



House of Commons
Committee of Public Accounts

PFI: The STEPS deal

**Twentieth Report of
Session 2004–05**

*Report, together with formal minutes,
oral and written evidence*

*Ordered by The House of Commons
to be printed 6 April 2005*

HC 553
Incorporating HC 1211-i, Session 2003–04
Published on 14 June 2005
by authority of the House of Commons
London: The Stationery Office Limited
£10.00

The Committee of Public Accounts

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Summary

In April 2001, HM Customs & Excise and the Inland Revenue (the Departments) transferred the ownership and management of most of their estates to Mapeley, a private sector consortium in a 20-year Private Finance Initiative (PFI) deal. The Departments expect to reduce running costs over the life of the deal and will have flexibility to vacate up to 60% of the estates, irrespective of the cost of breaking residual lease terms, which will be borne by Mapeley. Mapeley can also arrange additional accommodation and has provided over thirty additional buildings in the first three years of the contract.

Figure 1: Properties transferred to Mapeley

Type	Buildings (number)	Space (000 sqm)
Leasehold	415	775
Freehold	159	581
Total	574	1,356

Source: C&AG's Report

Mapeley won the competition for the deal because it had been considerably cheaper than the next best bid and was also lower than the estimated cost of retaining the estates in the public sector.

Mapeley was a new company that wanted to enter the commercial property market. Its bid was based on speculative returns from increases in commercial property values over a 20-year time horizon, with operating profits expected to be minimal. Mapeley also assumed that it would win other business on the back of the deal, but has not yet succeeded in doing so.

On signing the contract with the Departments, Mapeley transferred the freehold and long-leasehold properties to a company based in Bermuda. As a result, any capital gains made by Mapeley on the sale of the properties will not be captured under the current UK tax regime.

Seven months into the deal, Mapeley told the Departments it faced a serious cash flow problem and asked for additional money. The Departments refused. Following favourable movements in the commercial property market and the injection of further funds by its shareholders, Mapeley's financial position has improved. The Departments and Mapeley are, however, still negotiating a number of outstanding claims and the performance measurement system, agreed under a contract signed nearly four years ago, is not yet working satisfactorily.

On the basis of a Report by the Comptroller and Auditor General¹ the Committee took evidence from the Departments and Mapeley on the negotiation of the deal and on the management of risks following deal signature.

1 C&AG's Report, PFI: The STEPS deal (HC 530, Session 2003–04)

Conclusions and recommendations

- 1. It was a very serious blow indeed for the Inland Revenue to have entered into a contract with tax avoiders.** The Departments knew that Mapeley was owned by shareholders based outside the UK, but did not clarify the company's tax plans, or find out that it intended to hold the properties offshore until late in the procurement process. Departments should as far as possible discount gains from tax avoidance that may be factored into a PFI bid, since any price advantage to the Exchequer is likely to be offset by lower tax revenue.
- 2. For its part, Mapeley had always intended to hold the properties offshore to avoid paying tax.** Yet the company was less than open with the Departments, only making its intentions known to members of the Departments' project team very late in the procurement process.
- 3. Faced with Mapeley's financial difficulties, the Departments' negotiating position was weak and led to the prolonged negotiations following deal signature.** Ahead of signing the contract, the Departments had not given a high priority to analysing the possible termination scenarios or developing a fall-back position to ensure business continuity. Departments need to ensure that they retain a real option to terminate a deal in the event of contractor default.
- 4. Nearly four years into a 20-year deal, negotiations between the Departments and Mapeley have still to be concluded.** It is important that they should now meet their objective of concluding the current negotiations by Spring 2005.
- 5. The current negotiations should aim to agree a performance measurement system that balances rewards and reductions in payments.** Mapeley signed up to the performance measurement system suggested by the Departments even though it considered some aspects to be punitive. A performance measurement system can only function effectively when all parties are agreed on the criteria for, and the value of, deductions for poor performance.
- 6. After the STEPS deal was signed, a number of key staff in the Departments moved on and there were management changes at Mapeley.** Departments should avoid moving contract management staff unnecessarily, and contractors should commit to an appropriate degree of staff continuity between the procurement process and the operational phase of a PFI project.

1 Negotiations of the deal

1. Mapeley offered the lowest price by around £500 million (**Figure 2**) and its bid was also some £300 million lower than retaining the estate in the public sector, the best alternative to a PFI deal.²

Figure 2: Prices at selection of preferred bidder (£000 million)

Mapeley	1.43
Servus	1.92
Trillium	1.98

Source: C&AG's Report

2. Mapeley had not had any experience of the property outsourcing market before bidding for the STEPS deal. Nevertheless, Mapeley's shareholders were experienced in property management around the world and wanted to enter the developing market for such services in the UK. Mapeley had paid the Departments £220 million for the estate and will pay a further £150 million over the first ten years of the contract, through reductions in the annual charges paid by the Departments.³

Pricing and risk

3. The pricing of Mapeley's bid was based on returns from rises in the value of the properties transferred rather than profits from managing the estate. Mapeley had assumed that commercial properties would increase in value over the next 20 years at about twice the rate of inflation, even though, in the last ten years, price increases had been somewhat less than the inflation rate. The bid also assumed that Mapeley would win other business, spreading overheads over a number of contracts. However, subsequent to winning the STEPS deal, Mapeley has only won one other major contract in the UK.⁴

4. In testing the financial robustness of Mapeley's bid, the Departments decided to accept the risks inherent in a deal structured in this way. The Departments insisted on a relatively high level of equity investment from Mapeley's shareholders and an up-front payment of £220 million for the estates. At the time that STEPS was being procured, the market for such deals was relatively new, with only one major deal and one private sector provider. Apart from a very competitive price, the Departments considered that the end result of the process had been the creation of another provider of property outsourcing services, offering the prospect of competition in the market.⁵

2 C&AG's Report, para 9

3 Q 97; C&AG's Report, para 2.8a

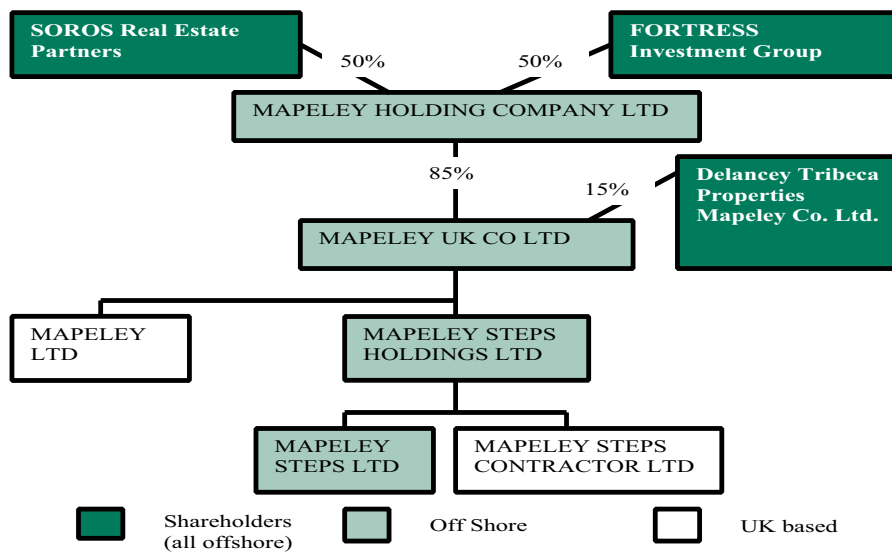
4 Qq 157, 169–170

5 Qq 24, 165

Asset transfer

5. The freehold and long-leasehold properties transferred under the deal are held by a subsidiary company based offshore (Mapeley STEPS Limited – **Figure 3**). As a result, gains from selling the properties would not be subject to UK tax. Furthermore, as Mapeley’s shareholders are also based offshore, they will not be liable to UK tax if they sell their shareholdings. Mapeley estimated that if it had been required to hold the properties onshore, its price would have increased by £55 million to cover extra UK tax that may have been due.⁶

Figure 3: The structure of Mapeley



Source: C&AG’s Report

6. Mapeley had always intended to hold the properties offshore but this intention had been made known to members of the Departments’ project team only late in the procurement process, between selection of preferred bidder and finalisation of the contract. The project team had taken the view that Mapeley’s intention to transfer the properties to an offshore company was a normal arrangement where shareholders were also based offshore. The Board of the Inland Revenue judged that the arrangement was legal, particularly as the shareholders were offshore. The Departments took the view that under public procurement law they had no choice but to go ahead with the contract.

7. With the benefit of hindsight the Departments said it had been a mistake that the bidding documents had not specified that the properties should be held onshore. The Government has since responded to the tax issues raised in this deal by suggesting a new clause for future PFI contracts that limits the ability of contractors to go offshore. As highlighted in the C&AG’s Report, the Departments consider that it remains to be seen how such a clause will work out in practice.⁷

6 C&AG’s Report, paras 12–13

7 Qq 2, 5–6; C&AG’s Report, para 14

2 Management of risks following deal signature

8. Seven months into the deal, Mapeley approached the Departments with a number of financial claims and requested more money to deal with a serious cash flow problem. It took the Departments some time to establish the nature and extent of Mapeley's financial problems. Following favourable movements in the commercial property market, the company's financial position improved and its shareholders provided further short term funding. However, even with this improved financial position, the deal was finely balanced.⁸

Contingency planning

9. The Departments and the banks that had lent money to Mapeley to buy the estate had "step-in rights" to take over the contract in the event of Mapeley's failure. Nevertheless, before the signing the contract, the Departments had not worked out all the consequences if Mapeley did fail. Since contract signature the Departments had considered what their position would be with the banks and how taxpayers' interests could be safeguarded. The Departments were still trying to encourage a greater degree of openness with Mapeley and its bankers. They had also commissioned work to build a better financial model of what would happen if, for instance, the property market collapsed.⁹ The Departments considered that their risk management strategy would provide an early indication if Mapeley were likely to get into financial difficulties again, and they expected Mapeley or its bankers to tell them if further problems were anticipated.¹⁰

10. In the STEPS deal, the money borrowed by Mapeley is secured on the Departments' estates, giving the lenders a higher degree of security than is normally the case under PFI arrangements.¹¹ In a standard PFI deal, finance raised by the private sector is secured on the future cashflows of the project. Since those cashflows are dependent on delivery of a service to the public sector, lenders to a deal will only recoup their investment and make a return if the project is successful.

11. The arrangements for the termination of PFI deals because of contractor default had never been tested, so nobody could be sure what would happen. It was normal to give banks and other lenders a commercial incentive to step in and sort things out so that the public sector continued to get a service, which was better than a system that gave financiers an incentive to step in to protect their own interests, regardless of public sector concerns. The Departments were still looking at what they would need to do to ensure that facilities management services for the estate were protected. The contract would not become void if Mapeley failed and the Departments retained rights of occupation over the buildings.

8 C&AG's Report, paras 15–16

9 Q 183

10 Qq 109–110, 143

11 C&AG's Report, para 3.16

Negotiations with Mapeley

12. At the time the C&AG's Report was published, the Departments and Mapeley were still negotiating a number of outstanding claims arising from the procurement process, such as discrepancies in property information. Data on the estates had changed throughout the procurement process as the Departments moved in and out of properties and service delivery altered. Only when the estates had been brought together under the STEPS deal had Mapeley concluded that there were discrepancies in the information provided by the Departments.¹²

13. Seven months into the deal, Mapeley had asked the Departments for an additional £27 million, based around some of the changes that had occurred in the estate. When this request was refused, Mapeley decided to fund the shortfall itself, and was now in further discussions with the Departments over variations and changes in the contract. Unless service delivery levels changed or the Departments decided to remain in buildings they had expected to vacate, Mapeley assured us that it would not ask for additional money again.¹³

14. The contract had not been put together in a completely satisfactory way and that was why negotiations were still ongoing. The Departments expected, however, to resolve the outstanding issues by the time HM Revenue and Customs comes into existence in Spring 2005.¹⁴

Performance measurement

15. There had also been contractual disputes about the performance measurement system under which Mapeley provided services for the estate. The system had been developed by the Departments and supplied to all three bidders for their consideration. Shortly into the operation of the system, it had become clear to both parties that Mapeley was devoting its resources to fixing reported faults, and was not undertaking preventive measures to avoid further problems occurring (**Figure 4**).¹⁵

Figure 4: Problems with the performance measurement system

- the system was overly complicated and required significant resources from Mapeley and the Departments to operate;
- the outputs did not always provide meaningful information to either party;
- Mapeley believed that failure points awarded under the system accumulated too rapidly, leading to unfair deductions which Mapeley considered to be punitive;
- the Mapeley Help Desk, which formed the basis for much of the performance data, focused on reactive tasks rather than the necessary balance of planned preventative and reactive tasks;
- the waiver process, which allowed performance deductions to be by-passed in certain circumstances (for example, where the Departments' own actions had prevented Mapeley from delivering services) was not applied consistently.

