about occupancy, it was likely that the building would be used by the Security or the Secret Intelligence Services. With this in mind it was noted that, if payment were delayed into the new financial year, attention might be drawn to the transaction through the estimating and accounting processes because, from 1 April 1988, departments in sole occupation of a building were to take provision for expenditure on major building purchases and works on their own votes. The purchase of Thames House would thus have become clearly identifiable as part of a Ministry of Defence or Foreign and Commonwealth Office vote; this

would have been undesirable for security reasons. To provide funds for the purchase, ministers obtained Parliament's authority for a late supplementary estimate for the Property Services Agency.

- 17** Meanwhile Berkley had lowered their asking price for the freehold to £110 million but the Agency considered this still above the true market value. They were aware that other companies had expressed interest in the property at a figure nearer to the £80 million which they considered a realistic price. They were concerned, however, that the keen interest they would need to show if they were to acquire the freehold before April 1988 might inflate the price.
- 18** They therefore discussed a “back to back” arrangement with Land Securities Ltd, who had been negotiating for the purchase themselves. Land Securities no longer wished to proceed but were prepared to continue on the basis that the Agency would take over their contract with Berkley as soon as it had been signed - paying Land Securities the £77.6 million they would pay Berkley - £2 million more than Berkley's purchase - and possibly Berkley's costs, estimated at £1.5 million. In addition, the Agency would pay Land Securities' own costs of £1.3 million. The full cost to the Property Services Agency would then have been up to £80.4 million, substantially less than that sought by Berkley.
- 19** The Agency heard rumours that Berkley might be selling the property to another buyer for £81.5 million. In order to continue negotiations with a view to acquiring the building within the financial year, they urgently sought and obtained the Treasury's approval to spend up to 10 per cent more than the £80 million previously authorised if this proved necessary.
- 20** Despite indicating that they were prepared to increase their offer, Land Securities were unsuccessful. The Agency believed that Berkley were keen to make a sale before Christmas 1987 and, rather than continue negotiations with others, accepted a firm offer by Leigh Estates (UK) Ltd, a subsidiary of the Mountleigh Group PLC, of £80.6 million. In practice this meant Leigh taking over Berkley's agreement with Imperial Chemical Industries. Leigh thus undertook to pay the instalments due in August 1988 (Thames House North) and December 1989 (Thames House South); they also paid Berkley a premium of £5 million, which included Berkley's costs of some £1.5 million, and reimbursed them the deposit of £11.3 million (on which Leigh then received the interest). The Agency estimated the total potential cost to Leigh, including Leigh's costs, at about £84 million.

21 In January, Mountleigh approached the Property Services Agency asking if they would be interested in purchasing Thames House for a “turnover of 20 per cent” (about £96 million to £100 million). The Agency did not regard this price as offering value for money and told Mountleigh that they could not countenance such a high profit margin using public funds. However, recognising the strategic value of the property, the Agency remained keenly interested and began negotiations again in early February following an approach from Mountleigh. After extensive negotiations Mountleigh, on behalf of Leigh, put forward two proposals on 17 February 1988 for the Property Services Agency to:

- a)** buy the benefit of the agreement with Imperial Chemical Industries to purchase, paying Leigh £10 million plus £3 million costs and £11.3 million to take over their deposit - this would leave the Agency in a direct contractual relationship with Imperial Chemical Industries, enabling them to negotiate directly regarding a discount for payment before 31 March of the remaining sums due; or
- b)** pay Leigh £82.484 million. This included a premium of £10 million, costs and £6 million as a discount for advance payment. It would reimburse Leigh for the deposit they had paid and leave them with responsibility for meeting the stage payments to Imperial Chemical Industries in August 1988 and December 1989, as planned. Vacant possession of each building would revert to the Property Services Agency once these payments were made. Mountleigh's formal offers did not refer to the interest due on the £11.3 million deposit. Property Holdings told me that in the course of negotiations, Mountleigh made clear to the Property Services Agency that this benefit was not included in either offer.

22 The Agency contacted Imperial Chemical Industries who were prepared to accept £60.7 million for immediate payment in lieu of the £28.3 million due in August 1988 and the £36 million due in December 1989. Adding the £11.3 million deposit and the other payments to Leigh under option (a) would effectively have brought the total price to £85 million. The Agency therefore decided to accept Mountleigh's second option, having negotiated the price down to £82 million. They paid this sum on 2 March 1988 into an account held by Leigh's solicitors pending the production of suitable guarantees for the £64 million due to be paid by the company to Imperial Chemical Industries. As part of the agreement, interest on the £11.3 million deposit continued to accrue to Mountleigh. The guarantees, provided by the Industrial Bank of Japan, were finalised on 24 March. The Property Services Agency continued to pay rent to Imperial Chemical Industries under their existing lease on Thames House South.

- 23** Property Holdings assured me that, at the time of purchase negotiations, although no separate survey was carried out by the Property Services Agency, they had the benefit of a number of structural surveys undertaken for previous purchasers and had, in addition, themselves carried out a number of tests on the fabric of the building. All these surveys had demonstrated that the building itself was basically sound but that many of the internal fitments would need refurbishment or replacement.
- 24** Once the Prime Minister had agreed in March 1988 to the Security Service occupying Thames House, detailed design work began. The design proposals included the eventual closure of Page Street - the road which separated the North and South buildings - and linking the two buildings for security reasons. However, as the buildings were effectively costing the taxpayer some £20,000 a day until occupation, the Property Services Agency were keen to arrange for necessary works to be started as soon as possible after completion. Work began on the North building immediately but, because of the features incorporated in the design by the Security Service, the Agency considered that the job could be carried out more efficiently and economically if Page Street were closed to public access immediately. This required an order by the local authority. To be able to apply for such an order, the Agency had to be the freeholder of the land beneath the entire highway. Normally the freeholder of property would own the land only to the mid-point under the highway and in this case Imperial Chemical Industries had retained the whole carriageway with Thames House South, for which purchase completion was some 16 months after Thames House North.
- 25** Recognising that a delay in gaining access would potentially be costly, the Agency entered into further negotiations with Imperial Chemical Industries to acquire the freehold of the whole site as soon as possible. The result was a novation agreement which provided for the freehold of both buildings to pass to the Property Services Agency in November 1988 - thus facilitating access to Page Street; vacant possession of Thames House South would occur in September 1989, when payment of the completion monies would be made.
- 26** Although the agreement did not alter the purchase price, the Agency agreed with Leigh and Imperial Chemical Industries that the companies would be left in the same financial position as though the novation had not taken place. They therefore agreed to compensate Mountleigh and Imperial Chemical Industries for loss of interest and rent, given the earlier settlement. This put the Secretary of State in a direct contractual relationship with Imperial Chemical Industries, committing him to pay the company the purchase price.

In a separate agreement with Leigh, which had already been put in funds by the Agency, the company agreed to pay Imperial Chemical Industries on behalf of the Secretary of State, when instalments fell due.

- 27** Had Leigh defaulted on these payments the Agency would have been liable to pay Imperial Chemical Industries for the buildings. To protect their payment to Leigh and avoid the risk of paying a second time, the agreement provided for Mountleigh to take over the guarantee from the Industrial Bank of Japan (paragraph 22) and to pay Imperial Chemical Industries the sums due should Leigh default. Payable Orders were prepared for the due dates in case of default but in the event they were not needed as payments were made as expected.
- 28** The Agency were, however, unable to proceed with immediate closure of Page Street because of delays in making contractual arrangements for works.
- 29** The detailed financial arrangements surrounding all these agreements were complex. In essence, the Property Services Agency's payment for Thames House in March 1988 comprised:

	£	
a	11,334,000	deposit, being 15% of the basic purchase price (£75.56m)
b	10,000,000	premium for Leigh, including reimbursement of monies they paid to Berkley
c	3,000,000	costs of Leigh
d	57,666,000	to provide for Leigh to pay the balances on Thames House North (£28.3m, August 1988) and Thames House South (£36m, December 1989)
	82,000,000	

The sum at d represented a discount of £6.56 million on the instalment payments totalling £64.3 million, which the Agency calculated represented a discount rate of 9¼ per cent - equivalent to average money rates at the time.

- 30** The National Audit Office recalculated the discount taking account of the fact that Mountleigh did not pass on to the Agency the interest paid by Imperial Chemical Industries on the deposit. Using 9¼ per cent for interest on the deposit, the National Audit Office calculated the effective discount rate at about 6½ per cent. The actual rates of interest paid by Imperial Chemical Industries proved to be of the order of 11½ per cent; while the Agency could not have foreseen these, it would have reduced the effective discount rate to about 5¾ per cent. In Property Holdings's view, it is misleading to assess the discount in this way as Mountleigh were not prepared to forgo the benefit of

the interest without a corresponding increase in the purchase price; the Agency had therefore considered the options solely on the basis of the terms offered.

- 31** The National Audit Office also re-assessed the offer made by Imperial Chemical Industries in February 1988 (paragraphs 21 and 22). The Agency compared it in cash terms with the amount required by Mountleigh: this showed that a deal direct with Imperial Chemical Industries would have cost an extra £3 million. The National Audit Office noted that the offer represented a discount rate of 4¾ per cent which Imperial Chemical Industries said they could not improve for tax reasons within the time available to the Agency. It appeared to the National Audit Office that the Agency might have been able to improve on the value of this option had they been able to reach an agreement with Imperial Chemical Industries to reduce the rent payable to them for Thames House South (£3·2 million, present value £3 million); and might have been able to reach a separate agreement with Mountleigh about interest paid on the deposit (£2 million, present value £1·8 million). Together these might have exceeded the cash difference between the two offers.
- 32** Property Holdings accept that these may have been negotiable but consider that neither party would have forgone these sums without compensation. The National Audit Office also noted that the Agency might have been able to secure a better offer from Imperial Chemical Industries in a new tax year. Property Holdings pointed out, however, that this would not have been possible if the Agency were to have obtained agreement by 31 March. In their view, even if Imperial Chemical Industries had subsequently been able to make an improved offer, they would not have bettered the alternative deal offered by Mountleigh.
- 33** The transactions which took place under the October 1988 novation and related agreements are set out in Annex 1, including the interest payments involved. The Annex also shows the payments in lieu of rent which the Agency continued to pay to Imperial Chemical Industries and the compensation received by the Agency for providing vacant possession (paragraph 8).

Vauxhall Cross

- 34** In December 1986 Regalian Properties acquired the former “Green Giant” site, near Vauxhall Bridge, from Mountleigh. Some six months later they asked the Property Services Agency whether they would be interested in a proposed new office block on this site. The Agency, while not having a particular occupant in mind at that stage, expressed some interest.
- 35** Regalian were not keen to proceed with an office development without a firm client: as is normal practice in discussing the leasing of a new building, they wanted the Agency to enter into a binding pre-letting contract, subject only to planning permission being granted for the proposal, with an indemnity to Regalian for fees (estimated at £½ million) and interest charges on the capital value of the site (estimated at £1½ million a year). The Agency, while understanding the developer's wish to protect himself, were reluctant to enter a binding commitment.
- 36** In view of the advantages offered by the site, however, ministers agreed that the Agency should continue discussions. In the course of these negotiations the Agency said that the outline specification of the building would need to be substantially modified to meet the normal requirements of a Government building. They wanted a taller, narrower building which would, by allowing better use of floor space, be more suitable for dividing into rooms to civil service standards and generate a 15 per cent efficiency saving. Regalian, however, were not prepared to construct a building of a design which they felt would be difficult to lease to other clients if the Agency decided not to proceed. The Agency therefore suggested that they might acquire the freehold on completion of the development. Regalian proposed a price of £131·8 million on the basis of their then current design, including an allowance for inflation over the course of the project.
- 37** In July 1988 the Prime Minister agreed to the purchase of the Vauxhall Cross building for the Secret Intelligence Service on terms to be finalised, but expected every effort to be made, compatible with the rules of financial propriety, to adjust the phasing of expenditure in a way most convenient to public expenditure plans; she believed that outright purchase would have considerable advantages for the management of the Service as well as make for a long-term saving in public expenditure.

38 The Treasury proposed that the building be purchased by a single payment before the end of the financial year. This would avoid having publicly to record and explain prospective payments each year in the estimates; and a detailed explanation would not be required for a supplementary estimate. This would minimise the risk of identifying the eventual occupants and prevent the security of the site being compromised. The Agency explored with Regalian means of paying for the entire building in advance of construction work, and the discount which might result. There remained much to be agreed, however, on construction details and costs. The Agency were aware that it might not be possible to reach a final agreement and pay by March 1989. They therefore considered contingency options, such as placing the total sum in an account held jointly by the Treasury Solicitor and the developer's solicitor - an option built in to the final agreement.

39 Draft Heads of Agreement were drawn up in August 1988. Although both parties were aware by this time that payment was to be made in advance, the draft agreement continued to reflect the conventional stage payment method initially envisaged, pending agreement on the discount for early payment. Based on a provisional purchase price of £130 million, the payment schedule showed:

£15m	(deposit) on exchange of contracts
30%	(less deposit and interest accrued) once planning permission granted
25%	one year later
25%	two years later
17½%	on completion
2½%	(retention) one year after completion

40 In December 1988 the Agency sought an independent valuation from the District Valuer. He considered that the present value of an office block of the proportions indicated would be of the order of £150 million and could see no valuation objection to acquiring the property for an advance payment of £125 million. He understood that the Agency wanted to apportion a value of £24 million to the site and raised no valuation objection.

41 On 23 December 1988 the Property Services Agency entered into an agreement with Regalian setting out the terms of the purchase. The price of the building, based on office prices in the area, was assessed at £299.77 a square foot. With a gross floor area of 450,625 square feet, this produced a purchase price of £135 million for the Regalian building. The discount for advance payment was provisionally calculated at £15 million, making the sum due £120 million. The Agency paid the deposit of £30 million and made arrangements for a late supplementary estimate to obtain funds for the

balance before 31 March 1989. Interest on the deposit accrued to Regalian to cover fees and expenses but with provision for it to be deducted from the purchase price should the agreement be finalised.

