Treasury Committee

Oral evidence: The Crown Estate Annual Report and Accounts 2013/14, HC 955

Wednesday 28 January 2015

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Watch the meeting

Members present: Mr Andrew Tyrie (Chair); Rushanara Ali, Steve Baker, Mark Garnier, Mr Andrew Love, John Thurso

Questions 1-69

Witnesses: **Alison Nimmo CBE**, Chief Executive and Second Commissioner, The Crown Estate, **Paul Clark**, Director of Investment and Asset Management, The Crown Estate, and **Rob Hastings**, Director of Energy and Infrastructure, The Crown Estate, gave evidence

Q1 Chair: Thank you very much for coming to give evidence to us this afternoon. Can I begin by asking you whether you have yet appointed an accountant to the audit committee, as I think the review of governance structures in The Crown Estate recommended?

Alison Nimmo: Thank you, Chair. It is good to be back again to give evidence to the Committee. If I could just introduce my colleagues, Paul Clark is our Director of Investment and Asset Management at The Crown Estate, and Rob Hastings is our Director of Energy and Infrastructure, so good afternoon.

Coming back to your question, we have appointed a financial accountant to our board—she started just before Christmas—called Paula Hay-Plumb. She is also chairing our audit committee.

Q2 Chair: How was it that you ended up without one with a £10 billion portfolio to manage? £10 billion, just for the avoidance of doubt if you are listening and thinking it is £10 million. This is quite a lot of money.

Alison Nimmo: We have a board of eight commissioners. They provide a lot of expertise across all sectors, including a number of members with very significant financial and commercial expertise. As part of the discussions we had had some years ago, we felt, looking forward, particularly as the business becomes bigger and more complicated and particularly on joint ventures, that we needed someone with a very specific accountancy qualification. When we went out—

Q3 Chair: Sorry, my question was: why did you not already have one? I may have put it slightly more politely, but why did you not already have one? Why has it taken a review to trigger it?

Alison Nimmo: The decision was made before the review. We were well on with recruiting the new commissioner before the review, but we follow public OCPA guidelines, so it takes some time to get commissioners on to our board.

Q4 Chair: They recommended you create a nominations committee. Has that been done?

Alison Nimmo: It has and it had its first meeting last November.

Q5 Chair: I will read something they say. The review recommended that, "The board should review the executives' attendance at board meetings and consider alternative approaches to encourage greater participation". What was the underlying problem there?

Alison Nimmo: There was not so much an underlying problem. The executive and the board have a very good working relationship, but one of the quirks of the Crown Estate Act is that it is a non-executive board. I am the only executive who sits on the board. In any normal, if you like, private sector, commercially run operation, you would have a number of non-execs and execs on the board. You would have a balance of the two. It was really just sitting back and, as part of the review, all of the senior directors were interviewed as well as the board members. Again, all just part of standing back, looking at how the business is run, and making sure that we are following all best practice. To reassure you, our chairman is Sir Stuart Hampson, former chief executive and chairman of John Lewis. I think you can see by our report and accounts, we are a well-run, well-governed business.

Q6 Chair: Are you going to publish the PwC review?

Alison Nimmo: We would not normally do that. We put the key recommendations in the annual report. We have shared the report with Treasury but we would not normally publish something like that, no.

Q7 Chair: It is quite important for your governance. You are a very unusual structure. Would you reflect on that? I see some merit in your publishing it, unless there is something in there particularly that might cause commercial problems, which I cannot think what they might be. Given it is effectively a public body—a lot of money at stake—I see some merit in the public seeing it. You do not have to answer now, unless you want to, but come back to us.

Alison Nimmo: We will reflect on that, yes. I think the important thing is the review, first of all, gave us all reassurance that the board was working well and that the business is well run and managed. Secondly, as I say, they made some recommendations, particularly about the future direction of the business and the succession strategy of the board, which we thought was very useful and we are getting on with implementing.