12 Q 100

13 Qq 35, 90, 101, 103

14 Qq 107, 144

15 C&AG's Report, paras 17–18; Ev 21

16. Nearly four years into the contract, the performance measurement system was still not working satisfactorily and the Departments were working with Mapeley to resolve the remaining problems. The estate had been managed internally for probably over 50 years and when it was transferred, Mapeley had been unsure how many calls would be received by its help desk or how many orders for new work it would get. It had also been difficult to get a performance measurement system up and running as the Departments had no previous experience of being a customer.¹⁶

Continuity of staffing

17. A number of key staff in the Departments had moved to other jobs very soon after contract signature, leaving only one key member of the original STEPS team still involved in the deal. There were also a number of management changes at Mapeley shortly after the contract was signed. The deal was still bedding in and, while there had been moves on both sides to work in partnership, it had not yet been fully achieved.¹⁷ It had also taken three years for the Departments to appoint a professional contract manager.

18. Significant turnover of staff after contract signature had been expected because of the different skills needed to procure a PFI deal, as opposed to delivering, managing and running a contract. But the Departments accepted that they had not recruited a professional contract manager soon enough and should have put in place earlier the people who were going to operate the deal, so that there could have been a proper hand over.¹⁸

16 Qq 23, 108, 112, 146–147

17 C&AG's Report, para 19

18 Qq 72, 106, 117

Formal minutes

Wednesday 6 April 2005

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan

Mr Ian Davidson

Mrs Angela Browning

Mr Alan Williams

The Committee deliberated.

Draft Report (PFI: The STEPS deal), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 18 read and agreed to.

Conclusions and recommendations read, amended and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Twentieth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

[Adjourned.]

Witnesses

Wednesday 27 October 2004

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Mr David Varney, Ms Helen Ghosh, Ms Siobhán Mary McHale, Inland Revenue/HM Customs and Excise, and **Mr Jamie Hopkins**, Mapeley

Ev 1

List of written evidence

The Public and Commercial Services Union
Inland Revenue

Ev 17

Ev 19

List of Reports from the Committee of Public Accounts Session 2004–05

First Report	The management of sickness absence in the Prison Service	HC 146	(<i>Cm 6496</i>)
Second Report	Tackling cancer in England: saving more lives	HC 166	(<i>Cm 6496</i>)
Third Report	The BBC's investment in Freeview	HC 237	
Fourth Report	Improving the speed and quality of asylum decisions	HC 238	(<i>Cm 6496</i>)
Fifth Report	Excess Votes 2003–04	HC 310	(<i>N/A</i>)
Sixth Report	Excess Votes (Northern Ireland) 2003–04	HC 311	(<i>N/A</i>)
Seventh Report	Foreign and Commonwealth Office: Visa entry to the United Kingdom: the entry clearance operation	HC 312	
Eighth Report	Ministry of Defence: Battlefield Helicopters	HC 386	
Ninth Report	The Drug Treatment and Testing Order: early lessons	HC 403	
Tenth Report	Welfare to work: tackling the barriers to the employment of older people	HC 439	
Eleventh Report	Improving public transport in England through light rail	HC 440	
Twelfth Report	Helping farm businesses in England	HC 441	
Thirteenth Report	Ofgem: The Social Action Plan and the Energy Efficiency Commitment	HC 442	
Fourteenth Report	Department for International Development: responding to HIV/AIDS	HC 443	
Fifteenth Report	Managing risks to improve public services	HC 444	
Sixteenth Report	Department of Health: improving emergency care in England	HC 445	
Seventeenth Report	London Underground Public Private Partnerships	HC 446	
Eighteenth Report	Financial management of the European Union	HC 498	
Nineteenth Report	The accounts of the Duchies of Cornwall and Lancaster	HC 313	
Twentieth Report	PFI: The STEPS deal	HC 553	

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 27 October 2004

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Jon Cruddas
Mr Frank Field
Mr Brian Jenkins

Jim Sheridan
Mr Gerry Steinberg
Jon Trickett
Mr Alan Williams

Mr Tim Burr, Deputy Comptroller and Auditor General and **Mr Jeremy Colman**, Assistant Auditor General, National Audit Office, further examined.

Mr Brian Glicksman, Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

PFI: The STEPS Deal (HC 530)

Witnesses: **Mr David Varney**, Executive Chairman, **Ms Helen Ghosh**, Director General (Corporate Services), **Ms Siobhán McHale**, Director of Estates, Inland Revenue/HM Customs and Excise; and **Mr Jamie Hopkins**, Chief Executive Officer, Mapeley, examined.

Q1 Chairman: Good afternoon. Welcome to the Committee of Public Accounts where today we are looking at PFI: the STEPS deal, and we are joined by witnesses from the Inland Revenue, HM Customs and Excise and a witness from Mapeley. Mr Varney is the executive chairman of the Inland Revenue/Customs and Excise. It is your first visit, I believe. You are very welcome. He is joined by Ms Helen Ghosh, director general, corporate services, and Ms Siobhán McHale, director of estates and, from Mapeley, Mr Jamie Hopkins who is the chief executive officer. Mr Varney, does it give the Inland Revenue any sense of shame that they are now known as a well known tax avoider?

Mr Varney: I do not think they are known as a well known tax avoider. I do recognise that in the agreement there is an unfortunate feature. As you know, the government changed the guidelines so for a forward procurement that would not arise.

Q2 Chairman: Why did you not specify in the bidding documents for this deal that these properties should be held onshore?

Mr Varney: With the benefit of hindsight, one can say it was a mistake.

Q3 Chairman: Will you please look at paragraph 2.24 which you will find on page 21? You will see there that it says: "The Board of the Inland Revenue only became aware of the tax arrangements late in the procurement" and the Customs and Excise were not told until after the deal had been signed. Why is that?

Ms Ghosh: I was not there. It was before my time, but—

Q4 Chairman: We are not interested in whether you were there or not. You represent this Department and you will answer questions on it.

Ms Ghosh: As you know, Sir Nicholas Montagu and Richard Broadbent explained in some detail the background of these events to the Treasury Select Committee in 2002 and—

Q5 Chairman: We are not interested in what was told to the Treasury Select Committee. We are interested in the evidence you are giving here today.

Ms Ghosh: As you will be aware, what happened was that this point about properties being held offshore was known to members of the project review team and, at the time, they took the view that this was a perfectly normal arrangement where shareholders were offshore and they did not regard it as in any way contentious. When the decision making was rising up to board level, my colleague Dave Hartnett, who was then the director of technical and policy, asked a question about the offshore nature of the shareholders and indeed the proposal to hold the properties offshore. Again, as the TSC discussed, the board at that time took the view that the arrangement was perfectly legal, particularly given that the shareholders were offshore. It established that they did not under EU procurement rules have the right to question that particular aspect of the tax arrangements and they therefore took the view that they had no choice but to go ahead and sign the contract which, as the NAO Report said, represented—

Q6 Chairman: Stop there. I am not going to ask questions on that for the time being. Staying on paragraph 2.24, page 21, please, Mr Varney, it says,

Inland Revenue/HM Customs & Excise and Mapeley

“The Government has responded to the tax issues raised in this deal by suggesting a new clause for future PFI contracts that limits the ability of contractors to go offshore.” Has this happened? Is it working?

Mr Varney: As the NAO Report says, it remains to be seen. It was included in the Aspire contract which is a computer service contract which we let. There are provisions in that which would stop it going offshore, but that is the only one I know of.

Ms Ghosh: That was a voluntary agreement we reached with Aspire because the change to the Treasury guidelines did not come in until after we were well down the track with Aspire. Our Aspire/Cap Gemini colleagues were perfectly happy to enter into that deal.

Q7 Chairman: May I ask the Treasury Officer of Accounts what is the view of the Treasury about these properties being held offshore?

Mr Glicksman: As the witnesses have said, this was a legal arrangement.

Q8 Chairman: Was it desirable?

Mr Glicksman: As they have also pointed out, the Treasury issued guidance to departments following these events to ensure that departments were aware of this possibility in the future and took steps to try and make sure that undesirable tax arrangements did not come about in future procurement contracts.

Q9 Chairman: Mr Hopkins, should you not be more honest with the departments about your intentions to hold some of these properties offshore?

Mr Hopkins: We are a company that is owned and was set up by non-UK resident shareholders, so we followed all of the current guidelines and reacted—

Q10 Chairman: That is not the question I asked you. Should you have been clearer with the departments about your intention which I put it to you you always had to hold these properties offshore?

Mr Hopkins: It is a very common structure that we followed and the departments set the process—

Q11 Chairman: Did you inform them about your intention to hold these properties offshore?

Mr Hopkins: We did.

Q12 Chairman: At what stage?

Mr Hopkins: November 2000.

Q13 Chairman: How close to the beginning of the process was this?

Mr Hopkins: It was in between preferred bidder and close of contract.

Q14 Chairman: Was it always your intention from the beginning of this process to hold these properties offshore?

Mr Hopkins: Yes, it was.

Q15 Chairman: As far as you were concerned, at the beginning of the process you simply were not asked by the departments so it is down to them, is it?

Mr Hopkins: We followed all the guidelines of the bidding process and—

Q16 Chairman: Given that your shareholders were based offshore, the departments should have realised from the beginning that it was natural for you to hold these properties offshore. Is that a fair question, Mr Varney? You were just grotesquely naïve, were you not?

Mr Varney: I think it is easy to be very clear after the event.

Q17 Chairman: What do you mean it is clear after the event? You do a deal with a company whose shareholders are largely based offshore. This results in massive, bad publicity for the Revenue and then you tell us that we should be wise after the event.

Mr Varney: You asked me whether it was possible to foresee that. I always think that, with the benefit of hindsight, it is clear that it should have been foreseen.

Q18 Chairman: Why do we need the benefit of hindsight to foresee it? Was it not clear at the time? Do you not have some of the brightest brains in this business?

Mr Varney: I think even with the brightest brains it is my experience often that you find events afterwards trip you up. This is one of them.

Q19 Chairman: They did what to trip you up?

Mr Varney: I think what happened was the concentration was on getting the estate into a shape where a PFI deal could be undertaken with all the lessons learned from the DWP experience. One of the lessons that was not learned was obviously the possibility of a tax shelter.

Q20 Chairman: What was this argument about tripping you up? I do not understand that.

Mr Varney: As you rightly said, after the event that was the feature of the deal which most people have concentrated on.

Q21 Chairman: Can you look, please, Mr Varney, at page 25, paragraph 3.14. You will see there that negotiations were still ongoing at the time of the Report. Is that correct?

Mr Varney: Yes.

Q22 Chairman: How can this be a real partnership if negotiations are still ongoing? These are very prolonged negotiations, are they not?

Mr Varney: Yes.

Q23 Chairman: Is it a real partnership?

Mr Varney: I think we are trying to get a real partnership. The nature of moving from owning your own estate, which you managed through all sorts of different locations, and pulling it together in order to bring in an outsider, you have to change to being a customer. There are features of the agreement which have not proved satisfactory from our point of view and we are together with Mapeley STEPS trying to resolve those in an agreeable way.

 Inland Revenue/HM Customs & Excise and Mapeley

Q24 Chairman: It is not just the bad publicity about being tied up with a tax avoider. It is also the nature of this contract which we, as a committee concerned with value for money, want to concentrate on. Would you please look at paragraph 2.17, page 19, Mr Varney? It tells us there that Mapeley STEPS' margins are very tight and they hope to win other business to spread its cost. Did it not seem rather risky to you to award such a large contract to a company operating on such a basis?