- 42** The agreement was conditional on planning permission being obtained and on reaching agreement on design and price - for which there was a clause allowing either party to withdraw. Once these two items had been resolved the agreement became unconditional.
- 43** As noted in paragraph 36, the Agency required significant modifications to the Regalian design. The parties agreed that these modifications would add £13.8 million to the cost, allowing for the developer's inflation provision.
- 44** The Secret Intelligence Service also wanted additional features incorporated in the main structure (* * *, document hoist and emergency generators). The costs, including consequent changes to the structure, could not be precisely estimated - the * * * in particular was unclear because the specific requirements approach the limits of current technology. These requirements were incorporated in a further supplemental deed to the main agreement. Regalian's provisional estimate of costs (£10.5 million allowing for inflation) were included in the purchase price but not at a fixed price, recognising that these additions would have repercussions on the basic works. Expert technical advice was to be sought and both parties recognised that a further payment might be necessary.
- 45** These modifications (paragraphs 43 and 44) brought the total purchase price to £159 million. The agreement with the developers included a fixed price contract which provided for the developers to bear the risk of any inflation beyond the six per cent a year included in the purchase price. The contract made provision for adjustments only for the following:

 - a)** any inflation on the basic extra works requested by the Agency (paragraph 43) above or below the level provided for by the developer, to be paid on completion of work on site by the relevant party (estimated at the time on the then rate of inflation in the building sector as likely to cost the Agency £9 million to £10 million). [Regalian's current expectations are that they will have to pay Property Holdings.];
 - b)** any additional cost or reimbursement for the special extra works requested by the Agency (paragraph 44);
 - c)** any additional works later requested by the Agency; and

d) unrecoverable VAT, which the Agency agreed to pay (then expected to be £16 million because of proposed changes in VAT legislation) [Property Holdings have told me that the developers now consider that the agreed purchase price is not liable to VAT and that other VAT liabilities will be small.]

46 During this time the Agency continued to discuss with Regalian the appropriate level of discount for payment in advance. The developer calculated the discount by assessing quarterly interest on his outgoings at forecast rates provided by Barclays Bank varying between 11 per cent and 13 per cent. However, his calculations were based on simple interest. Using the same basic figures but more conventional compound interest, the Agency calculated a discount some £4 million less than that offered by the developer. They therefore accepted the developer's basis of calculation. The actual discount calculated on the purchase price of £159 million on 14 March 1989, using the latest available forecast rates, was £24,375,627.

47 The National Audit Office re-calculated the value of the discount for the advance payment on the basis of the more conventional stage payment method, using the stages set out in the draft Heads of Agreement (paragraph 39). This showed a discount of about 13 per cent - equivalent to average money rates at the time. The National Audit Office noted, however, that at the time the agreement was finalised (March 1989), the developers were projecting a six month delay in the building works. Taking the consequential delays into account, the National Audit Office calculation showed the value of the discount to be $10\frac{1}{4}$ per cent; applying the Barclays forecast rates (about $11\frac{3}{4}$ per cent) to a delayed schedule of payments would have produced a cash discount of the order of £27 million. Property Holdings told me that, when the contract was signed in December 1988, there was no reason to suspect a subsequent delay. They considered that to have delayed signing might have jeopardised the deal. In their view the agreement reached represented good value for money.

48 To protect their interest in the advance payment, the Agency required the developer to guarantee its performance and enable work to be completed by another contractor should Regalian fail. Barclays Bank agreed to provide this guarantee. The bank held £90 million cash which Regalian funded using the advance payment; interest was paid to the developer. Regalian were empowered to draw on this deposit for the costs of construction and fees as work progressed. For this service Barclays charged $\frac{3}{16}$ per cent on the balance on deposit, which the Agency agreed to pay (which they estimated at £576,000 during the life of the project). Because of the existence of the

guarantee the Agency did not formally investigate the financial background of the company. Property Holdings told me that they took the view that because Regalian were property developers, their assets would not at any one time be substantial enough to provide adequate security. They therefore required a bond without the need for formal investigation.

49 The Property Services Agency originally wanted the bond set at £110 million, representing the full, inflated, construction costs of the project. However, the company pointed out that the £90 million on deposit with the bank would earn interest, which they considered would provide adequate cover. The Agency accepted this. To protect their position, they arranged with the bank that Regalian could not draw on the deposit until they had produced receipted expenditure of more than £20 million, and then only for the excess.

50 The Agency and the Secret Intelligence Service had kept in close touch with the relevant Treasury staff about the project. However, when the Service's external auditor queried the unusual arrangements for payment in advance they decided to consult the Treasury Officer of Accounts. His view was that the payment was in advance of need. It was therefore necessary to show that the Government would derive a clear benefit from paying the whole cost in advance instead of adopting the normal procedure of making stage payments for work done. In his opinion the terms of the deal did not appear to be so advantageous, beyond what could be achieved with stage payments, such that they justified early payment. Nevertheless they safeguarded the interests of the Exchequer once a decision to pay early had been made. The Treasury Officer of Accounts also questioned the invocation of security considerations to justify advance payment but concluded that this was a matter of judgement not within his competence. He considered that Accounting Officers needed to be very clear that the benefits to be obtained were sufficient to justify the course of action proposed; if not they would need a direction from ministers, having alerted them to the accounting considerations.

51 In response to these comments, the need for security cover was considered paramount as it was important to keep attention away from the building site. Spreading the cost over several years, particularly as the project would have to be recorded in notes to the Estimates or a note added about exclusion, might draw it to the attention of the Departmental Select Committee and others; this could more easily be avoided with a late supplementary estimate for a single payment in advance. And it would not have offered better value for money if the Property Services Agency had asked the developer to finance the

scheme until completion. The Treasury felt that a tough deal had been negotiated: there was a fixed price with a hefty discount and a banker's bond to underwrite the investment until the project was complete.

- 52** The matter was drawn to the personal attention of the Accounting Officer of the Property Services Agency who took the view that the contract contained adequate safeguards for the Government and indicated that he would be happy to defend the advance payment. The Permanent Secretary to the Treasury considered that the deal showed a significant internal rate of return and that stage payments would draw attention to the project. The Cabinet Secretary, who has responsibilities for co-ordinating advice to Ministers on the intelligence budget and accounting officer responsibilities for the Secret Vote (but not for the votes on which the expenditure would fall), said that the Treasury Officer of Accounts had not been as forthright in defence of what was proposed as he would have liked. However he was prepared to accept the advice of the Accounting Officers of the Property Services Agency and the Treasury that the arrangement was justified in terms of the exceptional value for money which it provided and the security advantages it offered since no alternative financing method would have provided an equally good chance of concealment during the period of construction.
- 53** Around this time consideration was also given to paying the VAT element (paragraph 45(d)) in advance as well. However, as proposals introducing VAT on new construction had not been announced, the Agency decided that such a payment could not be justified in anticipation of the Budget. While expressing concern about security cover for this large payment at the end of the contract in 1993-94, they felt that the risk would have to be taken and that the need for cover, with the building finished, would be of less concern. Property Holdings told me that they now understand that the purchase price will not be liable for VAT, and that non-recoverable VAT payable is likely to be small and can be met from existing resources on their vote.
- 54** The agreement with Regalian was finalised on 13 March 1989 and the Agency paid the balance of £104,527,339. Regalian subsequently repaid £226,867 representing final discount and interest adjustments.
- 55** In March the Treasury expressed their concern that variations in design and specification being agreed under the contract were resulting in significant increases in the purchase price. This concern was highlighted by the volume of changes already made since the agreement with Regalian in December 1988. The contract provided for all changes involving extra cost to

be paid for immediately and the Property Services Agency were concerned that there was inadequate control over changes to the agreed design. By 20 March 1989 these amounted to some £3.2 million and others were anticipated to be a further £3.6 million.

- 56** The Treasury were not prepared to accept additions beyond the £3.2 million already committed and said there should be a total design freeze. The Agency told the Treasury that this would not be practical but agreed that variation orders would in future be kept below £½ million a year, wherever possible, in order to maintain cover and not undermine the value for money offered by the original financial arrangements. A Steering Group of senior officials was asked to oversee the project and approve further variations, offsetting these with omissions wherever possible to prevent the project incurring new financial commitments.
- 57** On 29 March 1989 the Agency authorised, with Treasury approval, a further payment to Regalian of £4,233,000 for the cost of additional works. This was paid before the end of the financial year, within the Supplementary Estimate covering the purchase price. A further £206,000 was paid to the developers in December 1989 for minor variations in design. This was met from the Property Services Agency's vote.
- 58** In August 1989, specialist advice led the Agency and the developers to conclude that *** would be significantly more expensive than initial estimates suggested - but that the cost of abandoning the requirement would be even more so. After considering options for deferred payment, the Agency concluded that payment in 1989-90 offered the best value for money whilst preserving anonymity. A supplementary estimate of £10.15 million was obtained and payment was made in February 1990.
- 59** Regalian had also lodged a claim, in March 1989, for the delays caused by incorporating the special extra works (paragraph 44). The parties agreed that discussion of this should be deferred until construction work began, when the delays could be quantified. Once these effects were clear, the Treasury asked that payment be settled in 1989-90, provided this could be achieved on acceptable terms. After discussion, the claim was settled at £2,999,890 and paid in March 1990 from the Property Services Agency's vote. A summary of the financial position is at Annex 2.

Refurbishment and fitting out costs

- 60** This memorandum is concerned mainly with acquisition but anticipated refurbishment and fitting out costs are a relevant aspect of a purchase decision - matters which were taken into account by the Property Services Agency in assessing the property values.
- 61** In March 1987 the Agency estimated that the cost of modernisation and refurbishment to a basic office standard of Thames House would be in the order of £60 million. This estimate was made at 1987 prices without detailed surveys or an indication of the client's specific requirements; it was intended solely to give ministers a sound basis for comparing the cost of Thames House with the cost of other options prepared on a comparable basis. In April 1988, after Thames House had been purchased, the Agency estimated that the cost at 1988 prices of refurbishment to a basic office standard and fitting out the building, on the basis of surveyors' reports (paragraph 23), would be of the order of £150 million, with a further £20 million in fees. They made clear that the final cost would depend on a specific brief from the clients. By the following year the Agency had carried out a more detailed assessment based on the Security Service's requirements. Including some £30 million VAT (which had been payable from 1 April 1989) and a contingency provision, they then estimated that, at 1989 prices, the total cost would be £239 million.
- 62** The agreed cost of the Vauxhall Cross building includes the structure finished to a basic office standard. The cost does not include the fitting out work, nor the special requirements of the Secret Intelligence Service, other than those included in the main structure (paragraph 44). The fitting out works, excluding VAT (which only subsequently became payable) and the Service's specific requirements, were expected in November 1988 to cost around £35 million at 1988 prices. The current full cost of the works, including an allowance for inflation, is £96 million.
- 63** I would expect to return to the question of refurbishment and fitting out costs - borne on Ministry of Defence and Foreign and Commonwealth Office votes, and not Property Holdings' vote - when the actual expenditure is clearer. This is likely to be shortly before the occupancies of the buildings take place (May 1994 for Thames House and April 1994 for Vauxhall Cross).

Conclusions

- 64** The National Audit Office recognise the need for a high degree of secrecy in these two purchases. It is also clearly necessary to conceal the nature and purpose of the buildings so that work may proceed with the minimum of risk to their being compromised at a time when they are at their most vulnerable. It follows that there may be a need to adopt some unusual financial practices. There remains, however, a duty of care and a need to ensure that propriety is maintained and value for money obtained.
- 65** In the case of Thames House, it seemed to the National Audit Office that the Property Services Agency missed some opportunities to acquire the building directly from Imperial Chemical Industries in the earlier stages. This could have saved, for example, payments of £13 million to intermediaries.
- 66** Property Holdings accept that, with hindsight, the Agency may have been able to purchase the building at a lower price by seeking a deal in June 1987. However, they comment that, whilst the purchase of a property in such a strategic location had clear attractions, there was no clearly identified Government requirement for the building at that time and ministers did not consider a speculative purchase the best use of available funds. They nevertheless consider that once ministers approved the purchase in December 1987 they were able to secure Thames House at a commercially competitive price.
- 67** The advance payments for both buildings contravened normal rules but were made to minimise the risk of drawing attention to these projects. In the circumstances the National Audit Office regard these as acceptable reasons. The decisions to pay large sums by the end of March 1988 and March 1989 led, however, to the need for quick action and it appeared to the National Audit Office that this haste may have reduced the scope for establishing whether better value for money might have been obtained - for example:

On Thames House, whether

- a)** the Agency might have obtained the interest payable on the deposit. Property Holdings told me during the course of my investigation that Mountleigh were not prepared to forgo this at the price offered, but there is no record of the Agency having considered the point at the time of the negotiations (paragraphs 21, 29 and 30);

- b)** Imperial Chemical Industries might have been able to offer a better discount in a later tax year. Property Holdings told me they understood that this would have prevented purchase before April 1988 and it was unlikely that any subsequent offer would have bettered the alternative offer from Mountleigh. Again, the records show no overt consideration of the matter at the time (paragraphs 22 and 29);
- c)** the Agency might have had the opportunity to re-negotiate the rent payable to Imperial Chemical Industries if they had dealt with them directly. Property Holdings commented that Imperial Chemical Industries would have probably sought compensation for rent forgone, as they did under the novation but this was not put to the test since the Agency did not address the point with Imperial Chemical Industries (paragraphs 22 and 31);
- d)** Property Holdings said that, in their view, the purchase was based on adequate survey information to re-assure them of the building's basic condition; more detailed surveys would later determine the cost of specific client requirements. But a fuller survey of the condition of Thames House before purchase might have revealed the full extent of the remedial works that proved necessary in the event and so have influenced the negotiations on the purchase price (paragraph 23);
- e)** the additional staff and legal costs involved in drawing up the October 1988 novation to close Page Street could have been avoided. Property Holdings told me that the Security Service's requirement did not become apparent until after the deal was finalised, when the advantages of closing Page Street became clear; the novation sought to minimise further costs (paragraphs 24 to 28);

On Vauxhall Cross

- f)** when the agreement with Regalian was signed in December 1987, two matters remained conditional: obtaining planning permission and reaching agreement on design and price. The discount arrangements were, however, fixed and did not take into account the six-month delay in building works subsequently projected. Property Holdings commented that to have delayed signing the agreement until March 1988 might have jeopardised the deal (paragraphs 41, 46 and 47);

- g)** even though the Agency paid in advance they agreed to pay the cost of the bonding arrangements charged by the Bank on the cash deposit lodged by Regalian. Property Holdings commented that they would normally expect the vendor to pass on the cost of a bond directly or indirectly (paragraph 48); and
- h)** whether the Agency were adequately protected against the risks of Regalian's failure. Property Holdings told me that the bond covered the full contract price of the building. The National Audit Office remain concerned, however, that any additional costs in completing the work would have fallen to the Agency (paragraphs 48 and 49).

