

Audit Committee

Date: Thursday, 11 May 2000
Time: 9.30 am
Venue: Committee Room 1, National Assembly Building

Title: TEXT OF LETTER FROM AUDITOR GENERAL FOR WALES TO PERMANENT SECRETARY CONCERNING THE NATIONAL ASSEMBLY BUILDING, 19 APRIL 2000

As you will recall, I am currently examining issues relevant to the accommodation arrangements for the National Assembly. This examination was requested by the Audit Committee in response to recent public and political concern.

My review is intended to encompass the whole process which led to the decision on the location of the final home for the National Assembly. Thus I have looked at the way officials at the then Welsh Office went about identifying suitable options for the Assembly building, how they assessed these numerous options which led to the decision to locate the Assembly building at Cardiff Bay; and the project management of the refitting of the temporary accommodation at Crickhowell House as well as for the design of the new building. However, now that the First Secretary has reopened the decision on where the Assembly should ultimately be located and called for a further review of options available, I must obviously complete my work when this further review has been concluded. This will, of course, impact on the time scale for the completion and publication of my work.

Following discussions between the Finance Secretary and the National Audit Office, and my own discussions with the Chair of the Audit Committee, I have agreed to write to you about my findings on the economic appraisals of the three key sites in Cardiff, which were considered in February to April 1998, prior to the decision by the then Secretary of State to locate the National Assembly in Cardiff Bay. These three options were Cardiff City Hall, Bute Square and Capital Waterside at Cardiff Bay.

As agreed, this letter covers only these three sites and not the other options considered and rejected at the same time or earlier in the appraisal process, although these will be considered fully in my final report. My findings as reported in this letter are drawn from an examination of Assembly files and from interviews with officials. I have not verified this information with interested third parties.

The economic appraisals undertaken by the Welsh Office

For the financial comparisons, the then Welsh Office estimated the net present cost of the various options using the methodology and discount factors prescribed by the Treasury, as set out in their

"Green Book", *Appraisal and Evaluation in Central Government*, which was issued in 1997. The calculations reflect the estimated capital and running costs of each option over a 17-year period (approximately 15 years from completion of work on any new building) less any residual value at the end of that period. The location of the Assembly building was, of course, a policy decision made by the Secretary of State involving both financial and non-financial matters.

The appraisal methodology was applied consistently to all options. However, the main reservation to emerge from my review was the lack of sensitivity analysis to assess the potential likelihood and scale of the risks involved in each option, an appraisal recommended in the Treasury guidance to assess project risk. This technique assesses the key risks to a project to ensure that adverse changes to key assumptions would not eliminate the fundamental viability of the project. Key assumptions in this case were changes to the capital costs involved or to the amount of space required. In the event, the cost of the new building in Cardiff Bay is now estimated by Assembly officials to have increased by 90 per cent from the original estimate of £12 million to the current forecast of £22.8 million; and the Assembly's space requirement has increased by 66 per cent from the original requirement of 72,840 square feet to some 121,000 square feet.

Sensitivity analysis, applied in the manner recommended by the Treasury, would have been informative in assessing the impact of these risks on each option. In this case, however, we have performed sensitivity analysis to assess the impact of an increase in capital costs for construction and adaptation (by an increase of 50 per cent and also by 100 per cent). This analysis favoured the Cardiff Bay options, relative to the other two sites, as the expected capital costs were relatively low.

Costs and benefits included

The then Welsh Office obtained assistance in preparing the economic appraisals from the Property Advisors to the Civil Estate (PACE), a government agency that provides independent professional advice to government departments on major property projects. Further technical advice was provided by the Welsh Office's professional property management company, Symonds, and also from independent consultants that were engaged to advise on specific aspects of the options considered such as construction costs and property negotiations.

Economic appraisal is a technique for the financial comparison of options and, consequently, the then Welsh Office excluded certain costs that they considered would arise on all the options. For instance, they excluded the cost of security and, for the Cardiff sites, the cost of travel between sites, as these costs were assumed to be broadly the same for the options considered. However, at the request of the First Secretary, Assembly officials are currently assessing the travel costs for the Cardiff based sites.

For some aspects of the appraisal, assumptions had to be made about costs and arrangements which, while the best available, could not be verified properly at the time. In addition, since each site differed markedly in the facilities which it might be able to offer and the amount of work and development which would be needed, it was impossible to make comparisons between sites, in financial terms, on a

completely like-for-like basis. The figures referred to here therefore need to be treated with a degree of caution since they depend heavily upon estimates made at the time of the analysis and the facilities available under each option would not be identical.

The result of the economic appraisals

The capital costs, annual running costs and net present cost over the appraisal period for each of the costed options for the three key sites are shown in the table below. These costs are based on the appraisals that were submitted to the Secretary of State on 27 February 1998. This was the last occasion on which all three options were considered together. The appraisals were subsequently adjusted and refined as new information became available and negotiations proceeded.