Mr Varney: At the time the contract was awarded, there was only one other provider that had been contracted to the government. The difference between its bid and this bid was £500 million, so there was a sizeable incentive to look at this arrangement. If you look at the Report, you will find that at each stage the Department tried to learn from the previous DWP out-sourcing and tried to apply the lessons to see what the risks were. There were particular elements of the deal where it was felt that Mapeley were pricing very aggressively but there were other aspects where Mapeley could take advantage of the contract so in the round we had to make a judgment. The end result of this arrangement is the inclusion of another provider of these services so there could be beginnings of competition in the marketplace.

Q25 Jon Trickett: I want to briefly look at the public sector comparator which in the past we have usually concluded is to some extent a got up figure to provide a fig leaf so that you can privatise things which you wanted to do in the first place. The public sector comparator involves calculating the amount of risk which would have been retained by the public sector had the contract been handled in-house. This is detailed on page 36 in appendix five. In there it says that the additional amount of money added to the public sector comparator was £101 million. Is that right? The difference between the public sector comparator price with and without risk, which would have been retained had this been handled in-house, is £101 million. Am I understanding that sentence correctly?

Mr Varney: I think it is covering uncertainties.

Q26 Jon Trickett: The risk which would have been retained by retaining the contract in-house rather than privatising the contract.

Mr Varney: I think it is incredibly difficult when you are in a situation where you have all of your estate spread out and managed locally to pull it all back together, and then you try and create artificially what might happen if you were to manage it yourself. Given that, a lot of the incentive for these sorts of arrangements are that running an estate is not our major business. We do not have a competitive edge in it. We wanted, as is said in the Report, to get the advantage of releasing money that was tied up in that business and to bring in a professional standard—

Q27 Jon Trickett: I do not think you have achieved any of those objectives but I am just asking about risk and the externalisation of risk by going through

a PFI, which is what this is talking about here. The whole of this appendix deals with the public sector comparator. Allegedly, it would have cost more money to retain the contract in-house than it would have to go through a PFI. This paragraph seems to say that £101 million was the difference. The previous couple of sentences deal with the fact that the contract failed to externalise the risk, do they not?

Ms Ghosh: Surely what this paragraph is doing is explaining that this was not a standard PFI. This was not a design, build and operate PFI; this was a PFI where the property was built and we were handing it over to Mapeley. What they were doing here was making an assumption about what value they therefore put in for the risk in this type of PFI which, as they say here, was £101 million. That is still significantly—

Q28 Jon Trickett: We will come to that in a minute because the contract is not running to the price that was agreed, is it?

Ms Ghosh: It is actually.

Q29 Jon Trickett: It says in the previous two sentences: “. . . the STEPS differs from a standard . . . DBFO PFI deal in that there is no construction of an asset, the STEPS PSC had no risk adjustment for construction time or cost overruns. This risk is usually the largest risk adjustment in a standard PSC.” Are you sure that you did externalise the risk in this contract rather than retaining the risk in-house as the rest of the document appears to demonstrate, does it not? Since when the company got into trouble, as they did, basically we have had to bail them out.

Ms Ghosh: We have not.

Q30 Jon Trickett: That is how I read the paper and, with all due respect, I think I am entitled to make that judgment. Obviously you may disagree but I am simply asking you this: are you convinced that you did externalise all the risk that you could so that the public sector was protected?

Mr Varney: We did to the best of our ability try to use the techniques which had been used—

Q31 Jon Trickett: I am asking you not whether you used the best of your ability but whether or not you protected the public sector from the risks which were inherent in externalising the contract. It is a simple question.

Mr Varney: I think that is what we tried to do.

Q32 Jon Trickett: Did you achieve it?

Mr Varney: I think we did because what we have done and what this paragraph talks about is taking a public sector comparison and, £101 million is the difference between the mean cost and the minimum likely cost, so there was a range of cost outcomes. What it says is it took the mean cost as the comparator and in other words added back the £101 million.

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Q33 Jon Trickett: I am not sure you are addressing the point I am making. I want to move on to the questions which were tabled by the Member for Llanelli, responded to by Dawn Primarolo, which I think you are probably aware of. The contract was supposed to be running at £170 million a year, was it not?

Mr Varney: No.

Q34 Jon Trickett: The document here seems to say that.

Mr Varney: No, that is not what it says.

Q35 Jon Trickett: The facts are here, are they not: £234 million, £305 million and then the £311 million? They are the three sets of annual costs. I do not have the paragraph in front of me but the document elsewhere talks about £170 million a year. Why am I misunderstanding what the document says?

Mr Varney: Members can go to point four, paragraph 3(b)(iii), which is the £170 million. The £170 million comes from the cost of the total contract, which is estimated at £3.4 billion, divided by 20 which is £170 million. That number is a net number because it includes the £220 million we were paid up front. If you add that back, you get to £3.6 billion, which is about £180 million a year. That is the result of a model which assumes we will reduce our estate over 20 years by 40%. It is a model which gives you an average. It is not the price we will pay each and every year. We have audited what we paid to Mapeley. We are paying them in accordance with the contract. We have not bailed them out. We are paying for costs including utility costs, pass through costs and various other elements which we wanted to procure from them when it is value for money.

Q36 Jon Trickett: Given the fact that you have agreed this Report yourself personally, do you feel that that paragraph which you have just referred to gives an accurate picture of what is happening, given the fact that we are running in the last two years at over £300 million a year? Can you give us an estimate as to what the total value of the contract will be then?

Mr Varney: No, I cannot. We have obviously worried about how to do this and how to present this. When the Accounting Officers accepted this Report, it was accepted on the basis that this was helpful information but it is not the basis of a comparison, year by year, of what is expected. In order to do that, we have to model two things which are unknown: the extent to which the estate is going to be reduced and passed back to Mapeley which is one of the flexibilities we have; and whether we procure through Mapeley services, building works or minor building works. Each time we procure through Mapeley anything that is of a service nature, there is a value for money test and that is why I cannot predict how much money, in the end, will go to Mapeley.

Q37 Jon Trickett: There is a prediction in this paper and it would be reasonable for a Member of this Committee to draw the conclusion that that was the

likely sum of money which would be spent and that it would average out at £170 million, given that that is what is in the text. If you are saying that that is not the whole picture—it may be accurate in and of itself—are you able to provide us with a note telling us what your latest estimate of the annual costs is likely to be and what the aggregated costs at the end of the contract will have been?

Mr Varney: I can provide the Committee with a breakdown of what we have spent money on so far. I can then indicate the range of uncertainty that we will face as we make decisions going forward.¹

Q38 Jon Trickett: I think the Report is inadequate to that extent, if that is the case. We have had a note from the PCS,² one of the trade unions, that describes a number of matters which I do not have time to go into. One of the things that gives concern is the extent to which the management within the Civil Service no longer has control of what is happening inside the buildings. Are you aware of concerns in management at very senior level that some of the decision making procedures now are handled by Mapeley as to what goes on inside the buildings? Are you aware that there is frustration at senior level?

Mr Varney: Yes. I receive letters from time to time about the state of buildings and we take that up with Mapeley. I think that is a big issue for us but I do not think we should paint a picture that everything in the past was incredibly rosy and every office worked absolutely perfectly at all times.

Q39 Jon Trickett: I am asking about this contract. Are you aware, for example, that Mapeley have refused permission for staff to have third parties onto some of the buildings from time to time?

Mr Varney: That has not specifically been addressed to me in a letter.

Ms McHale: That is part of Mapeley's role as a landlord in this situation and on certain occasions they have provided permission for third parties to visit the sites.

Q40 Jon Trickett: When staff invite third parties into the building to discuss matters of relevance to the staff, perhaps staff welfare, are you aware that Mapeley are refusing permission for those third parties to come on site?

Mr Varney: I have not had a letter to that effect.

Q41 Jon Trickett: Are you aware?

Ms McHale: I have been made aware quite recently and suggested that I will take that up with Mapeley. I am certain that Mapeley will look at that constructively.

Q42 Jon Trickett: I have had three separate organisations drawn to my attention who Mapeley refused permission. They all seem to have legitimate reasons to be in the building. It would be helpful if you could provide us with a note and I will compare it with the information which I have received, which

¹ Ev 19–20

² Ev 17–19

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I will provide to the Chair.³ Are you aware that Mapeley are preventing staff functions from taking place on buildings, normal functions like retirement parties and so on, if they want to bring food and other matter onto the site? That is being prevented by Mapeley.

Ms McHale: If it is helpful, some of the issues here are associated with the contract bedding down and getting to know each other. Some of these are purely around communication. For instance, I myself was made aware of the issues on access for third parties. I have recently been made aware of access for parties and functions and such like. I think that as part of the relationship that Jamie and I have we should be exploring that.

Q43 Jon Trickett: The answer is yes, you are aware of problems?

Ms McHale: We are aware and we are dealing with it.

Jon Trickett: I have been provided with information which I think is worrying if the Civil Service have lost control of what happens in the ordinary course of their business within the building. I do not know why that should cause hilarity on your part, Mr Varney, but it clearly does.

Q44 Jim Sheridan: Why did it take three years to appoint a contract manager?

Mr Varney: I think we have come to a situation where we have looked at how to be a customer and what we found was that it required professional expertise that we did not have in-house.

Q45 Jim Sheridan: It has taken three years to make that decision?

Mr Varney: Yes, three years to bed this down and we have removed some problems off the table but in the nature of a contract like this we are going to be working on problems and opportunities as we go through the life of the contract.

Q46 Jim Sheridan: Picking up the PCS on the morale of the Civil Service, some of these problems could have been addressed if you had appointed somebody earlier.

Mr Varney: With the benefit of hindsight, I think that would have been wise.

Q47 Jim Sheridan: Is that a second benefit of hindsight?

Mr Varney: Hindsight is a powerful thing.

Q48 Jim Sheridan: You will also be aware that concerns have been raised over the two tier workforce. People have been transferred are people who have come in under lower contracts. Is that something that you think is acceptable?

Mr Varney: If it was part of the arrangement, I think some people did move across because they were doing work which was no longer to be done by us in terms of maintaining our own estate.

Q49 Jim Sheridan: Would you agree that that does damage morale when people are working on two different contracts?

Mr Varney: I am sure some people are unhappy about it. I think the issue we have is, with the pressures on us in terms of costs and everything else, whether it is our business to be running an estate on our own or whether we should go out and procure from the market people who are more professional at it than we are.

Q50 Jim Sheridan: This point concerns the tendering process. I find it incredible that neither the Treasury nor the Customs and Excise were involved, even from the Treasury perspective. I know you said that with the benefit of hindsight you have learned something. What are those things that you have learned?

Mr Varney: I think the NAO Report is absolutely clear in terms of recommendations for the department that are laid out, in terms of what we have to do, in terms of managing the risk and learning also about procedures in the event of termination and, on the other side, there are the lessons for other PFI deals for all departments.

Q51 Jim Sheridan: The taxpayer is expected to believe that these discussions were going on and neither the Treasury nor the Customs and Excise at any stage were involved?

Mr Varney: There was a working group with both the Treasury and Customs and Excise. What we have focused on is the extent to which the knowledge about the tax status was—

Q52 Jim Sheridan: You knew full well that this company was an offshore company and not at any stage did you think it appropriate to involve the Treasury?

Mr Varney: My two predecessors have both apologised for this failure to appropriately advise. You have in front of you a Report which seems to me to be very positive about the arrangements which have been entered into.

Q53 Jim Sheridan: Is there anything that that the Treasury have learned from this?

Mr Glicksman: As Mr Varney has said, his predecessor as accounting officer apologised to the Treasury Select Committee about the way in which this particular issue was handled and after the issue came to light the Treasury issued guidance to departments to try and avoid that sort of thing happening again.

Q54 Jim Sheridan: Mr Hopkins, is Mapeley financially secure now?

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Mr Hopkins: It is, yes.

Q55 Jim Sheridan: Mr Varney, do we have a plan B?
Mr Varney: Yes.

Q56 Jim Sheridan: What is it?
Mr Varney: We have a business continuity plan.

Q57 Jim Sheridan: If Mapeley failed to exist?
Mr Varney: Yes.

Q58 Jim Sheridan: What is plan B?
Mr Varney: I would rather provide that, if I may, as a private answer to the Committee.

Q59 Jim Sheridan: In terms of consultants, how many consultants' firms do you use?
Mr Varney: Since the contract has been signed, we have spent £1.8 million. We have used people who can help either in terms of particular legal advice on the contract or we can build in our own model of the Mapeley cash flows, the coverage of the debt and other things like that. We have taken specific advice where we do not have expertise, where we think we need expertise from outside.