Q8 Chair: Okay. You will come back to us on whether it is worth while publishing something. In your annual report you state The Crown Estate has stewardship responsibilities. What did you mean by that?

Alison Nimmo: Our core purpose under the Act is to maintain and enhance our estate, and that is subject to good management. As a commercial business but with a very long-term horizon, we see that stewardship is an important part of that. We have a specific, quite modest programme—particularly around the coastline of the UK—that specifically looks at small community projects.

Q9 Chair: I think we might be coming on to parts of that in a moment, but I want to clarify whether stewardship means that you are deviating from long-run return maximisation on behalf of the taxpayer from the asset base.

Alison Nimmo: Absolutely not, no. I suppose our stewardship programme is equivalent to a CSR programme in a FTSE100 company, where all the investment, either indirect or direct, goes back into how we run our business.

Chair: That is a helpful clarification of what is meant by stewardship in that context.

Q10 John Thurso: Good afternoon. I want to concentrate on two things. The first relates to what is happening in Scotland and then I have a few questions about Orkney Waters and the Pentland Firth, which I suspect will come as no surprise to you. The Smith Commission recommended that The Crown Estate in Scotland be devolved. Obviously, The Crown Estate does not have a political view on that, but there are a number of quite serious implications in terms of management. Have you seen the draft clauses that will give effect to this?

Alison Nimmo: We have, yes.

Q11 John Thurso: Have you had an opportunity to input to them?

Alison Nimmo: We have, yes.

Q12 John Thurso: Are there any aspects of that that you feel might give you particular difficulty in achieving the wishes of Parliament?

Alison Nimmo: No. In terms of our concerns about a managed transfer of the management of the assets—the protection of our fantastic team up in Scotland—we have about 35 people on the ground in Scotland transferring as a going concern and we feel that the principles governing that have been reasonably well captured. We were slightly disappointed there was not a time scale on the arrangements because, clearly, we are dealing with a team of people and a level of business uncertainty. We are now moving into transition and delivery mode, but we feel that it is in the best interests of our team, the assets and the wider picture, that the transfer is effected sooner rather than later.

Q13 John Thurso: It strikes me that there are a number of different ways in which this could be effected, which will depend on how the Ministers in each Parliament decide to co-operate on this. You could simply take the rib of Scotland out of The Crown Estate and say, "There you are, Scottish Parliament, bye-bye. We will now get on with the English Crown Estate". Bearing it in mind that the Scottish Parliament has indicated that it may wish to onward devolve quite a lot to local authorities, you could say, "You have all the legislative responsibilities and we report to you, but shall we continue running it until you decide what you want to do so there is one change instead of two?" There are quite a number of different variants along that line. Have you had an opportunity either internally to consider that or externally to discuss it with the relevant Ministers?

Alison Nimmo: That is a long question. I shall try to answer it fairly briefly.

John Thurso: Sorry, I will keep quiet for a bit.

Alison Nimmo: I think I know what you are getting at, Lord Thurso. We think the draft legislation last week, and the command paper that went with that, sets out fairly clearly what is going to happen. It is a fairly complete transfer of all our management responsibilities. We have already been having discussions with the Scottish Government at our executive level, in terms of briefing everyone on the assets we have, the expertise that we have in the team in Scotland, and how we manage the assets at the moment. We will continue to manage them and manage them well, as we have done for many years, until the point of transfer.

The one area that perhaps is not as clear or will need a lot more work—and the devil is in the detail—I suppose is around Rob's key area, which is the seabed interests. We were very clear when we briefed Lord Smith, and inputted into the legislation, that the strategic nature of the seabed around the whole of the UK is an important resource. I think Rob and his team have shown in The Crown Estate, through the single management of that, that we have created a lot of value for UK plc. Lord Smith talked about the carve-out of interests, particularly in terms of defence and energy. I think getting that bit of the legislation right to ensure that the Scottish seabed and the rest of the UK seabed is managed and co-ordinated in an integrated way going forward is important because it is a single market at the end of the day.