Option	Capital cost (£m)	Annual running cost (£m)	Net present cost (NPC) (£m)	Ranking by NPC
City Hall option 1:	39.4	1.7	47.4	6
Buy site (including £15.1 million capital costs deferred to year 7)				
City Hall option 2:	4.5	4.6	47.7	7
Hampton Trust lease option				
City Hall option 3:	4.5	4.2	45.0	4
MEPC/Grimley lease option				
City Hall option 4:	28.3	3.9	49.6	8
Exchange for Crickhowell House (including £11.2 million capital costs deferred to year 7)				
Bute Square	50.5	1.4	58.8	9
Cardiff Bay option 1:	17.9	2.3	38.7	1
Rent Crickhowell House; buy land and construct new building				

Cardiff Bay option 2:	5.0	4.0	45.2	5
Rent Crickhowell House and new building				
Cardiff Bay option 3:	19.5	2.4	40.9	2
As Cardiff Bay option 1 plus buy Pierhead Building				
Cardiff Bay option 4:	17.9	2.6	42.0	3
As Cardiff Bay option 1 plus rent Pierhead Building on 15 year lease				

These options are explained in more detail below. However, on the basis of these economic appraisals, the then Secretary of State for Wales, decided upon Cardiff Bay (option 4) to lease Crickhowell House and the Pierhead Building and to buy land to construct a new building to house the Assembly chamber. At this stage, the then Secretary of State envisaged housing the Cabinet and other key Assembly post holders in the Pierhead Building.

City Hall, Cardiff

The City Hall site had previously been considered as the preferred site for the permanent home of the new Assembly. However, negotiations to agree a sale price had been unsuccessful. The District Valuer's "open market valuation" of City Hall was £3.5 million. This is the normal basis of sale between a willing purchaser and a willing seller in the public sector. This was the maximum the then Secretary of State was prepared to pay to a public body for the acquisition of the building. Cardiff County Council did not accept this basis of valuation, taking the view that they should receive the full value of equivalent reinstatement of the facilities at City Hall.

This failure to agree a sale price led to the decision by the then Welsh Office in November 1997 to re-open the issue of the Assembly's location. Cardiff County Council subsequently put forward the following proposals for the Assembly being located in City Hall:

- a. acquisition of the site for £3.5 million but with additional financial benefits such as additional direct grants to the Council which the then Welsh Office valued at £7.5 million;
- b. two private-public partnerships involving the developers Hampton Trust and MEPC Grimley.

Under these proposals, Cardiff County Council would sell a long leasehold to the developers, who would then rent the building to the Assembly. In both cases, the then Welsh Office was unhappy about the nature of the works proposed and did not believe that the estimated costs were sufficient to fund the work required. Accordingly they added a contingency of £14.2 million (net present cost) for additional works;

- c. a property exchange option whereby the Assembly could acquire City Hall free of charge in return for sufficient space in Crickhowell House for the 500 staff who would need to be relocated from City Hall. Under this proposal, all costs – for City Hall and Crickhowell House - would be met by the Assembly for a period of five years.

It is clear that the acquisition and two lease options would have been much cheaper if the additional charges – to cover the total cost of acquisition or to include adequate allowance for renovation costs - had not been imputed by the then Welsh Office. However, on the evidence available, I consider that the principle of including these costs was reasonable (although the figures were difficult to quantify) and that the net present cost of these options would have been unrealistically low without them.

Furthermore, the economic appraisals may have understated the cost of upgrading the accommodation at City Hall. The then Welsh Office commissioned a formal conditions survey of City Hall which indicated the need for major investment to both the structure and to the mechanical and electrical services to satisfy the needs of the Assembly. These findings were consistent with a report prepared by Cardiff County Council in March 1997. The Council Chamber of City Hall was assessed as unsuitable for a modern Assembly (for instance, due to restrictions on public and disabled access; and on the provision of IT for members) and it was considered necessary to construct a new chamber for the Assembly (probably in the Banqueting Hall). Substantial investment would be needed to overhaul ageing mechanical and electrical systems and to carry out general redecoration, refurbishment and external landscaping. The then Welsh Office estimated that these costs would total at least £22 million, and based the economic appraisals on this figure. However, Symonds, the Welsh Office's project management company, had estimated the cost at £25 million and it would have been more prudent to use this figure.

In addition, in respect of the first option (to buy the site) and the fourth option (exchange with Crickhowell House), the economic appraisals assumed that only essential works would be carried out immediately and that most of the costs to upgrade the building would be deferred until year 7. This reflected a request by the then Secretary of State to explore ways of containing the initial set-up costs to around the £17 million estimate included in the White Paper on devolution. However, this deferral of work meant that the quality of accommodation and facilities would not be on a par with the Bute Square and Cardiff Bay options, which were based on a high standard of accommodation from the start. I estimate that the net present cost of these City Hall options would have increased by between £2 million to £3 million if the full capital costs had been included at the start of the appraisal period.