Q60 Jim Sheridan: How many consultants have you used?
Mr Varney: I can give you the answer.
Ms Ghosh: We are happy to provide a list.⁴

Q61 Jim Sheridan: PCS seem to have a number. They say that you have used 40 firms of consultants.
Ms McHale: That has been provided in a previous answer before, I think—.

Q62 Jim Sheridan: If it was provided in an answer previously, why does Mr Varney not know that?
Ms McHale: We do not have the detail at our fingertips today.

Q63 Jim Sheridan: He just said he did not know. You said it was provided in a previous answer.
Ms McHale: Some of these are construction providers who help on the various major works projects that we do. There can be quite a high number of consultants involved in those types of projects.

Q64 Jim Sheridan: But we do not know how many?
Ms Ghosh: We do know how many, but—
Mr Varney: I did not bring it with me and I answered about the contract.

Q65 Jim Sheridan: I would have thought one of the things we would want to know is how many consultants were used.

Mr Varney: I have said we will give you an answer.

Q66 Jim Sheridan: Prior to bringing in consultants, was there any assessment done in-house in terms of those people who may have been capable given the proper training to do the job rather than employing consultants?
Mr Varney: I am sure there was.

Q67 Jim Sheridan: You are sure there was?
Mr Varney: I am sure there was. We had historically managed this estate through individual locations. We were now pulling it together and managing it as a whole. Therefore, we were managing the estate across all of the Inland Revenue and Customs and Excise. That clearly threw up problems that we had not had to deal with before across the whole estate. We are not a real estate business.

Q68 Jim Sheridan: You understand the confusion and perhaps the frustration caused when people are being made redundant at the same time as you are bringing in consultants?
Ms McHale: To clarify, a lot of the consultants that we are using are extremely specialist skill sets. They are not skill sets that we could develop as transferable skills in-house. It is a preference and a priority to professionalise the contract management unit and grow that skill inside but sometimes we are not able to do that and we have to buy external advice.

Q69 Jim Sheridan: With the greatest respect, I have a view about consultants and certainly within the Civil Service it is too easy, when managers arrive at a difficult decision, to just reach out for consultants. It does not happen in the private sector. In the private sector if a manager asks for a consultant the manager gets sacked. They do not have two of them making the same decisions.
Mr Varney: With great respect, you have a very different experience of the private sector than I do.

Q70 Jim Sheridan: If we have to bring in consultants, why do we need managers?
Mr Varney: Because sometimes the consultants bring in specialist expertise. The consultant firms do quite well, most of it out of private industry.

Q71 Jim Sheridan: There has been a high turnover of staff. Could you explain the reason for that?
Ms Ghosh: Within the area covered by the contract?

Q72 Jim Sheridan: Yes.
Ms Ghosh: We would expect to have seen a significant turnover because of the different kinds of skill sets that you need in carrying out a procurement process, as opposed to delivering, managing and running a contract. We had always anticipated that there would be a reasonable staff turnover following the delivery of the contract. We did not recruit in particular Siobhán who arrived in April this year soon enough. Nonetheless, I should emphasise we have a highly respected contractual procurement group within the two departments—and there there

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has been considerable stability of personnel—who have been consistently offering very high quality, professional advice on contract management. We would have expected some turnover because it was a different set of skills. With hindsight, we were probably a bit slow in bringing in Siobhán but I brought her in under my leadership earlier this year. Meanwhile, we did have good in-house procurement advisers working with us.

Q73 Mr Steinberg: Mr Varney, you remind me of all chief accounting officers. You are desperate for praise. You made a comment about it being a good Report and you will learn as you come here over the next two or three years, I would suspect, that you will not get any praise whatsoever because it means that you are doing your job properly when you are being praised and that is what we would expect. It is the cock ups that we look at and you are responsible. Have you met Sir Nick recently?

Mr Varney: Not very recently. I saw him about a couple of months ago.

Q74 Mr Steinberg: Did he say he had dropped you in the mire?

Mr Varney: He was not as precise as that. I thought I read the other day that you were saying that the Committee had a very positive relationship with most of the people who came in front of it.

Q75 Mr Steinberg: We do. The department, I am told, expects to reduce the costs of running this estate by something like £344 million over the contract period of 20 years. Is that right?

Mr Varney: Yes, that was the public sector comparator.

Q76 Mr Steinberg: I certainly would never get a job at the Inland Revenue but my simple arithmetic says that is something like £17 million a year savings? Is it really worth it?

Mr Varney: We free up in total £220 million up front. We thought and we still think that on the back of the contract we will be able to better procure services because we will be able to do it on a consistent basis. For example, utilities. That is why we see the value being greater than is in the model. The comparator put up by the NAO envisages that 40% of the estate will be reduced. With the pressures that are on both in terms of efficiency on the one side—

Q77 Mr Steinberg: It is a yes, is it?

Mr Varney:—and technical change. I think it is inconceivable that in 20 years' time Revenue and Customs will operate the way they operate today, which is with a lot of paper based systems.

Q78 Mr Steinberg: I will take that as a yes. How much have you saved up to now?

Mr Varney: We can identify the values that we have saved in terms of the utilities fairly easily. We can include the £220 million paid up front. It is quite

difficult because of the number of decisions to go back and see what you would have done had you not had this contract.

Q79 Mr Steinberg: How much have you saved?

Mr Varney: It is very difficult to get to an answer. What we have done is—

Q80 Mr Steinberg: Surely you must know. If you are going to know whether the contract is successful or not, you have to know whether you have saved any money or not. You cannot wait 20 years to see whether you have saved the £344 million we are told you are going to. You must have some idea that you are saving money, or are you losing money at the moment?

Mr Varney: No. What you try and do in a situation like this is you try and work out what the alternative is at the point you make the decision. That was on the basis of the public sector comparator which is in this Report. Because of new tax credits and law enforcement work, we have more office space now than we had when we signed the contract. If I want to give you a saving, I have to go back and recreate the public sector comparator and then do a comparison.

Q81 Mr Steinberg: Are you telling us that you will never know how much you have saved?

Mr Varney: At the end of 20 years you will face the same problem. You have to think about what you would have done and what is the alternative. As time goes on, you make decisions. You either reflect them back or you say, "I make the right decision here for value for money . . ."—

Q82 Mr Steinberg: In 20 years' time you will be asking these same questions.

Ms Ghosh: We are going to work with the NAO to try and pin down these issues rather more closely. The Report is a snapshot of where we were at that moment. As the estate expands or contracts, the issues will be different. As the costs of utilities change, that will be different. We are about to embark on a piece of work with NAO colleagues and therefore we can map it and—

Q83 Mr Steinberg: I would suggest not to get in the habit of Sir Nick and try to talk us out. Jim talked a lot about consultants. How much did the consultants cost you?

Mr Varney: Since the contract was signed, £1.8 million.

Q84 Mr Steinberg: What about before?

Mr Varney: £7.5 million.

Q85 Mr Steinberg: Nine million quid?

Mr Varney: £8.8, yes.

Q86 Mr Steinberg: That is nearly £9 million out of the first year's profits?

Mr Varney: Yes, and it is out of a £3.4 billion contract.

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Q87 Mr Steinberg: We are talking about whether the taxpayer is getting a fair deal. Mr Hopkins, have you come back for any money yet? You will, will you not?

Mr Hopkins: We initially did.

Q88 Mr Steinberg: How much was that?

Mr Hopkins: It was around £27 million a year.

Q89 Mr Steinberg: You have asked for another £27 million a year. That is the profit gone. We are now minus £10 million a year.

Mr Hopkins: We did originally. That was based around some of the changes that you find on an estate of that size. Subsequently we have funded that ourselves and we are in conversations now over variations and changes, so there has been no additional money paid.

Q90 Mr Steinberg: Are you going to give us a guarantee this afternoon that your company will not come back to the taxpayer and ask for more money at the length of this contract, other than what you have signed for?

Mr Hopkins: Apart from where they change the service delivery or they are in buildings where they said they were not, absolutely.

Q91 Mr Steinberg: If you do come back, you are on the record so you will not want that money.

Mr Hopkins: As I said, apart from where things are changing and we are owed money for variations, that is absolutely the case.

Q92 Mr Steinberg: You have no proven record, have you, as a company in property management?

Mr Hopkins: Prior to this transaction, no.

Q93 Mr Steinberg: Why did you go to them? Purely financially?

Mr Varney: £500 million to reinforce—

Q94 Mr Steinberg: You were prepared to gamble the whole of the Inland Revenue estate on the basis of £500 million which they may at the end of the day cock up?

Mr Varney: The NAO Report makes very clear we followed all the lessons from DWP. We tried to look at how we minimised the risk in this contract. The public purse is better off to the extent of £500 million, plus it has competition and flexibility. That is not a gamble. That is a sensible decision.

Q95 Mr Steinberg: I would have been very suspicious when a company comes along and they can undercut everybody by half a billion pounds. Are you not suspicious at all about that? They do not have a record in property management and they can come along and undercut everybody by half a billion pounds and you think you are on a safe deal, do you?

Mr Varney: I think you do the due diligence which is described in the NAO Report but I do not see my job as trying to maximise the revenue of service providers.

Mr Hopkins: I think it is also fair to say, when you are asked a question of experience, you are talking about—

Chairman: I did not quite hear what he said.

Q96 Mr Steinberg: I heard what he said.

Mr Varney: I do not think it is my job to maximise the revenue of private sector service providers.

Q97 Mr Steinberg: What you are saying is you take the cheapest one, regardless?

Mr Varney: No, not regardless. The Report is absolutely clear that we tried to learn all the lessons of the DWP procurement and apply them, look at the risks and see if they were reasonable. That is why we used some of the consultants.

Mr Hopkins: You asked a question about the experience of Mapeley. The PFI out-sourcing property market is a new market in the UK. The first transaction which took place was the PRIME transaction. There has not been anything since in the public sector. Whilst Mapeley have not had experience, the shareholders of Mapeley are vastly experienced in property management service delivery in various guises throughout other platforms throughout the world.

Q98 Mr Steinberg: I bet you do an Oliver Twist. I will give you three years and you will be doing an Oliver Twist, coming back with the begging bowl.

Mr Hopkins: We have been three and a half years into this contract already.

Q99 Mr Steinberg: You are confident that you gave them the exact price, the correct price? You did not undercut deliberately, did you, to make sure you got the contract?

Mr Hopkins: We made it very clear, as it says in here, that we bid at very, very low operational margins. One of the things it is worth pointing out to the Committee is that—

Q100 Mr Steinberg: I read the Report and I think it was in paragraph 2.83 where it said the data that had been given by the Inland Revenue was not sufficient to make any decision on. Yet you, as a new company, did not have the data that you were able to make that decision on, a valid decision. Yet you were still able to undercut by £500 million. Perhaps it was a good thing because if you had had the data maybe you would not have gone for the £500 million cut.

Mr Hopkins: Data on a portfolio of this size changes throughout the process because constantly departments were moving in and out of properties and service delivery levels were changing. There were some inaccuracies in the data and that was made clear from both sides. I think both parties went into the transaction with that in mind, with a view to levelling off those through variations. As we have seen so far, there have not been any pass across of payments for those variations.

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Q101 Mr Bacon: Mr Hopkins, Mr Steinberg said you went back and asked for £27 million. The government did not pay you this money, did they?

Mr Hopkins: No.

Q102 Mr Bacon: Why did you have to ask for £27 million in the first place?

Mr Hopkins: Initially, as Mr Varney has said, when the estate was brought together and had not been managed by a previous contractor, when we put this on the table and started operating it, we realised that there were some discrepancies.

Q103 Mr Bacon: You under-priced your bid, did you not? It says in *The Times*—I would just like to get this clear because I read this in the newspapers and, as you know, you can never believe what you read in the newspapers—that you under-priced your bid. That is why it was so cheap and therefore you had to go back to the government for money. You asked them for an extra one-off payment but it was not made. That is all correct, is it not?

Mr Hopkins: Correct.

Q104 Mr Bacon: Well done, Mr Varney, for not making the payment, but you were kept afloat by rising property values and an £8 million injection from your backers. That is correct as well?

Mr Hopkins: Yes, that is right.

Q105 Mr Bacon: Mr Varney, since the NAO Report was published, have you paid Mapeley any money in addition to the sums specified in the contract?

Mr Varney: No.