68 The National Audit Office also noted that the Treasury, and the Property Services Agency themselves, were concerned that variations in design specifications on the Vauxhall Cross contract were leading to considerable new financial commitments. In particular the Agency failed to recognise, in the early stages of the project, the need to keep tight control over work classified as additional items falling outside the fixed price. The Agency did, however, take steps to rectify this before it got out of hand.

John Bourn
Comptroller and Auditor General

National Audit Office
31 March 1992

Annex 1

Thames House

Payments made under October 1988 novation and related agreements

Principal Payments

		£
Deposit	(already held by ICI)	11,334,000
11.11.88	Mountleigh paid ICI, on behalf of PSA, for Thames House North	28,259,440
29.9.89	Mountleigh paid ICI, on behalf of PSA, for Thames House South	35,966,560
	Basic Purchase Price	75,560,000 ^a
29.9.89	ICI paid PSA compensation under Landlord and Tenant Act (paragraph 8)	3,303,039
		£72,256,961

Interest Payments^b

	ICI paid interest on deposit of £11.334m to PSA, which PSA paid (less tax) to Mountleigh ^c	1,630,970
18.11.88	Mountleigh paid interest to PSA on £28.26m ^d	387,019
8.1.90	PSA paid interest to Mountleigh on £47.3m (THN price + deposit) ^d	1,781,546

Other Payments

Dec 88, Mar 89, Jun 89	PSA pay rent to ICI for Thames House North under original lease	£2,041,302 ^e
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- a For which PSA paid £88.56m, less discount of £6.56m for payment in advance (£82m net)
 - b Ignoring tax
 - c 5 payments; interest remained payable to Mountleigh until September 1989 as originally agreed with PSA in the £82m settlement
 - d To leave Leigh in the same financial position as they would have been under the earlier agreement - ie Thames House South transferred in August 1988 and Thames House North in December 1989
 - e £640,434 per quarter
-

Annex 2

Vauxhall Cross Building

		£m
	Cost of Regalian design, inc fees (or £142·088 per square foot)	62·144
	Cost of PSA design based on Regalian costs at £142·088 per square foot	64·03
	Cost of PSA design	82·212
	extra cost of PSA design	£18·182m
	Calculation of purchase price:	
	Cost at £299·77 per square foot	£135·084m
	Inflated (at 6% pa over 5 years) cost of extra cost of PSA design	24·346
		£159·43m
	Calculation of payment:	
	Purchase price	159·43
	Discount for payment in advance	24·376
	NET BASIC PURCHASE PRICE	£135·054m
	Payments made	£
23.12.88	Deposit	30,000,000
	Interest on deposit ^a	679,661
13.3.89	Paid on completion of agreement	104,527,339
		135,207,000
20.3.89	Adjustments	(226,867) (\$54)
	BASIC PURCHASE PRICE	135,054,373
29.3.89	Variation orders	4,233,000 (\$57)
		139,287,378
12.89	Variation orders	206,000 (\$57)
		139,493,378
2.2.90	Special extra works	10,150,475 (\$58)
		149,643,853
14.3.90	Compensation	2,999,890 (\$59)
		£152,643,743

a Interest earned on deposit used towards payment

Appendix B

Security Service

Refurbishment of Thames House

Summary and conclusions

1 The arrangements for the purchase of Thames House were the subject of my memorandum of March 1992. This memorandum examines the refurbishment of the building to meet the requirements of the Security Service. It considers the increase in refurbishment estimates, including the Security Service's specific requirements; the appointment of consultants; and additional space requirements.

Increases in costs

2 In March 1987 the Property Services Agency provided a provisional order of costs for refurbishing Thames House at about £60 million to provide a broad comparison with other potential building purchases. The Agency provided a revised order of cost in the range of £115 million to £145 million in November 1987 based on standard unit costs per square metre, although in the final versions of the submissions the upper figure was not included. Ministers approved the purchase of Thames House in December 1987 and the purchase was completed in March 1988. While at this stage the Agency was unaware of the eventual occupant or its special requirements, there were significant omissions from and qualifications to the estimates: these limitations were not drawn to Ministers' attention (paragraphs 1, 15 and 28).

3 In July 1988 a feasibility study showed that the orders of costs had significantly understated the likely cost of refurbishment but Ministers were not informed of the increases until July 1990, by which time the estimate had risen by 118 per cent to £251 million. Estimated costs later rose to almost £300 million before savings and changes in inflation assumptions brought the final cost down to £227 million (paragraphs 5, 8, 12, 15, 25 and 26 and Annex 1).

4 In submissions to Ministers the Service pointed out that the Agency's estimates had not been made on an appropriate basis and contained significant omissions. The National Audit Office calculated that the estimate of £115 million expressed in current terms would have amounted to

£179 million. Since then, the detailed project costings, based on a full understanding and development of the client's brief, have added some £48 million to the cost (paragraph 28 and Figure 1).

- 5 Because of its role the Service has a number of operational requirements which place particular demands on the use of its headquarters building - for example the provision of increased security, a reinforced shell to carry heavy plant and computer equipment, technical areas, bomb blast protection and emergency back-up systems. The National Audit Office calculated that these requirements added about £43 million to the basic cost (paragraphs 29 to 31, Figure 2 and Annex 3).
- 6 The Service recognised its lack of expertise to deal with the refurbishment at the outset and the Agency was appointed as project manager. The Agency asked its quantity surveyor to prepare proposals for the most suitable type of works contract. He made his recommendations in April 1989 but, because of disagreements over strategy, the contract was not let until July 1990 - a delay of more than a year (paragraphs 2, 6, 13 and 14).
- 7 In August 1989, just over a year into the design phase, the Service commissioned consultants to carry out a technical, cost and management review. This was critical of the way the project was progressing, although action to strengthen the project management team had already been taken by the Agency. As a consequence of this review the Service formalised and prioritised the project objectives and set a cost limit and a completion deadline (paragraphs 10 and 11).
- 8 Following concerns about cost increases expressed by the Prime Minister, developers Stanhope agreed to examine the project without charge in December 1990. They concluded that, although the building was well suited to the Service's needs, construction costs could be reduced by some £28 million as a result of design economies, reduced inflation forecasts and implementing a shorter timetable. Subsequently Stanhope were engaged as principal commercial advisors on management and on cost savings (paragraphs 21 and 24).
- 9 Consultancy and management fees on the project amounted to £37 million - about 16 per cent of total costs. This included £4 million for the Property Services Agency, £11 million for the management contractor, £16 million for the design team and £1.5 million for advisers appointed directly by the Service. The Service's principal, commercial advisers cost £931,000 (Annex 2).

Appointment of consultants

Space requirements **10** When revising its space allocations in the autumn of 1992 the Service quantified a need for an additional 21,000 square feet which could be provided most cost effectively by occupying some of the space set aside for use by another government department. The Treasury were given only two weeks' notice when the Service sought their approval, even though the Service had been aware of a likely increase in space requirements for some time (paragraph 32).

Conclusions **11** The Security Service is unlikely to undertake a project of this type again. Nevertheless, this case shows the importance of three general principles for project assessment and management:

- initial estimates should be adequately drawn up and any significant omissions or qualifications highlighted so that decisions can be made in the light of all material facts;
- objectives, including time and cost targets, should be set at the earliest opportunity to enable a project to be properly monitored and controlled and to minimise the risk of cost increases and delays; and
- the cost of consultancy work should be set against a pre-determined target percentage and be subjected to rigorous competitive tendering.

Refurbishment of Thames House

Cost estimates

- 1 As recorded in my earlier memorandum, when the purchase of Thames House was first being considered, the Property Services Agency provided a provisional order of costs of £60 million for modernisation and refurbishment to a basic office standard. This estimate was made at 1987 prices, without detailed surveys and without knowing who the eventual occupant might be. In November 1987 the Agency revised its estimate to a range of £115 million-£145 million, derived from a standard unit cost per square foot using past experience of carrying out refurbishment projects on similar government office accommodation in London. However, the upper figure was not included in the final submissions and a number of “health warnings” were omitted. Thus, the lower figure was used as part of the case for recommending the purchase of Thames House to Ministers in December 1987; and it formed part of the basis on which the Prime Minister provisionally agreed in March 1988 to the building being occupied by the Security Service.
- 2 Before April 1988, funding and sponsoring major building projects, including the provision of project management services and selection of other consultants, fell to the Property Services Agency. It procured and managed the works to a requirement and brief provided by the client department and, in effect, became the client. Under the new financial arrangements for managing capital projects the Service became one of the first departments to assume such responsibilities itself. It acknowledged its lack of expertise in handling a major building project, and decided to select external project managers. Special security problems made it difficult to use the private sector and it appointed the Agency. Arising from these revised arrangements responsibility for funding and sponsorship rested with the Security Service; the Agency continued to act as project manager but this was subsequently augmented by the appointment of various consultants.
- 3 In April 1988 the Agency revised its previous estimates, which it said had been based on a number of heroic assumptions. It concluded that, in the light of current available information about the building, refurbishment costs were likely to be in the order of £100 million with additional fitting out costs of some £25 million. In the absence of a detailed survey, it suggested that a prudent figure for the works and resource costs would be in the range of £140 million to £170 million.

- 4 The Treasury expressed concern at this increase, which came immediately after Ministers “took a difficult decision, in which overall affordability was an important factor” - especially as it still contained a wide margin of error. They expected costs to be kept within the assumed expenditure of £115 million unless the matter was reopened at ministerial level.
- 5 In July 1988 the Agency produced a new estimate of £144 million based upon the Security Service’s outline brief, excluding fitting-out costs. The Security Service calculated this to be within the approved figure of £115 million, allowing for inflation and the recent introduction of VAT on such expenditure.
- 6 In December 1988 the Agency appointed a quantity surveyor, and a design team consisting of firms of architects, mechanical and electrical engineers and structural engineers (Annex 2). Although the Service had some involvement as the client, the process of tendering, selection and the letting of contracts was carried out by the Agency based upon its established criteria.
- 7 In the following six months, arising from the Service’s specialised requirements, the consultants identified the need to demolish and redevelop part of the building with a consequential impact upon cost. On the basis of a revised client brief the quantity surveyor’s feasibility study in June 1989 indicated project expenditure of £160 million. This was later revised to £168 million after further changes to the brief. The Service therefore looked for further savings, identifying reductions of £11 million - mainly by halving the number of service cores and reducing the specification of the air conditioning.
- 8 The estimate for works costs of £157 million was adjusted to include resource costs, VAT, contingency, specialist fit-out costs and removal costs to give a full pre-contract costing of £239 million. This figure was included in the July 1989 submission to the Permanent Secretaries’ Committee on Intelligence Services seeking endorsement to proceed.

Cost reduction exercise

- 9 Later that month the Treasury asked the Security Service to consider the implications of restricting the expenditure to £152 million, being the estimate approved by Ministers of £115 million uprated by the GDP deflator to current prices. The Service told the Treasury in September 1989 that refurbishment within that sum would require omissions which would cause the project to fail to meet a number of its requirements:

- a shortfall in the available space due to structural limitations would mean that the Service would require additional accommodation for 600 staff;
- no funds would be available to provide secure garaging;
- there would be severe limitations on the amount of information technology equipment which could be installed;
- co-location of staff from existing diverse buildings would not be practical, thus perpetuating existing difficulties;
- funds for special facilities, such as laboratories, workshops and training areas would not be available;
- standby power would have to be reduced from the required 45 per cent to 50 per cent of normal requirements to 15 per cent, severely restricting the Service's ability to function in emergencies; and
- fewer security measures would lead to an increased risk and higher running costs for the extra staff required to compensate.

The Service concluded that limiting expenditure in this way would necessitate additional capital expenditure for other premises and facilities; and would mean that efficiency savings were not delivered and would deprive them of the operational and security advantages of co-location.

- 10** In 1989, after competitive tendering, the Service commissioned consultants, Turner and Townsend Project Management Ltd, to carry out a full technical, cost and management assessment. The report drew attention to a number of concerns. It found that there was no formal agreement between the Service and the project managers and requirements remained undefined; that the project managers had adopted a passive stance of liaison and interpretation rather than the pro-active role necessary for such a large and complex project; and that specifications had been raised, largely ignoring time and cost constraints. The Security Service told the National Audit Office that as from 1 April 1988 project management services were covered by the Property

Services Agency Standard Agreement. It was not possible to discover precisely when the Security Service became aware of the Standard Agreement, but the first recorded reference was in April 1990.

- 11** The consultants concluded that the project had been ineffectively managed by the project managers who were not providing the advice and support upon which an inexperienced client should be able to rely. Costs had escalated and the successful achievement of the project was in jeopardy. The Agency told the National Audit Office, however, that they had already recognised the need to strengthen the project management team and had a more senior dedicated project manager in post before Turner and Townsend were appointed.
- 12** As a consequence of the report the Service undertook a review of the project objectives and imposed a rigid cost limit of £147 million on works costs and a target completion date of September 1992. It also instructed the design team to review all aspects of the project to identify and evaluate potential cost savings highlighted by the consultants. This led to project costs being reduced by £21 million. In November the Service told the Treasury of the revised total, allowing for other changes, of £231 million at 1990 prices.