Bute Square

The option in Bute Square was to construct an Assembly building on a plot of land which was in the

ownership of Cardiff Bay Development Corporation and therefore available to the Secretary of State at no cost. The costed option provided a substantial building of approximately 80,000 square feet which would have provided all the facilities needed. The estimated capital cost for this building was more expensive than other new build options considered at the same time (at Atlantic Wharf and Prospect Place in Cardiff Bay). PACE provided the following explanations:

- the concepts that they were asked to cost were unusual and would have been difficult and expensive to build;
- a sewer running underneath the site would need to have been re-routed;
- costly underground car parking and slip roads would have been required. The site was small and may have required additional land, which also would have added to the cost.

The then Welsh Office also considered Bute Square to have a number of operational problems. The site would have provided a relatively small island site with considerable flows of traffic to either side, on what will become one of the busiest traffic junctions in Wales. Consequently, public access to the Assembly site would have been difficult or costly.

Furthermore, there would have been significant risks with this site because it would be located at the centre of a new development area. The pace of development could not be predicted with any certainty since a proportion of pre-letting was being sought by the developers before specific buildings would be built. There was little control over the buildings which would be constructed and it was possible that building work would continue for a number of years beyond occupation by the Assembly.

Capital Waterside, Cardiff Bay

On consideration of the economic appraisals and non-financial considerations, the then Secretary of State for Wales decided on 28 April 1998 to locate the new Assembly at Cardiff Bay. He opted for the fourth Cardiff Bay option, including:

- the adaptation of Crickhowell House to provide a temporary chamber and committee rooms for the Assembly as well as permanent office accommodation for members and staff;
- a new building comprising a chamber, committee rooms and public areas to be constructed on a plot of vacant land adjacent to Crickhowell House;
- the Pierhead Building, which was originally intended to house the Cabinet and other key Assembly post holders, and will now provide a public information and education centre and overspill office accommodation for the Assembly.

The economic appraisals of the Cardiff Bay options have understated some of the capital costs involved. All four options included £0.5 million as "enabling" works to adapt Crickhowell House into a temporary home for the Assembly. However, many of the facilities within Crickhowell House were to be permanent - such as offices for Members and officials, and the broadcasting facilities - and this figure seriously underestimated the cost. Indeed, subsequent adaptation works on Crickhowell House have, to

date, cost around £5.8 million.

Furthermore, the third and fourth Cardiff Bay options (obtaining the Pierhead Building) did not take account of any renovation works to bring the Pierhead Building up to an adequate standard, and which are now estimated at £1 million.

However, by way of offsetting the understatements above, the economic appraisals may have been overly prudent in their treatment of the rental costs of Crickhowell House. The economic appraisals included the full cost of renting the necessary space in Crickhowell House, although the Assembly would be liable to pay this rental cost whichever option had been selected. Treasury guidance would have permitted a lower cost to be included, that being the rental income foregone from sub-letting the vacant space in Crickhowell House if the Assembly were not located there. This is assumed to be the market value of rent for the property and would have resulted in a net present cost of about £1 million less than the figures shown above.

The final heads of terms agreement between the Secretary of State and Grosvenor Waterside includes the following terms:

- the purchase of part of the plot owned by Grosvenor Waterside for £1 (the new building to be constructed on that land);
- the extension of the remaining 20 years of the existing lease on Crickhowell House to 25 years, with an option to take a further 25 years at the end of the term, and a deferral of the current rent review for five years;
- a 15 year lease on the Pierhead building with an option to purchase in the first five years of the tenancy;
- the Welsh Office would cede 200 of the 400 parking places allocated to Crickhowell House, although the effect of this would not be felt for several years as alternative provision was made available on surrounding sites.

Conclusion

From my analysis of the economic appraisal of the three Cardiff sites at City Hall, Bute Square and the Capital Waterside site in Cardiff Bay, I have drawn the following conclusions.

- The then Welsh Office made good use of professional technical advice in appraising these three options.
- The economic appraisals were generally sound and provided a good basis on which to compare the three sites. Whilst some costs were understated – such as the cost of renovating City Hall and the "enabling" works to adapt Crickhowell House - it is unlikely that these would have materially affected the ranking of the options.
- It would have been advisable for the then Welsh Office to have undertaken sensitivity analysis of the options to assess the impact that the key risks might have had on the viability of the projects.

The value of such a technique is indicated by the increase in costs for the selected option as well as the increase in the space requirements for the Assembly. However, in this case, my own sensitivity analysis of the capital costs showed that such analysis would not have affected the ranking of the three sites.

I hope that you find this letter helpful. Naturally, all these matters can only be fully appreciated in the context of the full report and this letter is intended to assist your review, not as a final audit opinion on the merits of the economic appraisals.

I am copying this letter to Janet Davies AM, Chair of the Audit Committee.