Q106 Mr Bacon: In paragraph 3.14 it says that negotiations began in December 2002 and that they are still ongoing and this has prevented senior management staff from focusing on core business, “. . . and the departments have not yet been able to focus as much on core services as was envisaged.” Why, two years almost, after these negotiations started, are they still going on? What is taking so long?

Mr Varney: I think we have taken steps and it is a pity they have gone on so long, but I think we have been learning. Both parties have been learning. I think Siobhán’s recruitment, my arrival and Helen’s have brought a focus. We will move this forward as fast as we can consistent with getting the best value for the public purse.

Q107 Mr Bacon: When do you expect to conclude these negotiations?

Mr Varney: I would like to have it cleared by the time HM Revenue and Customs comes into existence, hopefully in April next year.

Q108 Mr Bacon: You have a performance measurement system for this contract. Is it working?

Mr Varney: Not completely. As Mr Trickett and Mr Sheridan said, there is a feedback from staff who do not feel it is working as well as it should do. Part of that is because I do not think we did a good enough job in dealing with expectations at the time of the

contract and part of it is because there are real problems which we have to resolve. That is what we are working on together with Mr Hopkins to see if we can resolve those in a satisfactory way. It is incredibly difficult to get a performance management system up when you have no experience of being a customer. You can go to everybody else in the world and talk about being a customer but if your whole experience is being able to do it with people in-house it is a quite difficult challenge.

Q109 Mr Bacon: If Mapeley were to get into financial difficulty again, how would you become aware of it?

Mr Varney: I would expect them to tell us. I would expect our own models to indicate. I would not be surprised if their financiers also made us aware.

Q110 Mr Bacon: Directly?

Mr Varney: Usually, when there is trouble, bankers arrive pretty quickly.

Q111 Mr Bacon: Mr Hopkins, the Report says in paragraph 3.25 that you think the charges under the PMS are punitive and therefore an unfair contract term. If that is the case, why did you sign this contract?

Mr Hopkins: We signed the contract because there was a performance measurement system that was given to all of the bidders to bid on. We took that in good faith and we knew what we were entering into.

Q112 Mr Bacon: Only afterwards did you say it was unfair.

Mr Hopkins: Absolutely. An estate that has been managed internally for probably over 50 years that then transfers to the private sector and you do not know how many calls you are going to be receiving on the help desk or how many orders you are going to be getting—the fairness is not all about just a penalty. The fairness is about making sure that it aligns us as a partnership so that we move forward and make sure things are being done properly. It is not just about the penalty.

Q113 Mr Bacon: Can I draw your attention to page 28, paragraph 3.3? It talks about staff turnover and points out that on both sites a lot of staff have moved on after the deal was signed. I was particularly caught by the fact that in Mapeley there were four services directors within seven months of the contract going live. Why was that?

Mr Hopkins: I think what that means is that four services directors across various services of Mapeley were employed at that time.

Q114 Mr Bacon: And left?

Mr Hopkins: No; were employed as direct managers of services, property and FM procurement. That was my reading of that statement.

Q115 Mr Bacon: It looks to me like the National Probation Service implementation of their information system strategy had seven programme

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managers in seven years and by that we understood there was one; then there was another and then there was another. You are saying that is not what that means?

Mr Hopkins: My understanding was that it meant we employed four separate service managers in various areas of the business.

Q116 Mr Bacon: Perhaps the NAO can turn that up. Is that what it means? It looks to me very much like there was one and then there was another.

Mr Colman: Our information is that that is what Mapeley told us so if Mr Hopkins says it means that then presumably he knows.

Q117 Mr Bacon: Nonetheless, it does seem there have been quite a lot of staff changes. A number of key staff members have moved on. The project board director and the deputy director moved on. Three of the four most senior procurement staff moved on very soon after contract signature, leaving only one key member of the original STEPS team still involved in the deal. Then it goes onto management changes at Mapeley. What have you done to try and ensure some sort of continuity, never mind succession planning?

Mr Varney: With Siobhán coming, we have been building a team up. It is my commercial experience that when you do a procurement deal the people who do the procurement are not the people who operate the deal. There is a different set of skills. I think there is a very clear caution in the Report for other departments doing this to concentrate on having in place early the people who are going to operate the deal, so that there is a proper hand over.

Q118 Mr Bacon: You mentioned, Mr Varney, the Aspire contract which I understand is going to take over and essentially the one that Customs has with Fujitsu will get merged into the main Aspire contract, probably with Cap Gemini. Is that right?

Mr Varney: Possibly. They are talking. The Aspire contract is Cap Gemini with the Inland Revenue.

Q119 Mr Bacon: Basically, you want to get rid of the PFI contract with Customs and concentrate on the Aspire contract?

Mr Varney: I am happy for the two parties to talk to each other first. I want to consider very carefully what is in our interests in terms of value for money.

Q120 Mr Bacon: What worries me is you are going to compensate Fujitsu—I think we do have some experience on this Committee—for no longer having its PFI contract, merge it all into the Aspire contract with Cap Gemini, of whom the main subcontractor is Fujitsu.

Mr Varney: I think you and I may share a similar concern.

Q121 Mr Bacon: Good. Finally, on consultants, a number of people have referred to the costs. What I would like to see, if you could send us a note, is a detailed breakdown since plainly there will be chartered surveyors, chartered quantity surveyors,

insurance, civil engineers, structural engineers and Lord knows what else. I am not clear where these all sit. Presumably they do not all sit within that £7.5 million, do they, or do they?

Mr Varney: That is procurement cost. That £7.5 million is mainly the procurement. It would have been, I suspect, mainly legal advice about the contract.

Mr Bacon: I am interested in the whole shebang, tax advice particularly and also when it was given because it seems to me extraordinary that the Inland Revenue could find out so late and Customs and Excise not at all about this offshore structure when they were presumably paying tax advisers quite a lot of money. Could you give us a detailed breakdown of all the advice from wherever it came, and whether it was under the heading of procurement or whatever other heading you want to put it under? If you could make it comprehensive, that would be very helpful.⁵

Q122 Mr Williams: I note an interesting congruity between times of appointment. Mr Varney of course came in when his predecessor left in September and that was the normal retirement date, was it not?

Mr Varney: Yes.⁶

Q123 Mr Williams: Ms Ghosh came in in September. Is that right? September 2004?

Ms Ghosh: No. I joined the Inland Revenue in April 2003 and I was appointed to my Customs and Excise dual role in September this year.

Q124 Mr Williams: What happened to your predecessor?

Ms Ghosh: There was not somebody holding the post. As it happened, there was effectively a vacancy on the Customs and Excise side.

Q125 Mr Williams: So it is a new post basically?

Ms Ghosh: It is effectively a new post, yes.

Q126 Mr Williams: Mr Hopkins, what has happened to the shareholdings in your company since this contract was signed?

Mr Hopkins: What has happened to the shareholders?

Q127 Mr Williams: The value of shares.

Mr Hopkins: It is a private company and we do not really value our shares on a regular basis because the—

Q128 Mr Williams: If it came to the shareholders selling, how would they?

Mr Hopkins: By internal agreement.

Q129 Mr Williams: There is no way we can work out what tax we have lost by the accretion in the value of shares to them?

⁵ Ev 21

⁶ *Note by witness:* Sir Nicholas Montagu retired in March 2004 at the normal retirement age. Ann Chant took over as acting Chairman, IR until David Varney's appointment in September 2004.

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Mr Hopkins: We obviously purchased some assets, so there is an asset base which has risen or dropped in value. We think that has performed well over the last couple of years. That is how we were looking at value.

Q130 Mr Williams: In addition to the £55 million that was referred to, there is an unknown amount of potential tax on share values that is accruing to your overseas shareholders?

Mr Hopkins: The £55 million comes from a calculation based on various assumptions which would assume we were not paying the corporation tax and the capital gains tax was paid on the increase.

Q131 Mr Williams: That related, according to the Report, to the movement of the property overseas. We are talking about the fact that the shareholders are overseas. There are two elements. The £55 million is said in the Report to be the result of moving property overseas.

Mr Hopkins: Correct.

Q132 Mr Williams: I am not asking about that. I am asking what else might have been lost in the lost taxable capacity as far as revenue is concerned, because the overseas shareholders will not pay profit on capital gains in this country, will they?

Mr Hopkins: That is right. It is very difficult for me to comment on the tax position of the shareholders.

Q133 Mr Williams: Really, when we say £55 million has been lost in a way in terms of the tax evasion, there is another sum which is quite indeterminable. What is the capital value of the company?

Mr Hopkins: It is a mixture of an operational business so there is an income stream on the service delivery and then there is an asset owning business so it is a difficult structure to put together.

Q134 Mr Williams: What happens if the company goes bust? You referred to having contingencies and you want to deal with that in private. In that case, I am sure the Chairman will agree that we have a private session at the end of this meeting. You will have that information available for us, will you?

Mr Varney: Yes.

Q135 Mr Williams: The Chairman also referred to the fact that Customs were not told until after the deal about the offshore nature of it. Unfortunately, because I was reading, I missed the reply. Can you repeat the reply? Why were they not told?

Ms Ghosh: Again, in their evidence to the Treasury Select Committee, Nick Montagu and Richard Broadbent gave the answer that effectively the reputational risk rested with the Inland Revenue in the sense of the nature of the tax arrangement. Therefore, the Inland Revenue board saw this as an internal issue rather than an external issue. I know Nick will have apologised for the fact that—

Q136 Mr Williams: Did you get the impression that they were a little surprised when they discovered it?

Ms Ghosh: Richard Broadbent again answered that question in the TSC.

Q137 Mr Williams: But Richard Broadbent is not here.

Ms Ghosh: Oh, I see. He commented in fairly neutral terms. I am sorry, I have not got the text of the TSC meeting in front of me.

Q138 Mr Williams: That was in evidence before a committee?

Ms Ghosh: That was in evidence before a committee.⁷

Q139 Mr Williams: I am not talking about that. I am talking about when he heard, not when he got before the committee

Ms Ghosh: I am afraid I was not privy to what happened in his private office when he heard.

Q140 Mr Williams: How was he informed? Did someone pick up the phone and say, “By the way, Jack, I thought you might like to know this is all offshore”?

Ms Ghosh: Your question is about how Mr Broadbent was informed?

Q141 Mr Williams: Yes.

Ms Ghosh: I do not know the answer to that but we would be happy to talk to colleagues who were in the private office at the time.

Q142 Mr Williams: That is rather unfortunate. I would have thought there would be some anecdotal evidence within the Department as to what went on. I would have anticipated some modicum of expression of interest or concern or questioning, would you not?

Ms Ghosh: I would not speculate but I am sure we can find some evidence for you if you would like to have it.⁸

Q143 Mr Williams: I look forward to reading it. I would look forward even more to reading the source evidence you collect before I read which of it you care to let us see! I think most of the interesting questions have been asked. You are still negotiating a number of claims. Is your contract robust enough? Time and again with PFI we have had permanent secretaries come here thinking they had built protection in and then finding that the contract does not stand up and on the first possible occasion the private sector says, “No, I am not paying up.” How robust is your contract?

Mr Varney: I think we have put a lot of effort into trying to make sure that it is robust and we did that firstly by requiring quite a high level of equity for these sorts of deals. The NAO Report indicates that there is a high level of equity. In the discussions which we had with Mapeley when they felt they were

⁷ Note by witness: Evidence taken before the Treasury Select Committee hearing: The Handling of the Joint Inland Revenue/ Customs and Excise STEPS PFI Project 11 December 2002.

⁸ Ev 21

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in the trouble that led to Mapeley shareholders putting more equity into the business, we have tried to do a business continuity programme to learn from other people. I do not think one can ever say everything is 100% certain but we have certainly struggled to make it as comprehensive and as coherent a programme of risk management as we can. It is interesting that what the NAO Report talks about for us is things that we are actually doing.

Q144 Mr Williams: If the contract is so robust why are the negotiations so protracted? If the contract is robust, one would have expected easy resolution to the problem, would one not?

Mr Varney: I think there is a difference between being robust and being completely satisfactory. This is not a completely satisfactory contract. That is what we are negotiating. On the question of whether it is robust we think we have taken measures and you have cross-questioned Mr Hopkins about the robustness of Mapeley's stance and he has given you assurances.

Q145 Mr Williams: I understand, Mr Hopkins, that your company felt that the performance measurement system was punitive?

Mr Hopkins: That is right.