Q14 John Thurso: I have a question for Rob on that, but can I ask one other question, which is on the numbers? Correct me if I have these wrong, but the Scottish Crown Estate is valued at around £236 million or thereabouts, roughly?

Alison Nimmo: In our last accounts it was £267 million.

John Thurso: Which is a very, very small part—3% or whatever it is—of the overall value of The Crown Estate. The annual income is £13 million?

Alison Nimmo: Between £13 million and £14 million per annum.

John Thurso: £13 million and £14 million, which again is a very small part. Capital expenditure over the last few years has been relatively high. More than 50% of the income per year is going into capital investment.

Alison Nimmo: It has been £12 million over the last three years.

Q15 John Thurso: You have quite a high investment rate going in, up to now supported by the rest of it as being one business. How will the Scottish Crown Estate manage to continue to make those investments, that level of capital investment, or will it need to rely on moneys from the Scottish Government to maintain that level going forward?

Alison Nimmo: When we were briefing the Smith Commission, one of the issues we put on the table as a real benefit for The Crown Estate being a UK-wide organisation was not only that we bring investment but the expertise that we bring from having that scale of operation. In answer to your question, post devolution and post transfer it is a viable, very nice little business. It generates a nice surplus but, in terms of capital for reinvestment, particularly in Rob's area of the business—things like carbon capture and storage, wave and tidal, offshore wind, aquaculture and such where you are talking about a significant investment—that would either have to be self-generated from the portfolio or from the Scottish Government.

Q16 John Thurso: Can I come to you, Rob? Because it is in my constituency, I happen to know that MeyGen are on the verge of the roll-out; very, very close to that. A great deal of work was done this summer getting the equity and the private sector involvement and all the rest of it, and there was quite a lot of difficulty in that. I am telling you that which you know to save time. What problems may occur in the period of transition from the current arrangement, where The Crown Estate is backing it, investors have a clear sight of that, and the new arrangement, which may be a couple of years down the track, where they will also have a clear sight? To what extent is that gap a danger to this very important moment of roll-out in marine renewable energy?

Rob Hastings: This is a specific question to the MeyGen investment. We have a £10 million investment alongside the co-investors. We know that it is about a £50 million project. We came to an agreement to invest. That agreement was concluded in November of last year and it initiates a stream of investment over time. It is time phased depending on the roll-out of the project. As that stands, that is a contracted and fully committed investment on our part with the counterparties, which is MeyGen and the co-investors as well, including Atlantis, the Scottish Government, Scottish Enterprise and HIE.

John Thurso: And DECC?

Rob Hastings: And DECC, yes.

John Thurso: We must not forget the Westminster effort.

Rob Hastings: Of course, yes. We are working on a programme now to simply roll out that investment schedule in accordance with the delivery of the asset as it goes into the water. We will continue to do that because, as Alison said, the timing is not clear exactly when the transition point will be of the handover of assets from The Crown Estate to the Scottish Government. We will continue to work the programme that we have, but we are working very closely with the Scottish Government to make sure that, if the timing is such that we need to manage our investment scheduling accordingly, we are in the right place to do that. Our primary objective is to make sure the project is successful, and that is what we are trying to work with all the counterparties to achieve.

Q17 John Thurso: That is the MeyGen one, which is locked in. There are other projects that you hope to put into place as part of the further roll-out in the Pentland Firth. To what extent are you concerned that it is more difficult to get private investment because of the change and, consequent on that, if there is difficulty, what should you be doing in discussion with either the UK Government or the Scottish Government to make sure that those projects are not derailed by the transition process?

Rob Hastings: The first point to make is that, in terms of our engagement with that process, so the commitment that we have already entered into and have contracted or otherwise, we will continue to manage that and satisfy that through to the point of transition. We are there to see that through.