Works contract

- 13** In February 1989 the Agency had instructed their quantity surveyors to advise on the most appropriate form of works contract. The surveyors concluded that, while a management contract would offer the advantages of flexibility and contractor input, there was a risk of performance failure by sub-contractors - a risk traditionally borne by the client in a management contract. They therefore recommended sequential tendering, a view endorsed by the Agency. Turner and Townsend disagreed with this approach considering that it focused too heavily on the allocation of risk and was not in the best interests of the client as it would fail to achieve the time objective by almost a year.
- 14** The Service decided to opt for a management contract, instructing the Agency to proceed to tender in December 1989 using a standard format which could be amended specifically for Thames House at a future date. To reduce the risk, the Service asked the Agency to insert a clause which would place on the contractor full liability for the execution of the works. In view of the reservations expressed by the Agency and its solicitors about the correctness of including this type of clause in a management contract and its workability,

the proposal was modified and the final contract meant that any claim by the client for damages would require proof of losses due to the management contractor's default. The contract was let on 6 July 1990 to J Mowlem & Co.

Submission to Ministers

- 15** On 19 July 1990 the Cabinet Secretary sought the Prime Minister's approval for refurbishment work to begin in mid-August at an estimated cost of £251 million at 1990 prices - or £296 million at cash prices. He explained that the previous estimate submitted to Ministers of £115 million had been based on a standard cost per square foot for an office building and had been only for comparative purposes; and it had not included VAT, inflation, fitting out, removal, contingencies or the special requirements of the Service, or made provision for the requirements of a listed building.
- 16** The Prime Minister was disturbed to learn of the huge increase in costs, commenting that the previous figures now appeared to omit some very significant elements of expenditure. The Cabinet Secretary explained that the Agency had begun in 1988 to indicate that the costs were likely to be higher than those put to Ministers, but that the Service, while keeping the Treasury informed, had decided not to report a succession of rising estimates to Ministers but to wait until the project managers had completed their examination so that firm figures were available.
- 17** The Prime Minister remained unwilling to authorise the project without the Service providing an explanation as to why the current costings were significantly larger than when approval in principle was first given. She recognised, however, that the design team and builders would have to be stood down if no further work were authorised; she therefore agreed that work could proceed on non-Service specific requirements provided that the Service reported on the minimum work which could go ahead, regardless of the eventual occupant. She also asked the Service to:

 - provide a history of why the costs had risen;
 - examine alternative ways in which it could be accommodated;
 - establish how the costs of Thames House compared with accommodation elsewhere; and

- consider how costs could be rephased so that they remained within the annual public expenditure provision.
- 18** Later that month the Cabinet Secretary provided a list of work which could be committed without prejudicing a decision on eventual occupancy. The Prime Minister approved this work, costing some £63 million, in August 1990.
- 19** In October 1990 the Cabinet Secretary addressed the other issues raised by the Prime Minister. The most important points were:
- no other freehold property falling vacant on the government estate in the near future could accommodate the Security Service;
 - a single building leasehold was considered poor value for money and would have to be located outside the central London area for it to be cheaper;
 - a multiple building location might be cheaper but was ruled out in the initial submission when operational efficiency and security considerations were taken into account; and
 - the public expenditure consequences of the cost increase could be reduced by rephasing expenditure but this would have a significant impact on the real cost of the project, which could not be defended.

The submission concluded that, if the original requirements for a single building and a Westminster location were to be met, there was no reasonable alternative to proceeding with Thames House to the current timetable.

- 20** Given the enormous increase in costs, the Prime Minister did not feel able to authorise the project without further examination. She questioned whether Ministers would have decided upon this option if they had been fully aware at the outset of what the costs were going to be and emphasised that it was essential to explore every avenue for possible savings. The Cabinet Secretary suggested that an outsider with experience of the construction industry should be asked to examine the project to see whether any further economies could be made.

Appointment of Stanhope Properties

21 In November 1990, with the Prime Minister's agreement, the Cabinet Office invited the Chairman of Stanhope Properties PLC, a firm of developers, to examine the project proposals. They agreed to provide a report without charge but, because of the short timescale, they confined themselves to a high level review. The main conclusions in their December 1990 report were:

- the building was well suited to the Service's needs and the design team's proposals to meet these were not luxurious or wasteful;
- the programme could be shortened by some 12 months; and
- construction costs could be reduced by some £28 million as a result of design economies and reduced inflation forecasts (£15 million) and by implementing a shorter timetable (£13 million).

Stanhope emphasised the importance attached to taking the recommendations as a package. In their view reprofiling the project, economies in design and revising the approach to management all needed to be implemented to optimise the effect. They also indicated their willingness to continue in the role of adviser.

22 The Agency told the National Audit Office that their Project Manager had already identified and notified to the client, savings of around £20 million arising from revised forecasts of future inflation and from implementation of value engineering study recommendations. The Agency also said that they had understood that there was a need to hold costs within the annual expenditure provision, thus precluding rephasing of the work.

Further submission to Ministers

23 In January 1991 the Cabinet Secretary reported the results of the Stanhope review to the new Prime Minister. He explained the need for further work to establish the practicality and acceptability of some of the proposals to ensure that private sector practices were compatible with the requirements of public accountability. The Prime Minister commented that this project was a sad tale of underestimating costs but accepted that the best course was to confirm the Security Service as the occupant of Thames House. He agreed that further work should be undertaken to find ways of delivering the savings identified.

- 24** The Service decided to continue with the Agency as project managers but appointed Stanhope as its advisers to ensure that savings identified were achieved and to ensure that the project would be completed on time and within cost estimates. With Treasury approval Stanhope's appointment was made without competitive tendering but was subject to continuous review of their charges. In making this decision, the Service took account of Stanhope's familiarity with the project and its special security requirements.
- 25** In March 1992 the Service submitted revised estimates to the Treasury showing a cash cost of £257 million based on a 48 month construction period. In addition, they identified potential savings of some £8 million which could be achieved if the programme were further reduced to 35 months. As this second option significantly added to the expenditure in the early part of the Public Expenditure forecast period and did not meet the Treasury requirement that public expenditure should not be increased, the Service sought approval for the longer programme. However, in view of the potential savings and to reduce the risks associated with a longer programme, the Treasury approved the shorter timescale, imposing a cash limit of £246 million after taking into account other factors.
- 26** There have since been a number of changes to take account of reviews of inflation, risk and contingencies and the latest estimate (June 1994) is £227 million. Refurbishment was finished in January 1994. The Service has since undertaken the specialist fit-out and installation of computer equipment. This final phase cost £17 million; work was completed in June 1994 and the phased relocation of staff was completed in December 1994.

Funding arrangements

- 27** Until 31 March 1994 expenditure (£204.3 million) was met from the Ministry of Defence's account (Class I, Vote 1) with the Department's Permanent Under Secretary acting as the Accounting Officer. The Cabinet Secretary was responsible for the funding arrangements and budget in his capacity as Accounting Officer for the Secret Services. From 1 April 1994 the remaining expenditure (£22.7 million) is being met from the new Single Intelligence Vote (Cabinet Office: Security and Intelligence Services Class XIX, Vote 2). The Cabinet Secretary remains the Accounting Officer for this Vote but under the new arrangements the head of the Security Service is the Accounting Officer for the Service's unpublished account within the overall vote.

Summary of reasons for the cost increase

- 28 When the Property Services Agency prepared its estimate of £115 million to £145 million in November 1987, it did not do so with any particular occupant in mind. It was thus unable to assess the scope and cost of particular requirements. In addition, there had been no detailed survey and the scope of any structural work required could not be determined. The Agency therefore based its estimate on notional costs per square metre applied to the floor area. In the event the building was allocated to the Security Service who required a significant element of non-office accommodation. In addition, their specialised requirements necessitated a redevelopment of the building behind the facade so as to avoid exceeding floor and foundation loadings. The calculation also made no allowance for the cost of fitting out to the Service's specific operational and security requirements, listed building status, removal costs, inflation or VAT, which did not apply to such works before 1 April 1989.
- 29 To establish the effect of inflation and VAT on the Agency's estimate of £115 million, the National Audit Office applied building indices to the forecast spread of expenditure and added VAT at the rate prevailing when the expenditure was initially planned. This indicates that, irrespective of the basis of calculation, the original estimate would have been £179 million in real terms. Since then the detailed project costing, based on a full understanding and development of the client's brief, have added some £48 million (21 per cent) to the expected outturn (Figure 1). The Service explained that, as the Agency's earlier estimate had been based on a notional value per square foot, it was not practicable to explain what the constituent elements of this increase might be. However, fit-out costs, not originally included and amounting to some £20 million, were a significant factor. The Service also pointed out that listed building status and general design modifications all contributed.

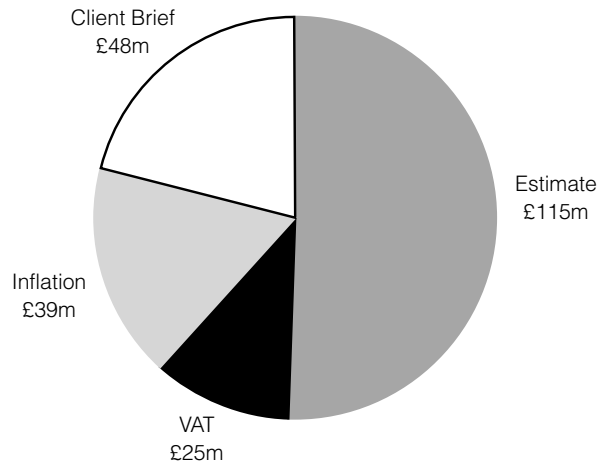
Cost of specialist requirements

- 30 In April 1992 the Treasury asked the Security Service to identify those costs which were attributable to its specialist requirements. The exercise apportioned the costs in four categories:
- **developer specification** - costs that would be expected within a standard developer's specification for a building constructed speculatively for the commercial market (main structure and services);

Original estimate as a proportion of the estimated final cost (£227m)

Figure 1

Development of the client's brief added £48 million to the overall cost.



Source: National Audit Office calculation based on Security Service and Agency data

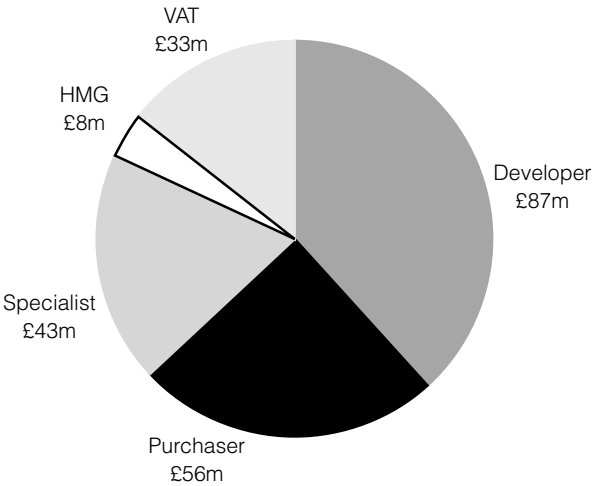
- **Government specification** - cost of meeting the Agency's requirements for the minimum standard of government accommodation, as laid down for the common user estate, in excess of a normal commercial specification;
- **purchaser specification** - costs which a single corporate tenant with a high IT usage in a commercially rented building would expect to bear to make it suitable for occupation (partitioning, catering, data wiring, communications and modifications specific to the occupant); and
- **specialist requirements** - items peculiar to the Security Service which would not be required by a normal tenant (laboratories, workshops, physical and electronic security measures).

31 The calculation excluded the specialist fit-out work to be carried out by the Service. The National Audit Office therefore updated the figures to take into account this omission and the changes which had since occurred. The results are shown in Figure 2. The methodology used to apportion the fitting out costs previously excluded was agreed with the Service although it pointed out that, while the calculation gave a broad indication of the split, the allocations were not precise because of the number of assumptions which had to be made.

Analysis of specialist requirements

Figure 2

Specialist requirements account for £43million (22 per cent of the cost excluding VAT)



Source: National Audit Office calculation based on Security Service data

32 The analysis suggests that a private sector client would have expected to pay £143 million excluding VAT to refurbish Thames House, whilst a normal government department would have incurred additional expenditure of £8 million. On top of this the Security Service has spent a further £43 million to adapt the property to meet its specialist requirements. The cost elements categorised as government or specialist are shown in Annex 3.

Increase in space allocation

33 When the Prime Minister gave provisional approval for the occupation of Thames House in 1988 she stipulated that spare capacity (70,000 square feet) should be used by another government department. During the design phase the Service recognised that it was not possible to make the most efficient use of the available space in Thames House because of the structural limitations imposed by the building - the most important constraints being office sizes restricted by the spacing of windows and the presence of support columns. By September 1992 there had been a net increase of 7 per cent in that part of the Service’s establishment to be accommodated in Thames House. In December 1992 the Service completed a final space allocation exercise, identifying a shortfall of some 21,000 square feet. Various options were considered, the most cost effective being to take over part of the 70,000 square feet set aside for another government department. The Treasury approved this in January 1993, to ensure the completion date of December 1993 remained achievable. They expressed their concern at the short notice.

34 The National Audit Office compared the size of the Service’s previous accommodation with Thames House (Table 1). This showed that although accommodation has increased by 80,000 square feet (22 per cent) there is little change in percentage terms between the different types. Standard office accommodation accounts for only 50 per cent of the total available space in Thames House.