Q146 Mr Williams: Who was irresponsible enough to sign up to that then?

Mr Hopkins: As I said earlier, we knew exactly what we were signing up to and its punitive nature is not necessarily just financial, rather that the punishment does not really reflect the crime. There are things which I think we can do working in partnership with the departments to make the PMS system work better in practice. We have signed up to it and we will live with that. I think developing it to make it better is a sensible thing for both parties.

Q147 Mr Williams: What if they do not agree to make changes?

Mr Hopkins: Then we live with what we have signed up to.

Mr Williams: Could we have an outline of the nature of these problems in a note, not an outline here and now but if the three of you could put a note in to explain to us precisely what it is.⁹ I think that is all I have to ask.

Chairman: Thank you very much. Mr Jenkins?

Q148 Mr Jenkins: Mr Varney, coming so late in the proceedings most of the questions have already been asked so there are just one or two brief things. Firstly, let me say that when I read this I thought it was a very good Report. I did, I thought it was a very good Report. I came here quite relaxed thinking it was going to be an easy session but I have got to tell you now that the Report is much better than your answers because I am getting more and more doubts as I listen to you. The longer it goes on the more doubts there are in my mind. When you signed up to this Report—I know you are going to answer me one

or two simple questions because I have only got simple questions—on page 2 in paragraph 4 it says there in summary “the deal has delivered benefits and more are expected; the Departments got a good price; and good risk management will be essential.” I bet when you signed that off you felt excellent and you ticked it off and signed it, but the paragraph above it 3(b) says one thing which I do not understand. It outlines the fact that there was an average annual charge of £170 million, equating to some £1,500 million over the period of the contract over 20 years. At the bottom it says in real costs £3.4 billion, and that is the figure you used. I thought that I had understood that and I understand that the average will not be £170 million every year because it will go up and it will go down. In the figures can you explain to a simple soul like me why the figures given by the Treasury show that we have paid £234 million in the first year, £305 million in the second year and £311 million in the third year, when the contract was averaged at £170 million? What does this mean? Does this mean that we are front-end loading and after ten years we will be rent free for ten years because that is the point when we hit 3,400 or does it mean that there is a variance in the contract, and if there is a variance in the contract why is it so large?

Mr Varney: I think we can cover this on both sides. I think it is very important to note that the numbers you refer to, as you rightly say, are real and the note on the 170 says: “This charge reflects the Departments most likely requirements for accommodation . . .” So part of answer lies, as I said earlier, in procuring other services as well as the buildings. We have obviously gone through the stage of having this audited to make sure that we can actually say we are not paying anything that is not in line with the contract. I will ask the contract manager and then Mapeley to comment.

Q149 Mr Jenkins: You explain this. We all want to know the answer to this one.

Ms McHale: By nature these contracts provide a framework where the Departments can have their relatively stable and predictable costs, the facility price which is indexed over the life of the contract, and then buy in other services as required. It is the other services that are creating this cost effect that you see where it perhaps looks as though we are paying a lot for the facility price. It is total costs and there are a number of other facilities services which the department has bought before the contract and we are incurring as cost layers before contract which are still coming through the cost layers. It is a confusion about what the facility price means. The NAO very helpfully qualifies this in the Report and says it is an accommodation charge which can go up and down in line with the departments' requirements, but it is the other cost layers that go through as a result of the buying power we have acquired through the contract with Mapeley.

Ms Ghosh: In a simple person's terms the kinds of things that make up the difference are things like utility costs which we pass through to Mapeley and Mapeley pass them on, things such as major or

⁹ Ev 21–22

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minor new works or if we want childcare provision. It is things that are not covered by the basic rent and accommodation costs.

Chairman: We will have to break there for a division.

The Committee suspended from 4.48 pm to 4.56 pm for a division in the House.

Chairman: Order, order.

Q150 Mr Jenkins: So in essence what we are saying is that we have two elements here. The first element is the contract which is averaged and will be paid at some £170 million a year. On top of that there is a flexible element which you are paying to the contractor over and above either the original contract concept or which you understood to be part and parcel of the contract originally but you could not quantify it at that stage?

Mr Hopkins: Can I have a little go. We signed up to provide a certain amount of services for 20 years. The base cost of that service (with full risk transferred to us) is the £170 million number. On top of that at the full discretion of departments there are other things that they can ask us to do or they can ask the rest of the market place to do which we bid for and then we win that business. In certain instances like utilities, which we have talked about, which is the £20 million number that passes through our company, we do not make any margin on that. The base contract of risk transfer is that £170 million.

Q151 Mr Jenkins: I am not averse to this contract and I am not averse to taking risks. In fact, I think too often we criticise departments for not taking risks and, effectively, costing us more money. I just want to clarify this so that everyone understands exactly what we are talking about.

Mr Varney: There is always a problem with analogies but it is a bit like we have bought a flat where we have agreed what the rent is going to be, which is the facilities price. On top of that we have the option of either paying the service charge or buying the services ourselves. That is the analogy and that is why the contracts are not quite so clear.

Q152 Mr Jenkins: It is not that aspect I am worried about. The concept I am worried about is this: I have got the flat, I have got the electric, I have got the gas, I have got the management charges; it is this other element of when I want an addition to the flat, when I want a wall put in. Am I going to go out to tender and get the best tender or am I now linked with a contractor who says, "This is our contract. This is what we can do"? You are all shaking your heads but I want to know because £170 million to £311 million is a lot of money, it is double the price, so in essence what is done for double the price? How many contractors have been brought in by your estates team when you have had a contract with this company which has not met what you thought was the right price? How many contracts have you given externally where you have not gone to your main contractor?

Ms McHale: We are actually in the process of doing this and that is part of the work we are doing for bedding down the contract when we are agreeing the new framework agreement for doing those deals. We always do it on a value-for-money basis. Mapeley are our first option provider. If they cannot do it and do not wish to do it commercially then we have the right to go to the market-place and test value elsewhere.

Q153 Mr Jenkins: No, no, no, you did not say that. You said specifically that if you got a job you could go to any contractor. You did not tell me that you had to go to Mapeley and almost say, "If you did not want to contract or tender for this I can go somewhere else."

Ms McHale: It is on a value-for-money basis so part of the benefit of this contract is having a relationship with the provider. That is what we are trying to build to get the most out of the relationship with Mapeley.

Q154 Mr Jenkins: I know your relationship. The relationship is quite simple: you did not tell them about the condition of the building and they did not tell you about the offshore basis. That is a brilliant start for a partnership based on trust. So I know your relationship and that is the difficulty. You have now dropped from 300 to 160 members of staff to run your estates team. Why have you got 160 in your estates team? Surely, it should be run by the contractor?

Ms McHale: We are actually at around 152 and as the relationship beds in we are getting further efficiency benefits in our operation and we expect to see that moving over time.

Q155 Mr Jenkins: But can you reduce it if you are in fact going to start tendering for every job that is not part of the base contract?

Ms McHale: That is why we are looking at arranging framework agreements with Mapeley so that we can have arrangements we can draw upon and we do not have to go into that level of detail for each task.

Q156 Mr Jenkins: Mr Hopkins, on the back of this part, this contract has to be shared out with new contracts/new business?

Mr Hopkins: Yes.

Q157 Mr Jenkins: Now you are in this market-place, how many new contracts and how much new business have you taken up in the last three years?

Mr Hopkins: We took on one major contract in addition to this which was the entire UK portfolio of Abbey National, all their offices, shops and back-up. Between the departments contract and that, it is a very sizeable business. We have also won a couple of smaller contracts which are hardly worth talking about. The major contracts are STEPS and the Abbey National bid.

Q158 Mr Jenkins: Mr Varney, you have mentioned, maybe rightly, "with hindsight" on a number of occasions and I think personally that anyone can

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have hindsight but if we pay people to be there to do an analysis we expect them to have foresight to avoid any problems. However, with hindsight at the present time do you think this is a good deal?

Mr Varney: Yes.

Q159 Mr Jenkins: When they tried in London many years ago to sell the lampposts off and lease them back, it was stopped by the Government because it was a bad deal, because no-one with any sense would sell the assets off and rent them back so in the longer term they would pay more for the assets. Why do you say yes it is a good deal?

Mr Varney: Because nobody thinks that the Revenue and Customs in 20 years' time will be the same shape as it is today. It is not the main task of Revenue and Customs to manage the estate. We have got an estate of some considerable size and I think there were benefits there. We are probably always going to need lampposts but business will be done in a different way. We have got a contract which covers the uncertainty which if we did not cover it when we changed our properties that would go straight through to my costs and I would have to bear the costs of downsizing the estate.

Q160 Mr Jenkins: I understand that but surely it is not beyond the wit of even our departments to get together and establish an estates team that looks after all government buildings and can fix the size of the building as and when they require it? We know we are going to downsize certain departments as some departments run out and other departments grow up. Are you saying we could not do this and we have to hand it over to a contractor outside?

Mr Varney: It is a question of what you think is value for money with the resources which you have got. Outside the public sector people have decided that property management or telephony or computer infrastructure is better served by having a professional outsider do it and having the career prospects of people working in it being professional rather than doing one of the other tasks. In each case you have to ask yourself whether there is a value for money for the public purse. That is what I thought the Report in front of the Committee has tried to establish.

Chairman: Your time is up, I am afraid, Mr Jenkins. Mr Trickett?

Q161 Jon Trickett: I just wanted to ask briefly about the corporate structure which Mapeley has adopted because they have got two companies, have they not, one dealing with the maintenance contract and the other one holding the property. Of what benefit to the public sector is that corporate structure?

Mr Varney: Well, I think that is a question of in the overall contract you have to say that what Mapeley offered was a bid which was half a billion less than the next bidder. They obviously took steps to put a structure together which was presumably the way they valued their bid but you will have to ask Mr Hopkins.

Q162 Jon Trickett: I am asking you because you are the public sector and that is what I am interested in looking at as part of the Committee of Public Accounts. It strikes me that the answer that Mapeley have offered us is that the asset portfolio enhancement in value which has taken place as a result of market changes has been helpful to them in the overall picture but that the revenue contract, if you like the maintenance, has been a struggle. You are still trying (in the jargon that you are using) to bed down. Supposing the contractor runs into trouble? What implications does that have for the asset-holding company?

Mr Varney: If the company is in trouble then the provisions of the deal are that they would be in trouble with the banks and therefore the banks would step in because the banks—

Q163 Jon Trickett: What steps did you take as the public sector to secure the assets because clearly they have set up two companies? What I am trying to get at is supposing they default on the operating contract what charge do you have then against the asset-holding company?

Ms McHale: We contract with one entity so if there is a problem with another entity it impacts the whole contract. We have a protection for the run off of the assets which is the £150 million deferred consideration for the first ten years of the life of the contract. So if anything happens during that time the compromises Mapeley's viability then we are entitled to a payment back from them as a first charge on the assets for this deferred consideration.

Q164 Jon Trickett: So there would be a charge on the assets by the government effectively, by the institution you represent even though the assets are held in a separate company to the operating company?

Ms Ghosh: We would have the first charge sufficient to cover so that in the end we would not only have our £220 million up front, we would have the proportion remaining of the additional £150 million which was part of the total valuation, so we would get our total valuation.

Q165 Jon Trickett: Okay. As I understand Mapeley's answer—and I think the Chairman will stop me if I go into this too much further because of my time—the enhancement in asset values has helped to protect the corporate structure which they have established. Was that enhancement in value in some way part of the evaluation process at the time the contract was being evaluated, since it is clear that property values have increased? In a property portfolio it is clearly a factor to be taken into account in evaluating values, is it not?

Mr Varney: The bid from Mapeley, as we rightly said, was thin on operating profit and relied on capital profits at the end. The response of the two departments was to respond to that uncertainty by looking at getting a high level of equity into the contract, getting as much value as they thought they could up-front and getting a protection for the £150

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million that they did not get over the first ten years of the contract, so they went for a risk mitigation strategy in face of that potential uncertainty.

Q166 Jon Trickett: If the property market suddenly collapses then Mapeley are in deep trouble really. What happens under those circumstances? I am not asking you, Mr Hopkins, I am asking the public sector.

Mr Varney: We have already had one set of negotiations against that background and we have been fairly robust. As we have said, we have not parted with any money.

Q167 Jon Trickett: Against the background of a collapse in property values?

Mr Varney: That is a matter for Mapeley.

Chairman: In terms of plan B we are going to go into private session. There are one or two other supplementary questions from Mr Steinberg and Mr Jenkins.

Mr Steinberg: Just very quickly on two issues on whether or not you got a good deal. Jon has been discussing the £220 million that Mapeley paid to you. How do you know that was the correct figure? How do you know it should not have been more? Why was it not more? That is the first question. The second question is that they claim they are £500 million cheaper than anybody else. They claimed they were able to do this because they were going to save £55 million through tax evasion by going offshore. You are tax inspectors, you know exactly how much you charge me and I get a bill every year. How do you know it is not more than £55 million? It could be more than £55 million. That is maybe why they did it in the first place because they knew that they are going to make much more than £55 million. Have you done any calculations to find out whether £55 million is a true figure? Finally, the last question is do you find it embarrassing that the Inland Revenue and Customs and Excise are now being run from a country that is offshore and other people use for tax evasion?

Chairman: To be fair, I did ask this question right at the beginning and I think their answer was that they have apologised.

Mr Steinberg: That is a different question. I am asking do they find it embarrassing.

Q168 Chairman: I did ask was it a matter of shame which is even stronger. Do you want to add anything to your earlier answer?

Mr Varney: No, I am quite happy to rest—well, I am not happy but I am content to rest with my earlier answer.

Q169 Chairman: You are not happy with your earlier answer or you are not happy with the situation?

Mr Varney: Not happy with the situation, as I explained right at the beginning. Can I deal with the two issues. The £220 million estate was independently valued by property specialists and

they established a value of £370 million. We felt, in consultation, that £220 million was the amount upfront that we could get which would keep bidders in the contract. So it was a judgment figure and it was consistent also with the deal that DWP had done. It is about the same percentage. Then on the issue of the £55 million, which is the Mapeley evaluation of the capitals gains that they will make, that gain is based on a series of assumptions, that first of all UK tax will not change in terms of capital gains tax legislation; secondly, it is an assessment on Mapeley's behalf of the relative rates of inflation of office buildings and the Retail Price Index. That is how the £55 million comes about. In broad terms the £55 million rise is assuming that properties will increase in value over the next 20 years at about twice the rate of inflation.

Q170 Mr Steinberg: So you think that the £55 million is an accurate sum?

Mr Varney: In the last ten years the rate of property increase has been somewhat less than the rate of inflation. I am in no position to judge what is going to happen over the next 20 years. I can only tell you what the assumptions are.

Mr Steinberg: I could go down a different line there.

Chairman: Mr Jenkins?

Q171 Mr Jenkins: I want to go back to the 160 estate staff and the skill base they have within them. I know they must be doing jobs and contracts and evaluating what work is going to be put to Mapeley, *et cetera*. I would like to develop that and see what they actually do and how you see their future. Also I do not believe it when Mr Varney said, "We are not experts in estate management we should get out of it and do our own work," because you do have to have a pool of skilled labour there in the real world to evaluate contracts. On your contract compliance officers; who is responsible for the health and safety aspects of the staff insofar as do you have a proactive process on this and there is the perception (not true in any way, shape or form) that if there is a worn carpet or a problem in the area that Mapeley is not going to want to come along and lay a new carpet, they want to cut costs to make more profit on their estate. So how do you get this balance between health and safety in the workplace? Who is responsible for it, who is going to force it through? As an individual worker is it clearly laid out who I go to, who I see, who is responsible for it and what action is being taken, because I think we need to answer the question in that area?

Ms McHale: Can I start off with a head count of the estates team. It is 152 at the moment—

Q172 Mr Jenkins: The Report says 160. We go on this Report; it is our Bible.

Ms McHale: The Report says 160. We are taking advantage now with a static head count as it stands at the moment of 152, as I have just said. We are experiencing further benefits as the contract beds in and we are beginning to deal with things which are currently deemed not to be functioning well in the

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contract, we are improving the change mechanism and working towards PMS. We are developing these processes with Mapeley at the moment but that is more labour intensive than it will be once the contract is fully bedded down. We expect that we will have a team of specialists managing the contract which is correctly targeted but delivering that in a more efficient fashion and working with our provider to do that. On the health and safety question, if I may, we are working with Mapeley again to look at the incidence of health and safety reports and review this across the organisations. We have had a degree of union inspection notices. We are also raising issues ourselves across the contract and Mapeley, as they look in their own audit process, are picking up issues. At the moment we are working on a comprehensive strategy compliance audit across the contract to review health and safety arrangements.

Q173 Mr Jenkins: Is there a clearly laid out channel that an individual knows who to go to to get it sorted out?

Ms McHale: Yes, there are business contacts for health and safety, there are contract management contacts, and there is the Mapeley help desk for raising these issues, so there are several channels available to employees. I also have regular meetings with employee representatives to test that.

Q174 Chairman: Thank you. Before we move into private session one or two questions from me. Paragraph 1.12 on page 13 deals with the fact that we have alluded to, that you can vacate up to 60% of the estate over the next 20 years. Quite apart from the fact that you cannot predict what your needs will be in 20 years' time, you have paid for it up-front anyway, have you not, so what is this flexibility worth in reality?

Mr Varney: We have exercised some of the flexibility already. We have released about 70,000 square metres of space already although our total requirement has gone up, and we expect that as we put Inland Revenue and Customs and Excise together, should that find favour with the House, then we will be looking to rationalise the estate.

Q175 Chairman: What I was asking about is the way the original contract was drawn up. Why did you not just pay the costs of vacating the property as they arise? Would that not be easier?

Mr Varney: If we were faced with the situation we are faced with today, which is a flat cash settlement, releasing property would cost us money which we would have to pay. Mapeley will take some of that property back. They will be able to review whether they can do something else with it, which we could not do, so we have a flexibility against the drivers of where the Revenue and Customs are going to go which will turn out to be very valuable.

Q176 Chairman: That is a fair answer. Mr Hopkins, what incentives do you have to minimise your finance costs when they are simply passed on?

Mr Hopkins: Minimise our finance costs?

Q177 Chairman: Yes to your banks.

Mr Hopkins: To our banks when they are passed on?

Q178 Chairman: Yes, to the Revenue.

Mr Hopkins: I am not sure I understand the question, sorry.

Q179 Chairman: Well, it is in the contract, is it not, that your re-financing with the banks will be passed on?

Mr Hopkins: Refinancing? Sorry, the question?

Q180 Chairman: What incentive do you have to reduce those costs when those costs are passed on effectively to the Revenue?

Mr Varney: Can I help? When we entered the bidding, clearly the bidding put pressure on the providers to go and get the best financial terms. Unless there was a conspiracy among the banks—and you will see in the Report there were a variety of financiers—it was a bidding process which should have put pressure on Mapeley and the various others to get the most suitable terms that they could from their bankers.

Chairman: Alright.

Q181 Mr Williams: What use have you been able to make of the 70,000 square feet that have been released?

Mr Hopkins: It comes in two forms, either freeholds or leaseholds so it depends on where it is and what it is. We have managed to sell a freehold down at Southampton where we paid some of the development gain back to the departments. They have a share in that.

Q182 Mr Williams: They do have a share in any profit?

Mr Hopkins: We pay part of the profit we make on the property back to the departments. That is part of the transaction. Some of the leaseholds that we have had we still have sitting vacant so that is the risk transfer that is passed across which is something we need to deal with.

Mr Williams: To save time can you let us have a note on this arrangement.¹⁰ I am relieved to hear that you are sharing the profit.

Q183 Chairman: Lastly before we go into private session, there is one further question that we can ask in public. If you look at 3.7, which you will find on page 24, you will see that you needed to find out more about the cost consequences of the deal being terminated. It says: "The Chairman also believed it was crucially important to get a better understanding of the consequences of the contract coming to a premature end . . ." What I do not

¹⁰ Ev 22

Inland Revenue/HM Customs & Excise and Mapeley

understand is why you signed the contract without working out all the consequences of your position on termination?

Mr Varney: I think that is indeed one of the lessons from this Report. It is drawn out precisely by the National Audit Office in terms of lessons to be learnt for the future.

Q184 Chairman: Thank you very much. We will now move into private session. Would members of the public and people who are not officials connected to this please leave.

Mr Varney: Chairman, would you be happy if Mapeley withdrew?

Chairman: Alright.

Memorandum submitted by the Public and Commercial Services Union
MAPELEY STEPS CONTRACT IN CUSTOMS & EXCISE AND INLAND REVENUE PCS BRIEFING
INTRODUCTION

The Public and Commercial Services Union (PCS) is the largest civil service trade union, with a total membership of 310,000 working in over 200 civil service departments, non-departmental public bodies and related areas. PCS is uniquely qualified to comment on the merger as we represent the vast majority of staff and senior managers employed by Customs & Excise (over 18,000 members) and Inland Revenue (over 60,000 members).

PCS is committed to achieving high quality public services and we represent the staff who are a fundamental resource required to deliver customs and revenue services to the public. PCS therefore wants to be at the centre of change within the new department and looks forward to positive and pro-active industrial relations.

STEPS TO SUCCESS

PCS believes that in order to be effective HMRC will require the following:

- A commitment to equitable, consistent and high quality public services.
- Winning the confidence and trust of customers and staff alike.
- Examination and review of the impact on HMRC of the government's proposals for the future of the civil service.
- An end to the scandal and waste generated by the privatisation of public service functions.
- Valuing, and investing in, staff to establish a highly-trained, skilled and committed workforce with good job security, pay, conditions and career development opportunities.
- An end to the practice of using consultants in place of in-house staff who possess the qualifications for a particular job.
- Good industrial relations to be at the heart of the operation and culture of HMRC.

MAPELEY STEPS CONTRACT

Given the negative impact of a number of privatisation/contracting-out exercises within Customs & Excise, Inland Revenue and throughout the civil service, we believe that any proposals to further outsource HMRC work would be a mistake. The emphasis should be on utilising and developing in-house skills and solutions.

A particular example, which underlines this point, is the Mapeley STEPS affair, where Revenue and Customs offices were sold three years ago to an offshore company under the Private Finance Initiative (PFI). This sale brought great discredit and controversy on both departments. Payments to Mapeley are now averaging £307 million per year, rather than the anticipated facility price of £170 million. The contract may prove to be significantly more expensive than the rejected alternative of retaining the offices under public ownership. In addition over 40 firms of consultants and advisors have been used on the STEPS deal, at a cost to the taxpayer of £13 million to April 2004.

Contract Responsibilities

Business users within both Customs & Excise and Inland Revenue find the Mapeley contract very confusing. There is a significant lack of clarity over which part of the estate Mapeley have responsibility for and which parts are outside the STEPs contract. This, combined with Mapeley's internal structure and sub contracting for fault reporting and repair, have led to an increase in the number of Union Improvement Notices (UINs) being served on both departments and Mapeley. There are also extensive delays in repair work actually being carried out.

Health and Safety

Business users have encountered a significant degree of inertia on the part of Mapeley to undertake to their health and safety obligations, as demonstrated by the serving of UINs. In some extreme cases, Mapeley have only accepted their obligations hours before the attendance of the Health and Safety Executive. In fact their whole approach to meeting their legal health and safety obligations could be categorized as reactive rather than pro-active; at one site which encountered a lighting failure Mapeley's solution was to erect a fairy light style arrangement of bulbs suspended across the ceiling. There are also ongoing problems related to the removal of asbestos throughout the HMRC estate.

Legal Obligations

There are reports of problems regarding Mapeley's compliance with legal requirements in relation to the Disability Discrimination Act (DDA) and TUPE obligations for staff transferred from the civil service, where PCS has had to intervene to ensure that agreed pay and conditions commitments are implemented.

Financial Stability

Members working in the Estate and Contract Management Unit (ECMU) have expressed their concerns over the financial stability of the contract and Mapeley. It is not unusual for the ECMU to haggle with Mapeley over the cost of work, after it has been completed.

National Audit Office (NAO) Report

In May 2004 the NAO published their Report into the STEPS contract. This Report highlighted a number of initiatives being undertaken by the departments to ensure that management of the contract was more effective. One of these was a "review of the estates roles and responsibilities to remove duplication and ensure clear process and accountabilities". This review did start, but has been shelved.

PCS believes this review should continue, and be expanded to include the wider aspects of industrial relations and staff morale.