Comparison of size of previous estate and Thames House

Table 1

The average net usable area has increased by 22% (excluding garage facilities)

	Old Estate ^a		Thames House		Increase
	Sq ft ^b	%	Sq ft ^b	%	%
Offices	236,000	60	242,500	49	3
Computer suites	14,400	4	19,100	4	33
Technical areas	64,100	16	89,000	18	39
Other ^c	52,500	14	96,100	19	83
TOTAL	367,000	100	446,700	100	
Increase			79,700		22
Garage facilities	22,900	6	47,000	10	105 ^d

a Only buildings occupied by staff moved to Thames House

b Net usable area

c Conference, catering, training and file storage facilities

d The configuration of the building has resulted in a 25% decrease in the number of parking bays

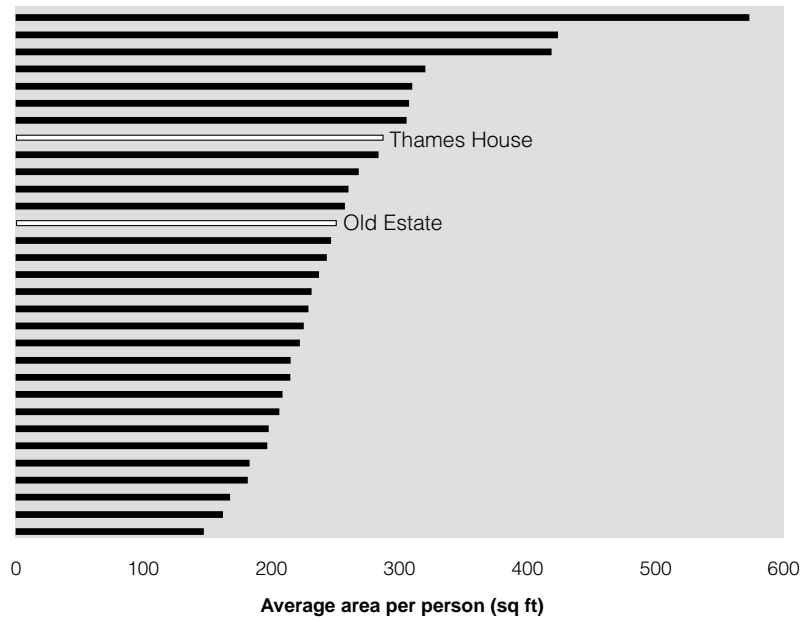
Source: Security Service and Property Services Agency

35 The National Audit Office also compared the average occupation density of the Service’s previous estate and Thames House with that of other government departments. Figure 3 shows that the Service has provided a higher average area per person in Thames House than in the previous estate and in both cases the average area is slightly higher than most government departments. The Service told the National Audit Office that this was a result of the nature of the Service’s operational requirements which meant that only half of the usable area was allocated to standard office space.

Comparison of average occupation densities

Figure 3

Accommodation in Thames House allows more space per person (281.9ft²) than the previous estate (249.6ft²) or most government departments



Source: Government Purchasing report, 1992, and Security Service

Note: The area per person is based upon lettable space and includes non-office accommodation

John Bourn
Comptroller and Auditor General

National Audit Office
November 1995

Annex 1

Thames House: chronology of main events

Date		£m	Price basis
Mar 87	PSA order of costs for basic office refurbishment	60	1987
Nov 87	PSA revised order of cost for office refurbishment ^a	115-145	1987
Dec 87	Ministers approve purchase of Thames House		
Mar 88	Prime Minister approves occupancy by Security Service		
Aug 88	Outline order of cost estimate ^b	144	1988
Jun 89	Feasibility study cost estimate ^c	160	1989
Jul 89	Submission to PSIS	239	1989
Nov 89	Treasury informed of revised estimate	231	1990
Jul 90	Submission to Prime Minister ^d	251	1990
Jan 91	Prime Minister's approval ^e		
Mar 91	Submission to Treasury ^f	257	cash
Mar 91	Re-submission to Treasury ^g	246	cash
Nov 91	Cash limit revised ^h	239	cash
Jun 93	Cash limit revised ⁱ	227	cash

a Based upon a standard refurbishment cost per square foot. Costings excluded specialist client requirements, fitting out, contingency and VAT

b Produced by the Property Services Agency based upon the Service's outline brief. Costings excluded variation of price and fitting out

c Produced by the quantity surveyor based upon the Service's detailed brief. Costings excluded VAT, fees and specialist fitting out

d Cash costs predicted as £296.2 million

e Approval given but cost reductions of the order of £28 million identified by Stanhope to be investigated further

f Security Service sought Treasury agreement to proceed using a 48 month construction period

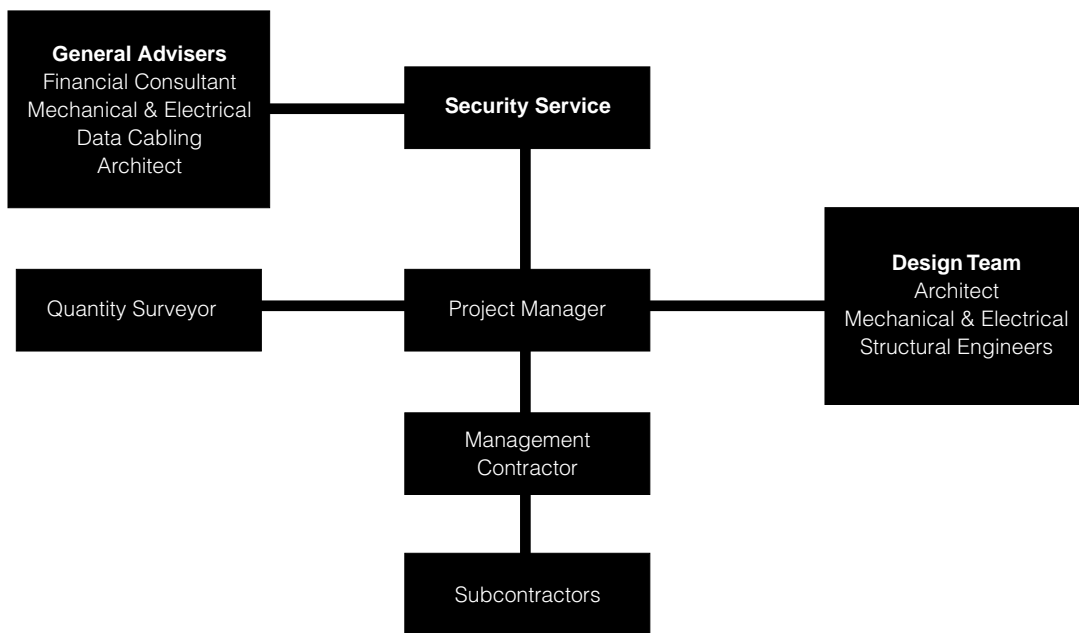
g Construction period reduced to 35 months, cash limit of £246.4 million agreed in April 1991

h Savings of £7.5 million identified

i Savings of £1.4 million (Jun 92), £2.3 million (Feb 93) and £7.8 million (Jul 93) identified

Annex 2

Consultants involved in the refurbishment of Thames House



	Company	Fee
Consultants (in house)		
Financial	N Parry	143
Mechanical & Electrical (O&M)	Cranham	159 ^a
Data Cabling	Admiral	42
Architectural	Murphy	178
Professional Team		
Quantity Surveyor	Northcroft, Neighbour & Nicholson	3,817
Architect	Gollins, Melville & Ward	9,628 ^a
Mechanical & Electrical	T Dunwoody & Partners	5,015 ^a
Structural Engineers	Oscar Fabers	1,700 ^a
Project Management	PSA Projects	3,336 ^a
Management Construction	Mowlems ^b	11,000 ^a
Others		
Building Control/Fire/ Explosives/IDS	PSA/Special Services Group	1,035 ^a
Commercial	Stanhope Properties PLC	931
Technical assessment	Turner & Townsend Project Mgt Ltd	35
Total		37,019

a Project Outturn

b Included in works cost

Source: Security Service

Annex 3

Government specification and specialist security works

Works	Additional requirements	Total contract price	Cost of additional requirements
		£m	£m
Government Specification			
Mechanical and electrical services	Higher specification plumbing, ductwork, Building Management Services systems and maintenance	30.4	4.0
Lifts	Lift control and maintenance to PSA standards	2.9	0.2
Fire protection	Statutory fire regulations	1.9	0.4
Fibrous plaster	Requirements imposed by English Heritage	1.9	0.9
Miscellaneous	Partitions and fittings	2.6	0.5
Preliminary works		24.2	1.3
Consultancy fees		25.0	1.3
Specialist Security			
Demolition	Additional demolition to allow strengthening of building	2.2	0.9
Excavation	Laboratory drainage	4.4	1.1
Steel & roofworks	Steel for frame strengthening and general roof strengthening	8.9	3.4
Fire protection	Protection to structural steel	1.9	0.6
Secondary glazing	Incorporation of anti-blast requirements	1.3	0.5
Mechanical and electrical services	Specialist air conditioning, higher than normal resilience and back-up systems	39.4	8.5
Security systems	Circle lock doors, security kiosks, ID system, CCTV	2.3	2.3
Document distribution system	Specialist Service requirement	2.6	2.6
Automatic file retrieval system	Specialist Service requirement	4.2	4.2
Miscellaneous	Includes site security and security curtains	3.4	1.7
Preliminary works		24.2	5.4
Specialist fit-out	Specialist Service requirements	17.0	1.8
Consultancy fees		25.0	6.0
Contingencies		17.1	4.0

Appendix C

Secret Intelligence Service

Fitting out of Vauxhall Cross

Summary and conclusions

1 The arrangements for the purchase of Vauxhall Cross for the Secret Intelligence Service were the subject of my earlier memorandum in March 1992. This report updates the final purchase price; considers the increase in fitting out costs, including the Service's special security requirements; and examines the appointment of consultants and the requirement for additional space.

Increases in costs

2 In November 1987 the Secret Intelligence Service using a Property Services Agency guide, advised that the order of cost of fitting out a building of the size of Vauxhall Cross was £22 million. While not a firm estimate, it was designed to provide a broad comparison with other options when seeking ministerial approval for the project as a whole. The Prime Minister's approval to go ahead was obtained in March 1988. In September 1988 the order of cost for fitting out increased to £43 million, including £35 million for works services. This included only limited provision for the Service's specific requirements and was subject to wide tolerances as there were numerous variables yet to be quantified in detail such as the developer's specification, and the extent to which the developer would be expected to undertake additional work. This order of cost was incorporated into the November 1988 Public Expenditure Survey submitted to Ministers although it was not drawn specifically to their attention (paragraphs 5 and 15).

3 By July 1989 the order of cost had risen to £77 million as a result of revised inflation assumptions, added requirements for management and advice, and increased costs of wiring, furniture and removals. In June 1990 the Service told the Permanent Secretaries' Committee on Intelligence Services that they would be unable to provide reliable costs for Ministers for another year. In September 1990 the Cabinet Secretary advised Ministers that, although reliable costs were not available, additional funds of the order of £50 million would be required in 1992-94. At this time the Service's internal estimate had increased to £107 million (paragraphs 6 to 9).

4 Based on outline design proposals, in June 1991 the Service produced the first detailed costing of £96 million which was included in the 1991 Public Expenditure Survey round approved by Ministers - though the increase over the original estimate was not drawn specifically to their attention. By the time the Service considered they were in a position to put firm estimates to Ministers, costs had fallen further to £89 million. Therefore, in May 1992, they sought ministerial approval for the project on the basis that expected costs had fallen compared with the 1991 Public Expenditure Survey round. The Treasury approved this figure as a cash limit; it currently stands at £81 million (paragraphs 10 to 14 and Annex 1).

Project management

5 Because the commercial and specialist fitting out stages of the project were closely linked to construction, and because of security considerations, the Service recognised the benefits of continuing to use the same project management and design teams. They therefore appointed the same Project Managers, Design Team and Quantity Surveyors as employed on Phase 1 using lump sum contracts based upon negotiated tender. A number of works contracts were also negotiated, using yardsticks, rather than competitive tender (paragraphs 16 to 20).

Cost of specialist requirements

6 The Service have a number of operational requirements which place particular demands on the use of their headquarters building – for example, the provision of increased security, extensive computer suites, technical areas, bomb blast protection and emergency back-up systems. The National Audit Office calculated that these requirements added about £28 million to the basic cost of Phases 2 and 3 and £54 million in total when the Phase 1 elements are included (paragraphs 24 to 26).

Space allocation

7 * * * (paragraphs 27 to 29).

Conclusions

8 The National Audit Office recognise that the Secret Intelligence Service is unlikely to undertake a project of this type again. Nevertheless, in terms of proper accountability, this case illustrates the need for significant omissions or qualifications to estimates to be clearly highlighted so that decisions can be made in the light of all material facts.

9 While the project management and other contracts were not put out wholly to competitive tender, the Service ensured that the alternative arrangements represented good value for money. The project has been completed on time and the building was fully occupied on 30 June 1994.

- 10** Vauxhall Cross provides 23 per cent more space than the previous accommodation but it allows for the use of more modern technical facilities; and it improves the working environment considerably. The available space is not out of line with normal civil service accommodation - especially when allowance is made for specialist requirements.

Fitting out of Vauxhall Cross

- 1 The project for a new headquarters building at Vauxhall Cross for the Secret Intelligence Service was divided into three phases:
 - Phase 1 - the construction by Regalian Properties of a developer's office block, modified to suit the Service's requirements, with the Property Services Agency acting as the Project Manager;
 - Phase 2 - the main fitting out by commercial contractors under the control of the Service with PSA Projects as the Project Manager;
 - Phase 3 - the fitting out of specialist areas by Service staff or contractors working under direct Service supervision, followed by the phased move from previous accommodation.

Completion of Phase 1

- 2 Phase 1 was covered in my first Memorandum in March 1992, at which time the Property Services Agency had paid some £152.6 million to the developer, Regalian. This sum comprised the basic purchase price of £135 million and an additional £17.6 million for variations, special extra works and compensation payments. The Agency accepted that this additional amount would be subject to adjustment when the scope of the work was finalised. Practical completion of Phase 1 was achieved two weeks ahead of schedule on 14 September 1992, at which point the building was handed over to the Service.
- 3 By May 1993 an initial estimate of the final cost of the additional work had been made and the developer repaid £5 million as a first instalment of the settlement figure. This was followed by a further repayment of £1.65 million in September 1993. The final purchase price was thus £146 million.

Funding arrangements for Phases 2 and 3

- 4 Until 31 March 1994 expenditure on Phases 2 and 3 (£66.5 million) was met from the Foreign and Commonwealth Office's account (Class II, Vote 1) with the Office's Permanent Under Secretary acting as the Accounting Officer. The Cabinet Secretary was responsible for the funding arrangements and budget in his capacity as Accounting Officer for the Secret Services. From

1 April 1994 the remaining expenditure (£14.8 million) is being met from the new Single Intelligence Vote (Cabinet Office: Security and Intelligence Services, Class XIX, Vote 2). The Cabinet Secretary remains the Accounting Officer for this Vote but under the new arrangements the head of the Secret Intelligence Service is the Accounting Officer for the Service's unpublished account within the overall Vote.

Cost estimates for Phases 2 and 3

5 In November 1987 the Cabinet Secretary submitted costed options for a new headquarters building to the Prime Minister. The Vauxhall Cross option included an order of cost figure for fitting out a standard office building of this size of £22 million at 1987 prices. The works services element of £17 million was based on a Property Services Agency guide of £50 per square foot for a basic office accommodation fit-out of similar buildings of comparable size and complexity. The Prime Minister's approval to go ahead was obtained in March 1988. In September 1988 the Property Services Agency revised their order of cost formula to £100 per square foot which represented the typical upper range figure for a commercial office development. This increased the works services cost to £35 million at 1988 prices. After adding the Agency's fees for professional advice, computer wiring, furniture, removal costs and inflation, the forecast increased to £43.3 million in cash terms. This figure was included in the 1988 Public Expenditure Survey forecast submitted to Ministers but was not drawn specifically to their attention.

6 By July 1989 the estimated cost had risen to £77 million in cash terms as a result of:

- revised inflation assumptions for works services;
- an added requirement for the Property Services Agency, rather than the developer, to manage the project as opposed to merely offering professional advice;
- increases in the estimated cost of computer wiring, furniture and removals; and
- an additional requirement for professional advisers to manage the fit-out, security guards to oversee contractors, and duplication of computer equipment during the phased move.

7 The Treasury asked the Service to consider the implications of limiting the fitting out works to what could be afforded within the figure of £43.3 million approved by Ministers, uprated for inflation to £45.7 million. The Service resisted the imposition of a cash limit at this stage, pointing out that the order of cost figures were based on standard office fit-outs, which did not reflect the extensive specialised requirements of the client. These could only be costed once a full specification of the works required was available. Nevertheless, in February 1990 they examined the practical consequences of containing expenditure on the fit-out to within the figure of £45.7 million. Using the latest available estimate of £108.7 million, savings of £63 million (58 per cent) would have to be achieved to meet this target. They considered three options:

- obtaining cheaper materials and labour;
- decommissioning a proportion of the building, and
- reducing the fit-out requirements.

8 The Service considered that:

- after taking advice from the Property Services Agency, the first option would not achieve savings of even half the required amount if basic standards of safety and quality were to be met;
- whilst the second option was feasible in theory it would be necessary to decommission over half of the building - which would then necessitate the Service being split over two locations; and
- after excluding fit-out items considered non-essential to the Service or to the functioning of the building, the savings produced would be less than one-third of those required.

9 The Service concluded that, if the Treasury were to recommend to Ministers that no further funds should be made available, and this course of action were approved, serious consideration would have to be given to abandoning the project. Towards the end of February 1990 the Treasury expressed its concern at the Service's continuing reluctance to seek formal ministerial approval for the costs of Phases 2 and 3. Whilst recognising the importance of not imposing a cash limit based upon inadequate estimates, they pointed out that the further these were refined, the less scope there would be for changes, leaving

Ministers in a position where they could only make minor alterations. In June 1990 the Service informed the Permanent Secretaries' Committee on Intelligence Services preliminary committee that they were unlikely to be in a position to provide reliable costs to Ministers for at least another year. In September 1990 the Cabinet Secretary advised Ministers that, although reliable costs were not available, additional funds of the order of £50 million would be required in 1992-94. At this time the Service's internal estimate had increased to £107 million.

- 10** Based upon the design team's Outline Proposal report in April 1991, the Quantity Surveyor prepared a works estimate in June 1991 which enabled the Service to reduce the total estimate for Phases 2 and 3 to £96 million. At this point the Service informed the Treasury of key dates and latest cost estimates. They said that the next stage of the estimating procedure on completion of the Scheme Design would normally form the basis on which funding approval was sought from Ministers. In this instance, however, this stage would not be reached until mid-November 1991 and if ministerial approval were considered necessary in September the submission could be based upon the current, less accurate, Outline Proposal Costing.
- 11** The Service pointed out that the division of the project into three phases had resulted in the most cost sensitive options being included in Phase 1. This, together with the "Supplemental Deed", which gave the contractor the right to veto any requests for modifications to Phase 1, effectively restricted the scope for major changes to Phases 2 and 3.
- 12** The Service also reviewed the Stanhope Properties report on the Security Service's new building to ascertain whether the recommendations could be applied to Vauxhall Cross. They concluded that the report's suggestions had already been introduced for the elements of the project which were directly comparable. The Treasury agreed that a formal independent review was not required and, after receiving further details of the works services costs and space requirements, they approved a cash ceiling of £96 million. This figure was included in the September 1991 Public Expenditure Survey submission to Ministers, though the increase over the original estimate was not drawn specifically to their attention.

13 In December 1991 the Service submitted to the Treasury a reduced estimate of £92.2 million based upon the Scheme Design. In spring 1992 the Treasury asked the Service to provide a cost comparison between Vauxhall Cross and the Security Service headquarters. In the light of this comparison the Treasury concluded that:

- building costs, excluding special security features, were consistent with the rents which a landlord could command, given market yields when the building was acquired;
- the unit costs of the occupational elements, which usually fall to a commercial tenant were comparable between the Security Service building (£78 per square foot) and Vauxhall Cross (£82 per square foot); these costs were higher than many other buildings on the government estate but not unreasonably so, and
- the specialist costs relating to the requirements of the intelligence agencies were lower in the Vauxhall Cross building.

14 In May 1992, after taking into account a further reduction of £2.9 million in the contingency provision, the Treasury indicated that it was content for the Service to make a formal submission to Ministers. The Service therefore advised Ministers that costs, at £89.3 million, were within the £96 million they had agreed in the 1991 Public Expenditure Survey round. The Treasury then approved a cash limit of £89.3 million in July 1992. There have since been two reductions to the cash limit to take into account a decrease in the number of on-site security staff and a fall in the estimated works outturn. The present cash limit is £81.3 million.

Reasons for cost increases

15 When the Property Services Agency prepared its order of cost of £22 million in 1987 it was based upon broad assumptions at current prices. In September 1988 the Agency warned the Service that the revised estimate of £35 million for works services was subject to wide tolerances as there were numerous variables yet to be quantified in detail. These included:

- the specification of the developer's building;
- the specification of the building required;

- the specification of the fitting out works;
- the programme to completion; and
- the extent of the work to be undertaken by the developer.

It was not until June 1991, some 33 months later, when the Quantity Surveyor's cost estimates were available that the Service were in a position to produce an estimate for Phases 2 and 3 of £96 million which they were prepared to include in the 1991 Public Expenditure Survey submission. The estimate was revised downwards six months later based upon the full Scheme Design.

Project management

16 When seeking to identify the most appropriate method of managing and executing the fitting out stage of the project, the Service took advice from the Property Services Agency and the Central Unit on Purchasing. They concluded that they could either recruit suitable personnel to enable them to manage the project effectively themselves, employ the Property Services Agency or retain private sector consultants. The Central Unit on Purchasing advised the Service that if they were to seek a commercial management arrangement, impartial professional advice would still be required in order to ensure that the correct consultants were selected. In addition they considered that:

- the distinction between Phase 1, for which the Property Services Agency were Project Managers, and Phase 2 was slightly artificial in project management terms;
- the Agency had expertise in government requirements, Civil Service standards and security measures;
- the Agency could continue to preserve security cover until commissioning and handover; and
- the Agency would be able to assist in the security clearance of key contracting personnel.

The concluding advice was that, in the light of these points and the Treasury's misgivings about following the largely untried commercial route on a project of this size and sensitivity, the Service should retain the Property Services Agency as project managers.

Appointment of consultants

- 17 As the three phases of the project were closely linked the Service decided to retain the Phase 1 Design Team appointed by the developer, and the Quantity Surveyor who had acted for the Property Services Agency. The Service told the National Audit Office that this decision was based upon the consultants' familiarity with the project and their proven expertise in Phase 1. The agreements were based upon lump sum contracts subject to adjustment for inflation and were by negotiated tender.

Appointment of the Management Contractor

- 18 After satisfactorily negotiating the contract price the Service decided to retain the same Management Contractor used by the developer on Phase 1. This approach was aimed at providing an element of continuity and allow a smooth transition between the phases.

Negotiation of Phase 2 works contracts

- 19 In April 1992 the Design Team and the Management Contractor recommended that seven of the 28 works contracts, worth some £17.4 million or 46 per cent of the works cost, should be negotiated rather than competitively tendered. This approach was endorsed by the Project Manager. All the firms concerned had been engaged by the Management Contractor on Phase 1 after competitive tendering and the work to be undertaken in Phase 2 consisted of modifications or extensions to Phase 1 contracts. The consultants considered that by using the same contractors the Service would benefit from the knowledge and expertise acquired and should avoid any conflict over warranties and design responsibilities. The Service agreed that the packages should be negotiated providing that the cost did not exceed the yardstick based upon a pre-tender estimate provided by the Quantity Surveyor.

- 20 The National Audit Office examined the negotiated prices for these contracts and compared them with the cost plan prices and the yardsticks. The contracts were let for £16.8 million; this compares favourably with the cost

plan price of £17.4 million and the yardstick price of £19.2 million. The remaining works contracts were put out to competitive tender by the Management Contractor.

21 Practical completion of Phase 2 was achieved, on schedule, on 24 December 1993. Although the building was not sufficiently advanced for full occupational purposes because of delays in the construction programme, the Service accepted that the level of finish was sufficient to allow Phase 3 to begin. This ensured that the project as a whole was not delayed.

Phase 3

22 Phase 3 was divided into two parts: 3a, the specialist fit-out, and 3b, the phased move of staff from the old estate. The works element was carried out by a mixture of in-house staff and external contractors under the supervision of the Service. In all cases where the Service employed contractors, competitive tendering occurred. The constituent elements of Phase 3 expenditure are shown in Table 1.

Cost of Phase 3 works **Table 1**

This analysis shows the constituent elements of Phase 3

	Estimate	Estimated outturn	Variation	
	£000	£000	£000	%
Computer equipment	864	887	23	3
Communications	1,967	2,470	503	26
Removals	518	120	(398)	(77)
Temporary staff	891	475	(416)	(47)
General office furniture	3,122	2,985	(137)	(4)
Clearance of Century House	96	50	(46)	(48)
Catch-up contract	260	650	390	150
Overlap utilities	125	88	(37)	(30)
Security equipment	450	450	-	-
Contingencies	910	-	-	-
	9,203	8,175	(1,028)	(11)
VAT	1,488	1,358	(130)	(9)
Total	10,691	9,533	(1,158)	(11)

23 The Service completed Phase 3a on schedule, on 31 March 1994. Phase 3b was completed on 30 June 1994 at which time the building became fully occupied. To date the Service has settled over 99 per cent of the Phase 2 and 3 contracts worth £74.7 million. The items still to be finalised have an estimated value of £0.4 million.

Cost of specialist requirements

24 In replying to a Treasury request for comparative costs, the Secret Intelligence Service identified those costs which were attributable to their specialist requirements. The exercise apportioned the costs into four categories:

- **developer specification** - costs that would be expected within a standard developer's specification for a building constructed speculatively for the commercial market (main structure and services);
- **Government specification** - cost of meeting the Agency's requirements for the minimum standard of government accommodation, as laid down for the common user estate, in excess of a normal commercial specification;
- **purchaser specification** - costs which a single corporate tenant with a high computer usage in a commercially rented building would expect to bear to make it suitable for occupation (partitioning, catering, data wiring, communications and modifications specific to the occupant); and
- **specialist requirements** - items peculiar to the Secret Intelligence Service which would not be required by a normal tenant (laboratories, workshops, physical and electronic security measures).

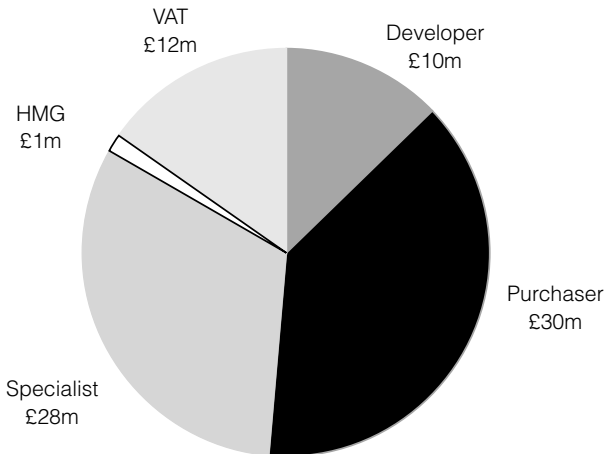
25 As this calculation excluded Phase 3 work, the National Audit Office updated the figures, also taking into account subsequent changes to the cash limit. The methodology used to apportion the costs previously excluded was agreed with the Service although they pointed out that, while the calculation gave a broad indication of the split, the allocations were not precise because of the number of assumptions which had to be made. The results are shown in Figure 1.

26 The analysis suggests that a private sector client would have expected to pay £40 million, excluding VAT, to fit-out Vauxhall Cross, whilst a typical government department would have incurred additional expenditure of £1 million. On top of this the Secret Intelligence Service have spent a further £28 million to adapt the property to meet their specialist requirements. This is in addition to the estimated £26 million spent on security requirements as part of Phase 1. The cost elements, categorised as government or specialist, are shown in Annex 3.

**Analysis of fit-out costs
(Phases 2 and 3)**

Figure 1

Specialist requirements account for £28 million (35 per cent of the cost excluding VAT)



*Source: National Audit Office
calculation based on Secret
Intelligence Service data*

Increase in space allocation

27 The National Audit Office compared the size of the Service’s previous accommodation with Vauxhall Cross (Table 2). This showed that, although accommodation has increased by *, there is little change in percentage terms between the different types. * * *. The Service explained that conference space in the old headquarters building was severely limited, a situation which was remedied in Vauxhall Cross by providing accommodation for formal discussions and ad hoc meetings. The significant increase in computer space reflected the need to provide Service computers previously housed in the Security Service’s premises and for future expansion of the central processors and associated equipment.