Contract Management

Only very recently has an experienced contract manager been permanently appointed to the ECMU to manage the contract, three years into its life, even though both departments have accepted that the contract has needed to be managed more robustly for a number of years. It had been identified that there was a lack of commercial contract management skills within the ECMU. Notwithstanding this, departments are increasingly having to invoke contractual obligation clauses against Mapeley in an effort to ensure compliance.

The general perception of staff across all businesses, in both Customs & Excise and the Inland Revenue, is that the contract is failing. They are witnessing a general deterioration in their work environments, in an attempt to cut costs. Staff are the front-line main business users of the Mapeley contract, and as much as the departments may say that the contract is working, the users of the estates see it failing and view it with suspicion. The Mapeley contract has a minimum 20 year term, ie a further 17 years during which HMRC will be unable to change the contract or guarantee changed behaviour on the part of Mapeley.

Staff Morale

This environment is inevitably having a demotivating and demoralising impact on staff, which is not helped by the threat of job cuts, redundancies and relocations. It is in the interests of the employing department, the public and the staff themselves that employees feel secure, valued and able to do their jobs effectively.

ROLE OF THE PRIVATE SECTOR

The Mapeley contract is not the only example of waste and inefficiency. For example, the Revenue has paid out nearly £1 million in compensation since April 2003 to members of the public suffering delays and errors arising from the IT contract with Electronic Data Services (EDS). The PAC's report on the matter was published in April this year, indicated that 400,000 families had not received their child tax credit and working tax credit payments on time. Furthermore, one in five applications had been assessed incorrectly. The Revenue was forced to make interim payments, which were then clawed back, in many cases causing additional suffering and hardship to those who the credits were meant to help.

We regret that consideration is nevertheless being given to outsourcing further IT functions. We hope the lessons will be learnt, and that any such initiatives will be withdrawn. We refer to the HMRC Chairman's acknowledgement, in his evidence to the treasury sub-committee on 13 October 2004, of the pitfalls involved:

"I wish I could say that the private sector was incredibly better. The evidence in the US is that about 25% of the IT projects deliver value. In Europe we think it might even be slightly less."

The Institute for Public Policy Research has recently demonstrated that there is a marked tendency for public bodies to choose Private Finance Initiative (PFI) contracts so they can write assets and debts off their balance sheets, even if doing so is not cost-effective.

PCS also has major concerns about the extent of the use of private consultants in place of in-house staff who possess relevant qualifications, often acquired at public expense. We wish to see the government undertake a thorough review of the extent of this practice.

CONCLUSION

We look forward to working with the HMRC Chairman and his senior management team in order to deliver high quality services via good industrial relations, exploiting and developing in-house skills and solutions and an end to the negative consequences of further outsourcing public sector work.

PCS has an established record of delivering agreed change through effective industrial relations and close working relationships with managers at every level. We have indicated our support for government and departmental initiatives, including new tax credits, and have supported the government at difficult and testing times (for example our support for rural communities during the foot and mouth crisis).

PCS therefore looks forward to being at the heart of the debate about the Mapeley STEPS affair and the wider questions posed by the issue of private sector contracts within HMRC. We would welcome the opportunity to provide further written or oral evidence to the select committee on our vision for the new department.

Mr Frank Campbell

Mr Ian Lawrence

October 2004

Supplementary memorandum submitted by the Inland Revenue

Question 37 (Jon Trickett): Are you able to provide us with a note telling us what your latest estimate of the annual costs is likely to be and what the aggregated costs at the end of the contract will have been?

There are two broad categories of payment under the contract. The Facility Price for serviced accommodation is calculated per property and is fixed for 20 years (subject to RPI). It may only be increased as a result of agreed changes in the amount of space or the scope of services required by the departments.

The contract also creates an overarching framework for the departments to obtain other services as required. These include utilities, major and minor works, childcare, etc. These pass through costs are paid for separately from the Facility Price, using a mechanism contained in the contract.

**BREAKDOWN OF PAYMENTS TO MAPELEY STEPS CONTRACTOR LTD
(FIGURES SHOWN—CASH BASIS INCLUSIVE OF VAT):**

	<i>Payments to Mapeley (cash basis inc. full VAT)</i>		
	<i>01-02</i>	<i>02-03</i>	<i>03-04</i>
	<i>£ million</i>	<i>£ million</i>	<i>£ million</i>
Facility Price	196	219	233
Payments on account for new services/buildings*		9.4	4.7
Pass through costs**	38	76	73
TOTAL***	235	306	311

* Payment on account figures include full VAT.

** Includes: Utilities, Major works, Minor works, Confidential Waste, Childcare subsidy, Catering variations, Churn, Furniture, *Ad hoc* security, Bottled Water.

*** Totals are rounded.

Predicting future payments—The total payments in either category are difficult to predict over a 20-year period due to the pace of change the departments are managing.

The pass—through costs are on a demand and volume led basis. Again this is difficult to project across a 20-year contract. As can be seen years two and three show greater expenditure on these costs—this is reflective of the contract bedding in but also a difference in take up rates by the departments. Given the degree of changes envisaged the average payment of the first three contract years would not reflect the future shape and operation of HMRC.

The average NAO Facility Price is currently estimated at £170m per contract year. This figure has been misinterpreted as a total yearly contract cost estimate. In actual fact it is an indicative average of the most likely Facilities Price over 20 years as qualified by the NAO themselves in the STEPS report.

Question 42 (Jon Trickett): I have had three separate organisations drawn to my attention who Mapeley refused permission. They all seem to have legitimate reasons to be in the building. It would be helpful if you could provide us with a note and I will compare it with the information which I have received, which I will provide to the Chair

The departments have the right to use the premises for their operational purposes and to invite third parties onto site. There is a responsibility on Departments’ staff to ensure any legal, Health and Safety and security considerations are dealt with appropriately. If any damage were sustained to the Premises as a result of such services Mapeley would have recourse against the Departments in line with the contract.

The STEPS contract does permit the Departments to use the premises for a sports or social club which is intended for the benefit primarily of the employees of the Departments. This can encompass activities such as book and chess clubs, and also allow for visits to the premises of organisations such as the Civil Service Sanatorium Society. (This would include The Benenden Healthcare Society and other civil service related organisations). The Departments are not permitted to grant leases of premises or part premises to these clubs or organisations without consultation.

Under the terms of the STEPS Contract the Departments have a right to grant access to, and use of, the premises for its own contractors eg its PFI IT providers.

We have received feedback relating to an issue with access concerning The Benenden Healthcare Society. We are currently talking to Mapeley to ensure the practical application of the arrangement under the contract is absolutely clear.

Question 60 (Jim Sheridan): How many consultants have you used?

We have procured advice from 18 organisations in conjunction with the STEPS agreement. (April 1999 to September 2004.)

Burness Solicitors	Legal
Deloitte & Touche	Financial Consultancy
Drivers Jonas	Surveying
Evolve	Management Consultancy
Government Actuaries Department	Actuarial Services
Hewitt Bacon & Woodrow	Financial Services
Lovells	Legal
Wragge & Co	Legal
BWA Facilities Consultancy	Management Consultancy
Gerald Eve	Surveying
Insignia Richard Ellis	Surveying
NM Rothschild & Sons	Financial Consultancy
Tughan & Co Solicitors	Legal
Xansa UK Ltd	Management Consultancy
WT Partnerships	Surveying
Cambridge Economic Advisors Associates	Management Consultancy
IBM Global Services	Management Consultancy
Watts & Partners	Surveying

Two Parliamentary Questions were asked on this subject in June 2004. The answers given inadvertently included general departmental consultancy not related to the STEPS Contract. The financial element of these enquiries has subsequently been corrected by way of a pursuant answer.

Question 121 (Mr Bacon): Could you give us a detailed breakdown of all the advice from wherever it came, and whether it was under the heading of procurement or whatever other heading you want to put it under? If you could make it comprehensive, that would be very helpful.

STEPS PROJECT PROCUREMENT PHASE—(PRE APRIL 2001)

<i>Source</i>	<i>Type</i>
Burness Solicitors	Legal
Deloitte & Touche	Financial Consultancy
Lovells	Legal
Insignia Richard Ellis	Surveying
Tughan & Co Solicitors	Legal
Watts & Partners	Surveying

STEPS CONTRACT MANAGEMENT—(POST APRIL 2001)

<i>Source</i>	<i>Type</i>
Burness Solicitors	Legal
Deloitte & Touche	Financial Consultancy
Drivers Jonas	Surveying
Evolve	Management Consultancy
Government Actuaries Department	Actuarial Services
Hewitt Bacon & Woodrow	Financial Services
Lovells	Legal
Wragge & Co	Legal
BWA Facilities Consultancy	Management Consultancy
Gerald Eve	Surveying
Insignia Richard Ellis	Surveying
NM Rothschild & Sons	Financial Consultancy
Tughan & Co Solicitors	Legal
Xansa UK Ltd	Management Consultancy
WT Partnerships	Surveying
Cambridge Economic Advisors Associates	Management Consultancy
IBM Global Services	Management Consultancy
Watts & Partners	Surveying

The committee asked specifically about tax advice received, the departments did not obtain any external advice in this respect.

Questions 139–143 (Mr Williams): I am not talking about that. I am talking about when he heard, not when he got before the committee. I look forward to reading it. I would look forward even more to reading the source evidence you collect before I read which of it you care to let us see!

There is no record of Mr Broadbent's reaction when he first learnt of the off shore structure of Mapeley. His comments thereafter are well documented, for example in the Minutes of Evidence taken before the Treasury Sub-committee, 11 December 2002 where he said:

“Yes, I think they should have told us. I think it is regrettable that they did not. I have a degree of understanding for them.”

Question 147 (Mr Williams): Could we have an outline of the nature of these problems in a note, not an outline here and now but if the three of you could put a note in to explain to us precisely what it is.

STEPS Contract PMS—A detailed PMS was included within the STEPS contract. By its nature, the system is complex to reflect the range of services and performance levels that need to be managed. Although scenario testing was carried out prior to contract go-live, it was recognised that the true effectiveness of the PMS would not be known until a period after the contract start. In recognition of this, the contract allows for both Mapeley and the Departments to propose and agree changes to the PMS.

Although the basis of the contractual PMS remains sound, it was found that a number of elements within the process were not delivering in line with original expectations, either in terms of the financial penalties that Mapeley were being subjected to or as an incentive for service improvement gains. The following specific points were identified within the contracted system as causing problems:

- the system is overly complicated and requires significant resource from both Mapeley and the Departments to operate;
- the resulting outputs do not always provide meaningful management information to either party;
- Mapeley believe that failure points awarded under the system accumulate too rapidly, leading to unfair deductions (which Mapeley consider to be punitive);

- the structure and nature of the Mapeley Help Desk, which forms the basis for much of the PMS generated data, focuses primarily on reactive tasks rather than the necessary balance of planned preventative and reactive tasks;
- the waiver process, which allows performance deductions to be by-passed in certain circumstances (eg where the Departments' own actions have prevented Mapeley from delivering services) are not applied consistently.

During the first year of the contract, action was taken to address some of the problems that had arisen. A joint review was undertaken, resulting in Mapeley making a number of changes to the original system. Further progress has been made since.

Question 182 (Mr Williams): To save time can you let us have a note on this arrangement. I am relieved to hear that you are sharing the profit.

Background—Development Gain can apply to any property vacated and disposed of under the terms of the STEPS contract. The gain is calculated by reference to the IPD (Investment Property Databank). If the increase in value is in line with these indices and no higher, then the departments would be ineligible to obtain any % of the increase.

Detail—If there is an increase in value over and above the IPD indices between the base value and Mapeley disposal then the provisions within the contract take effect. In this case, the departments are entitled to a % share of the gain less reasonable STEPS Contractors costs incurred.

The Departments share is:—

- 30% of any Development Gain less than £1,000,000;
- 40% of the whole of any Development Gain between £1,000,000 and £4,999,999;
- 50% of the whole of any Development Gain between £5,000,000 and £9,999,999; and
- 60% of the whole of any Development Gain in excess of £10,000,000.

There are also provisions which deal with further Development Gain. The provisions are essentially claw back measures to deter the STEPS contractor agreeing back to back deals with developers which reduce benefit to the departments.

Sharing the profit—The properties subject to development gain being discussed with the department are:

- Custom House—Southampton
- Portcullis House —Southampton
- Kew Sorting Centre—London
- Towergate—London
- Pope Street—London

30 November 2004