Comparison of size of previous estate and Vauxhall Cross

Table 2

*The average net usable area has increased ****

	Previous Estate ^a		Vauxhall Cross		Increase
	Sq ft ^b	%	Sq ft ^b	%	%
*	*	*	*	*	*
*	*	*	*	*	*
*	*	*	*	*	*
*	*	*	*	*	*
*	*	*	*	*	*
Other ^c	35,944	*	48,386	*	35
TOTAL	*	*	*	*	
Increase	*	*	*	*	*

a Only buildings occupied by staff moving to Vauxhall Cross

b Net usable area

c Restaurant, dining suites, library and reprographics

Source: Secret Intelligence Service

28 * * *

29 The National Audit Office also compared the average occupation density of the Service's previous estate and Vauxhall Cross with that of other government departments. Figure 2 * * *. The Service also pointed out that the previous estate was significantly overcrowded and did not meet fire or health and safety regulations in a number of areas. * * *.

Comparison of average occupation densities

Figure 2

*Accommodation in Vauxhall Cross ****

* * *

Source: Government Purchasing report, 1992, and Secret Intelligence Service

Annex 1

Vauxhall Cross: chronology of financial submissions

Date		£m	Price basis
Nov 87	Submission to Prime Minister ^a	22.4	1987 VATEX
Nov 88	Order of cost included in 1988 Public Expenditure Survey approved by Ministers ^b	43.3	cash VATEX
July 89	Revised order of cost ^c	77.0	cash VATEX
Jun 91	Costed scheme included in 1991 Public Expenditure Survey approved by Ministers ^d	96.0	cash VATIN
May 92	Ministers approved new estimate	89.3	cash VATIN
July 92	Cash limit set	89.3	cash VATIN
Nov 92	Cash limit revised ^e	87.7	cash VATIN
Jul 93	Cash limit revised ^f	81.3	cash VATIN

a Based upon PSA order of cost for works services of £50 per square foot for standard office accommodation

b Based upon PSA revised order of cost for works services of £100 per sq foot for a commercial office development

c Additional PSA fees of £7million, addition of IT costs, professional fees, new telephone system and guards

d Quantity Surveyor's costings at Outline Proposal stage

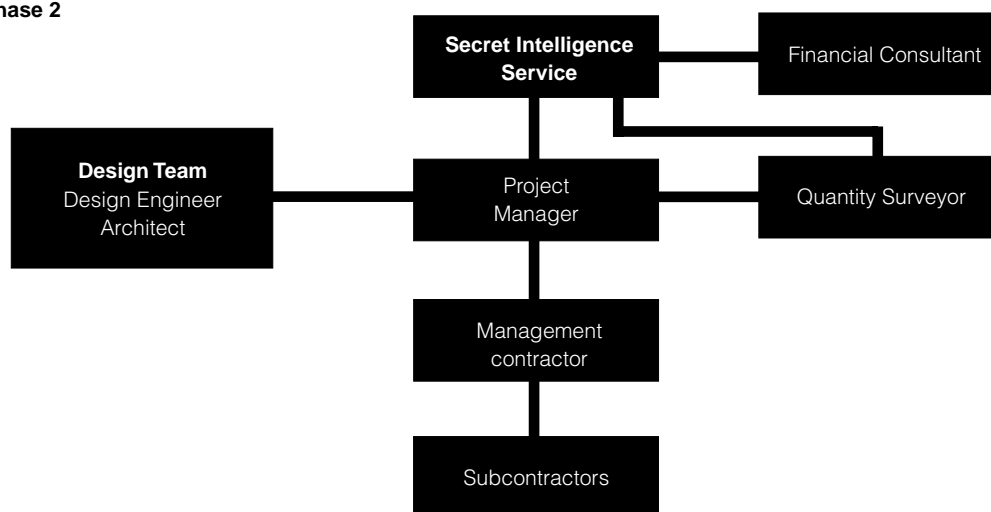
e Decrease of £1.6 million for security staff

f Reduction in works costs and contingency provision of £6.3 million

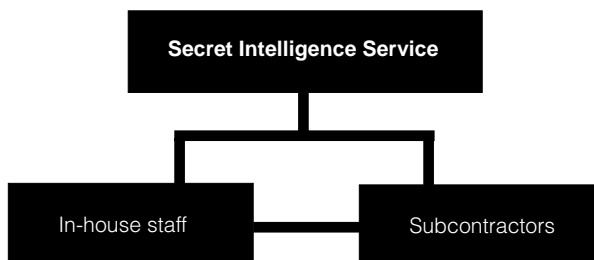
Annex 2

Consultants and contractors involved in the Vauxhall Cross fit-out

Phase 2



Phase 3



Specialisation	Company	£000
Design Team	Ove Arup (design engineers)/ Terry Farrell (architect)	6,024
Quantity Surveyor	George Corderoy and Company	1,218
Project Manager	PSA projects/TBV Consult ^a	1,390
Management Contractor	Laing Management Limited	6,744
Others		889
Financial Adviser	Nigel Parry	210
Total		16,475

Source:

The Secret Intelligence Service

a Post privatisation of PSA

Annex 3

Government specification and specialist requirements

Phase	Works description	Base price ^a		Government specification		Specialist requirements		Total
		£m	%	£m	%	£m	%	£m
Phase 1	Payments to developer	113.1	75	12.9 ^b	9	24.9 ^c	16	150.9
Contract price	Fees	1.7	65	0.3	12	0.6	23	2.6
		114.8	75	13.2	9	25.5	16	153.5
Phase 2	Works costs	21.9	58	0.6	2	15.3 ^d	40	37.8
Cash limit ^e	Management contract costs ^f	3.6	58	0.1	2	2.5	40	6.2
	Fees ^f	5.1	59	0.1	1	3.5	40	8.7
	Internal costs ^g	0.5	33	-	-	1.0	67	1.5
	Other ^h	6.4	57	0.2	2	4.6	41	11.2
		37.5	57	1.0	2	26.9	41	65.4
Phase 3	Communications ⁱ	2.4	86	-	-	0.4	14	2.8
Cash limit ^l	Furniture	3.1	100	-	-	-	-	3.1
	Security ^k	-	-	-	-	0.5	100	0.5
	Other ^l	2.8	100	-	-	-	-	2.8
		8.3	90	-	-	0.9	10	9.2
	Total	160.6	71	14.2	6	53.3	23	228.1
	VAT							13.0
	Grand Total							241.1^m

a Combined cost of developer and purchaser specification

b Includes £8.6m for the changes required by the PSA to meet Common User Estate requirements

c Includes ***, delay claim (£2.6m) and internal/external additional requirements (£2.7m)

d Includes structural works (£0.6m), security works (£4.2m), technical facilities (£5.2m) and resilience (£0.2m)

e Phase 2 element of Phase 2/3 cash limit of £87.7m (ie £89.3m approved by Ministers in July 1992 reduced in Nov 1992 by £1.6 million for decrease in site security staff). The cash limit was subsequently reduced to £81.3m

f Apportioned pro-rata in line with the works costs

g Security during Phase 2 and certain consultancy services

h Inflation and contingency

i Migration of computer equipment, setting up of communications highways

g Phase 3 element of Phase 2/3 cash limit of £87.7m (see note e)

k Closed circuit television and intruder detection equipment

l Includes removal costs (£0.5m), temporary staff required for the move (£0.9m), clearance of vacated buildings and overlapping utilities (£0.3m), modifications to Phase 2 space layout (£0.2m) and contingency (£0.9m)

m As mentioned in paragraph 25 of the report, these figures are based on data prepared in 1992 about the division of costs between standard government and specialist requirements. The latest estimate of the total cost of Vauxhall Cross is £146m purchase price and £75.1m for fitting out (a total of £221.1m)

Source: Secret Intelligence Service and the National Audit Office

Appendix D

Report by the Chairman of the Committee of Public Accounts

Purchase of Buildings for the Security Service and the Secret Intelligence Service

Introduction and summary of conclusions and recommendations

- 1** In 1988 and 1989 the then Property Services Agency made arrangements to acquire buildings for occupancy by the Security Service and the Secret Intelligence Service at a cost of £82 million and £135 million respectively.

- 2** On the basis of a memorandum by the Comptroller and Auditor General I took evidence from the Cabinet Secretary and Property Holdings. I examined the two purchases separately, in each case considering the requirement for the new buildings and their size, the risks to value for money from the unusual financial arrangements which were made and, in so far as it affected the purchase price, the cost of refurbishment and fitting out. I have considered the evidence provided and my main conclusions and recommendations are as follows:
 - a)** in both cases I recognise the need for special accounting treatment on grounds of national security but the arrangements made contained some unsatisfactory features. I also consider that extra risks to value for money arose because of the desire to conclude arrangements within the relevant financial years (paragraphs 21, 43 and 44);

 - b)** it is important, notwithstanding the need to maintain the interests of national security, that procedures for securing value for money are applied at least as rigorously as they should be elsewhere in government departments (paragraphs 24 and 44);

On Thames House:

- c) I would expect constraints arising from the original design of existing buildings to be taken into account before a decision to purchase is made. It is fortuitous that, in the event, these constraints did not lead to the Government's purchase decision being called into question (paragraph 20);
- d) while a discount was obtained for early payment, the desire to conclude the deal before 31 March 1988 resulted in a breach of Parliamentary Supply and Government Accounting procedures in that expenditure was incurred in advance of need: this seemed to me to take special accounting treatment too far (paragraph 21);
- e) extra risks to value for money arose from the desire to spend money by the end of the financial year - notably whether negotiations were as complete as they might otherwise have been, whether full consideration was given to the legal details of the purchase, and whether sufficient account was taken of refurbishment costs (paragraph 22);
- f) making payment before the transfer of legal title was a questionable risk - with a substantial amount of public funds - taken solely on the grounds of secrecy. I am pleased to see that the risk did not come to fruition (paragraph 23);
- g) while I accept that the discount for advance payment was part of a package deal, the rate was noticeably lower than those generally available. I was disappointed to learn that the Property Services Agency had not kept a record of their negotiations. I consider it important that major purchase decisions should be fully documented (paragraph 25);
- h) I am concerned that a mistake was made regarding ownership. There should be thorough consideration of details affecting a purchase, even when arrangements need to be made quickly (paragraph 26);

On Vauxhall Cross:

- i) paying up front for a building before a brick has been laid is in essence incurring expenditure in advance of need: this again seemed to me to take special accounting treatment too far (paragraph 43);
- j) extra risks to value for money arose because of the desire to spend money by the end of the financial year - whether there was sufficient time to establish firmly that the newly designed building was adequate for its

intended use, whether appropriate steps were taken to safeguard the Government's advance investment, whether adequate attention was paid to likely design changes to minimise variation orders, and whether sufficient account was taken of potential fitting out costs (paragraph 44);

- k)** I am concerned that the assessment of net usable area was too high and that the building will be 14 per cent short of estimated requirements (paragraph 45);
- l)** I would expect departments to carry out basic checks of a company's financial background where substantial investments are involved (paragraph 46);
- m)** I recognise that the Property Services Agency took action once they realised that costs were getting out of control but am concerned that variation orders totalled £24.5 million, exceeding the Treasury target by a significant margin (paragraph 47);

on refurbishment and fitting out:

- n)** I am particularly concerned at the rise in the cost of refurbishment and fitting out of both buildings. It is clearly important to have as clear an indication as possible of likely costs so that soundly based decisions can be made about potential purchases (paragraphs 27 and 48); and
- o)** I look to the Comptroller and Auditor General to follow up both cases so that I may consider taking further evidence (paragraphs 28 and 48).

Thames House

Property negotiations

- 3** Thames House comprises two buildings: Thames House North and Thames House South. The latter was partly held by the Property Services Agency, as part of the Government's civil estate, on a lease which expired in 1982 but had been renewed under the Landlord and Tenant Act 1954.
- 4** The Property Services Agency had had discussions with the owners, Imperial Chemical Industries, intermittently since 1980 about buying various freehold interests in Thames House. The latest in this series of negotiations began in February 1987 at the owner's behest. Although the Agency had no firm plans

for the building at the time, Ministers were attracted to the prospect of acquiring more freehold property. However they felt that the estimated cost of acquisition and refurbishment, at £100 million, was too high.

- 5 Estimates prepared by the Property Services Agency later in the year increased to £75 million to £80 million for acquisition plus £60 million for refurbishment, taking account of rising property prices and more detailed survey data. Ministers were not prepared to seek colleagues' approval for a higher offer before the General Election. Although Imperial Chemical Industries extended their deadline until shortly after the election, the properties were sold in June 1987 to Berkley House for £75.6 million. Berkley paid a deposit of £11.3 million, on which Imperial Chemical Industries paid them interest, pending vacant possession of the two buildings in August 1988 and December 1989.
- 6 Two months later Berkley approached the Agency about taking up a tenancy and later offered the freehold for £150 million (£300 million refurbished). By this time the Security Service were seeking new premises and Thames House seemed to be suitable - though the Agency were not prepared to pay the asking price, which they considered to be excessive. Negotiations continued, the Agency having secured Ministerial approval to spend up to £80 million. This approval was conditional on the expenditure being incurred by 31 March 1988 so that funds could be provided by way of a supplementary estimate and hence attract less attention. This was seen as a distinct security advantage as it minimised the risk while works were being carried out before occupation. In the event, however, Thames House was sold to Leigh Estates, a subsidiary of the Mountleigh Group, for £80.6 million in December 1987.
- 7 Shortly afterwards, Mountleigh asked the Agency if they would be interested in purchasing Thames House. After negotiations, Mountleigh made two proposals: that the Agency should pay Leigh £13 million plus the deposit of £11.3 million, leaving the Agency free to negotiate directly with Imperial Chemical Industries; or that the Agency should pay Leigh £82.484 million, including a £6 million discount for payment in advance. The Agency chose the second option and, having negotiated a further reduction, paid £82 million for Thames House on 2 March 1988.

Location and size

- 8 The Cabinet Secretary assured me that sites outside London had been considered. Although more expensive, the Government felt that the Security Service should be neither sent outside London nor split up. At the same time there was a need for the Security Service to remain within easy reach of the Home Office, the Metropolitan Police and Whitehall. There was also a need to move out of buildings which needed a major refit, to bring together some of the staff currently located in 12 separate buildings and to improve on the cramped conditions arising from increases in staff numbers. In addition, the existing estate did not fully meet fire, health and safety regulations and was insufficiently resilient in the light of threat assessments.
- 9 The Service's forecast needs were for 406,000 sq ft, a 25 per cent increase over their current 319,000 sq ft. Thames House was expected to provide for a surplus of 70,000 sq ft over that requirement. There has been a 7 per cent increase in staff since the purchase decision was taken which will use up a further 21,000 sq ft. Currently some 1,855 staff are expected to move into Thames House. Although averaging 230 sq ft for each staff member, this was not to provide larger offices but to make allowance for their need for a great deal of high technology equipment.
- 10 A more recent feasibility study on Thames House has shown that, amongst other things, more effective use could be made of the basement area, increasing the net usable area by 27 per cent to 493,687 sq ft - although providing only a 3 per cent increase in office space. It has not, however, been possible to make the most efficient use of the available space in Thames House because of constraints imposed by the original design of the buildings.

Financial arrangements

- 11 Thames House changed hands three times in a short space of time, in effect causing the Property Services Agency to pay some £13 million to intermediaries. Property Holdings said that they did not think the Property Services Agency had been too cautious in negotiations. They had not identified a client department at the time and therefore had no voted funds for acquisition.
- 12 Given the security requirement to arrange the purchase of, and the full payment for, Thames House before 31 March 1988, I was concerned to establish whether opportunities to secure the best value for money had

nevertheless been obtained. Property Holdings said that they had kept in touch with Imperial Chemical Industries during the negotiations with Mountleigh. This was not, however, documented. Imperial Chemical Industries had offered a reduction for advance payment which represented a discount of $4\frac{3}{4}$ per cent, when money rates were about 9 per cent. The company had indicated that they could not improve on this offer for tax reasons but Property Holdings were not aware of them.

- 13 Property Holdings said that Mountleigh's offer contained no specific proposition about interest on the deposit of £11.3 million - worth about £1.6 million - nor did they explore that avenue as they believed that the benefit of the interest was not negotiable. Taking account of interest on the deposit, the National Audit Office calculated the discount at $6\frac{1}{2}$ per cent.
- 14 Property Holdings emphasised that, while the issue of interest was not part of the negotiations, it was a question of considering the whole package, which they considered provided value for money. The Property Services Agency secured a reduction of £480,000 in the total price. Compared with the original price paid by Berkley, the increase was 18.5 per cent whereas capital transactions in general had gone up by 30 per cent; compared with Mountleigh's purchase, the increase was 7 per cent at a time when property prices were rising at 9 per cent to 10 per cent over a three month period. Mountleigh's offer was open until 24 February 1988 and Property Holdings suspected that, on the evidence of rising property prices, the price would then have gone up.

Refurbishment

- 15 Anxious to proceed with refurbishment work as early as possible, given that the buildings were effectively costing the taxpayer £20,000 a day, the Property Services Agency wanted to start work on the North building, which came into their possession first. To do this they needed to close Page Street, the road which separates the North and South buildings. However they discovered that Imperial Chemical Industries had, contrary to normal practice, retained ownership of the land beneath whole highway with the South building. This led the Agency into a novation agreement which provided for ownership of both buildings to pass to them in November 1988 but leaving all the other parties involved in the same financial position. The Agency were nevertheless unable to proceed with the immediate closure of Page Street because of delays in making contractual arrangements for the works.

- 16 Property Holdings accepted that the ownership position was clear on the drawings and agreed that the Property Services Agency should have realised the position before. The mistake cost between £10,000 and £15,000 but did not delay the project.
- 17 The estimated cost of refurbishing Thames House rose from a provisional £60 million in 1987 to £239 million by 1989. The earlier estimate was made without the benefit of detailed surveys or an indication of the client's specific requirements. It was nevertheless intended to give ministers a sound basis for comparing potential costs with other options.
- 18 Property Holdings said that, although their predecessors had not commissioned a structural survey before purchase, they had had full access to information on surveys carried out for others; and the Agency had conducted their own tests on the fabric of the building. They assured me that no structural faults had been found.
- 19 The main increase in refurbishment costs arose a month after purchase, following survey results; the estimate then rose to £170 million. Special requirements by the Security Service later added £41 million and changes in VAT rules added another £30 million. The Cabinet Secretary assured me that, had these figures been known at the time, they would not have affected the decision to purchase Thames House.

Conclusions

- 20 I note that consideration was given to alternative sites and to maximising the use of space available. I also note that constraints arising from the original design mean that it has not been possible to make most efficient use of space. I would expect such factors to be taken into account before a decision to purchase is made; it is, perhaps, fortuitous that, in the event, these constraints did not lead to the Government's purchase decision being called into question.
- 21 I recognise the need for special accounting treatment on grounds of national security so that appropriate secrecy may be preserved but these arrangements contained some unsatisfactory features. First, the legal transfer of the property did not take place until well after payment had been made. While a discount was obtained for early payment, the desire to conclude the deal before 31 March 1988 resulted in a breach of Parliamentary Supply and Government Accounting procedures in that expenditure was

incurred in advance of need rather than being returned to the Exchequer as unspent and surplus to requirements. Incurring expenditure in advance of need seemed to me to take special accounting treatment too far.

- 22** Second, I consider that there were extra risks to value for money arising from the desire to spend money by the end of the financial year - notably whether negotiations were as complete as they might otherwise have been, whether full consideration was given to the legal details of the purchase, and whether sufficient account was taken of refurbishment costs.
- 23** Third, there was the fundamental risk of making payment before the transfer of legal title: while certain precautions were taken, this remained, in my view, a questionable risk - with a substantial amount of public funds - taken solely on the grounds of secrecy. I am pleased to see that the risk did not come to fruition.
- 24** I regard it as important, notwithstanding the need to maintain the interests of national security, that procedures for securing value for money should be applied at least as rigorously as they should be elsewhere in government departments.
- 25** While I accept that the discount for advance payment was part of a package deal with Mountleigh, the rate was noticeably lower than those generally available. I was disappointed to learn that the Property Services Agency had not kept a record of their negotiations. I consider it important that major purchase decisions should be fully documented.
- 26** I am concerned that a mistake was made regarding the ownership of land beneath Page Street, which cost between £10,000 and £15,000 - though this did not, in the event, delay the project. It nevertheless underlines the need for thorough consideration of details affecting a purchase, even when arrangements need to be made quickly.
- 27** I am alarmed at the enormous rise in the cost of refurbishing Thames House from £60 million in 1987 to £239 million in 1989. I am assured that the fault did not lie in inadequate surveys before purchase. Nevertheless it is obviously important to have as clear an indication as possible of likely costs so that soundly based decisions can be made about potential purchases.

- 28 I shall be interested to see how the refurbishment works out in practice and look to the Comptroller and Auditor General to follow this up so that I may consider taking further evidence.

Vauxhall Cross

Initial considerations

- 29 In 1987 the Property Services Agency were approached by Regalian Properties to see whether they would be interested in a proposed new office block on the former "Green Grant" site near Vauxhall Bridge. After initial negotiations Regalian proposed a price of £131.8 million for the freehold purchase.
- 30 In July 1988 the Prime Minister agreed in principle to the building being acquired for the Secret Intelligence Service. For security reasons the Treasury proposed that the building should be paid for, in advance of construction, before 31 March 1989. The Agency were aware that it might not be possible to reach final agreement and pay by this deadline. They therefore considered contingency options, such as placing an amount in an account held jointly by the Treasury Solicitor and the developer's solicitor.
- 31 The Agency explored with Regalian the discount which might result from payment in advance. Taking account of modifications required by the Agency and the Secret Intelligence Service, the cost of purchase was settled at £159 million and the discount at £24 million.
- 32 In the meantime the Agency consulted the Treasury Officer of Accounts about full payment before construction. He considered that the payment would be in advance of need and that the deal proposed did not appear to be so advantageous, beyond what could be achieved with stage payments, such that it justified early payment. However, the Accounting Officer of the Property Services Agency, the Permanent Secretary to the Treasury and the Cabinet Secretary confirmed their satisfaction with the terms of the deal and that the need of security warranted payment in advance. The Agency paid Regalian the balance due, allowing for a deposit, on 13 March 1989.

Location and size

- 33** As with the Security Service, the possibilities of locating the Secret Intelligence Service outside London were considered but rejected. Co-location of the two services was also considered but it was not an operational requirement and it proved impractical to find a building or site of sufficient size.
- 34** The forecast needs of the Secret Intelligence Service were for 350,000 sq ft, compared with existing space in Century House of 182,000 sq ft. The requirement was reduced to 295,000 sq ft by the end of 1987. The extra space was required mainly for additional demands for computer space and to bring occupancy up to standard.
- 35** The Property Services Agency agreed modifications to Regalian's design; this was to provide a taller, narrower building which would be more suitable for dividing into rooms to civil service standards and generate a 15 per cent efficiency saving. The cost of these changes was £8 million. The Agency thought that they had achieved the efficiency savings.
- 36** An analysis during the feasibility study on the first phase of the project indicated that the original assessment of the net usable area of the building was too high. The final figure of 252,497 sq ft represented a shortfall of 14 per cent on the estimated requirement.

Financial arrangements

- 37** Had a contract been let in the normal way, stage payments would have been made and 2½ per cent of the final sum would have withheld for a year as retention money. To provide an alternative means of guaranteeing performance, the Agency required Regalian to provide a bond. The company's bankers put up a bond of £90 million against cash deposited by Regalian; the Agency paid the cost of the bond, estimated at £576,000.
- 38** This bond was some £20 million less than the Agency would have liked. They pointed out that the gap was covered by the interest which would accrue on the £90 million and by Regalian not being allowed to call on the guarantee until £20 million of work had been completed. The Agency accepted, however, that they were not covered for the additional costs of another contractor. They also admitted that they had not investigated the financial background of the company nor made enquiries of the company's bankers.

- 39 The agreement with Regalian was for a fixed price but made allowance for adjustment for special items, such as * * *, where the cost was uncertain. The * * * proved to be significantly more expensive than expected - * * *. Because the cost of abandoning the requirement would have been even more expensive, the Agency paid the extra costs. Property Holdings explained that the more costly alternative arose because the Secret Intelligence Service would not * * *; this would have meant another capital purchase and finding an occupier for Vauxhall Cross.
- 40 By March 1990, one year after the agreement with Regalian, the Property Services Agency had paid a further £17.5 million to Regalian. This included £10 million * * *, £3 million in compensation for delays and £4.2 million for variation orders.
- 41 Property Holdings accepted that by December 1989 a number of variations had been agreed without full control. There was then an agreement with the Treasury that variations would be limited to £½ million a year. In total, however, variations had amounted to £24.5 million. Property Holdings said that they would no longer follow the same procedures: they had issued revised guidance in June 1992 about handling private developer schemes.

Fitting out costs

- 42 In November 1988 the cost of fitting out Vauxhall Cross and meeting the Secret Intelligence Service's special requirements, other than those in the main structure, was £35 million. The current estimate is £87.6 million. This sizeable increase was mainly attributable to inflation, additional special requirements and the imposition of VAT. The Cabinet Secretary recognised that the increase in costs on Thames House and Vauxhall Cross had come as a shock but they were now exercising tight control and both had since worked out well. The original purchases contained no surprises: they were delivered at the expected prices, except for the * * * at Vauxhall Cross. Although the original refurbishment/fitting out costs had escalated they have since been coming down.

Conclusions

- 43 As with Thames House, security considerations led to some unusual financial arrangements. Again I recognise the need for special accounting treatment on grounds of national security but consider that these arrangements, too, contained some unsatisfactory features. Paying up front for a building before

a brick has been laid is not normal practice and seems to me to have been an unnecessary risk with public funds; in essence the expenditure was again in advance of need with the same consequences described in paragraph 21 above. Here again it seemed to me to be a questionable risk - with a substantial amount of public funds - taken solely on the grounds of secrecy. I am pleased to see that this risk did not come to fruition either. I would have been even more concerned had recourse been made to making payments before an agreement had been reached, as was at one time considered.

- 44** More generally, I consider that extra risks to value for money arose because of the desire to spend money by 31 March 1989, in particular whether there was sufficient time to establish firmly that the newly designed building was adequate for its intended use, whether appropriate steps were taken to safeguard the Government's advance investment, whether adequate attention was paid to likely design changes to minimise variation orders, and whether sufficient account was taken of potential fitting out costs. As noted earlier, I regard it as important, notwithstanding the need to maintain the interests of national security, that procedures for securing value for money should be applied at least as rigorously as they should be elsewhere in government departments.
- 45** I am pleased that Property Holdings are satisfied that they will achieve the expected efficiency savings arising from the changed design. I am, however, concerned that the assessment of the net usable area of the building was too high and that the building will be 14 per cent short of estimated requirements.
- 46** The Property Services Agency took steps to protect their advance payment for the construction works although the bond would not have been sufficient had the company failed in the early stages. Enquiries were not made of the company's financial background; I would expect departments to carry out such basic checks to safeguard their interests where substantial investments are involved.
- 47** Initially the Property Services Agency allowed cost increases to get out of control. I am pleased to note that they took action to minimise risks for the future though I am concerned that variation orders totalled £24.5 million - 15 per cent of the undiscounted price. This exceeded the target agreed with the Treasury by a significant margin.

48 I am particularly concerned to see that the cost of fitting out Vauxhall Cross has more than doubled. Again, I would like to pursue this aspect further, beyond the effect on the purchase decision, and look to the Comptroller and Auditor General to follow this up so that I may consider taking further evidence.

Robert Sheldon
House of Commons

June 1993