Beyond that, in terms of understanding where the management transfers to and how that management will be undertaken, it is not clear to us. It is fairly early days. The draft legislation for the transfer has only just been drafted, but we are working very closely with the Scottish Government counterparty, which we think is going to be managing this, to understand what would help it in terms of trying to set up what it has to come. It is very early days for that. We would expect that process to take a year, possibly longer.

In terms of its impact on the industry—the other part of your question—clearly, uncertainty is never a particularly good thing for investors. We are not seeing any signals yet that that uncertainty is destabilising that investor community. In reality, there are much bigger challenges that they are facing right now. There are technology challenges. There are capital market difficulties in terms of attracting investment, and then there is just the sheer job of getting on and doing these quite complex and difficult projects. They are the things that are mostly preoccupying the investment community at the moment. These sorts of constitutional issues have not quite hit their radar and I suspect they will be standing by waiting to see what happens to be able to determine where they land.

It is a little bit early but we are hopeful that, by trying to create a seamless transition with the Scottish Government, the degree of uncertainty that investors may have can be avoided as much as possible.

Alison Nimmo: Just to reassure you, we are working well with the Scottish Government at an executive level. I was up there a couple of weeks ago and we will be ready to make as smooth a handover as we possibly can.

Q18 John Thurso: My concern is not to put any question on Smith, which are tablets brought down from the mountain and written in stone, but to ensure that the practical difficulties flowing from that—both in management and in getting investment—are being considered by you and that you are being heard by the relevant Ministers at whichever end of the process it is.

Alison Nimmo: That is in everyone's interest, so, just to reassure you, those conversations are taking place.

John Thurso: I apologise to you; I have to go to the Audit Committee of the House of Commons in half an hour. I will stop there, Chairman, but sorry if I leave.

Q19 Mark Garnier: Mr Clark, in 2013/14 The Crown Estate produced a 5.7% increase in revenue from the previous year. To what extent is this revenue growth driven by factors outside your control, for example, external demand in the market, foreign investors coming into, say, London, driving up rents, and how much is within your control?

Paul Clark: For the most part, foreign investment in London is driving capital values rather than rental values. In the short term, that will feed through. There is always an underlying element of it, which is the market. It is always a debate as to what the market is and what is being done. Certainly, the areas where we have been the most active have been the areas that have produced most of our outperformance in the last full financial year. For example, our West End development pipeline has produced a considerable uplift in rental income. They have let faster and at higher rents than we would have expected off the original appraisals. Our capital market trading has also played into that, in respect of selling some lower yielding property and bringing in some market rented property. Our activities in offshore wind have also been a significant element of our income growth.

Q20 Mark Garnier: Looking at the property portfolio, you mentioned the West End property. Have you done much to enhance the value of that?

Paul Clark: We are currently in the middle of what is The Crown Estate's largest ever development programme in the West End. Between July 2013, when we completed something called One Eagle Place, and March 2016, when we are due to finish a development that we named St James's Market, we will bring about 900,000 square feet of mixed use space into the core West End. Consequently, we are comfortable that we have picked a good time in the market. 2008, 2009 and 2010 were not great years for the West End occupational markets. They have been slowly picking up since then, but certainly since about the September before last, so September 2013, there has been a notable improvement in the underlying occupier demand in office markets in particular.

Q21 Mark Garnier: Your capital value at 31 March 2014 was £9.9 billion, up 15% from the previous year, which is quite a significant increase. £1 billion of that is a result of property revaluation gains. That is quite a significant increase. I suppose my question is partly: are you looking at your net asset value on a year by year basis?

Paul Clark: We value it quarterly.

Q22 Mark Garnier: You value quarterly. To go up £1 billion in one year is quite a significant jump. Is that because of this investment that you have been making in the property so you have increased the value of it, or is it because you just got it wrong in the previous years?

Paul Clark: No, each year we have independent Red Book valuations from our independent valuers. NAO sit in on the annual valuations at the end of the financial year, but we meet with our valuers quarterly so we see the uplift during the course of the year. If you look at the industry as a whole and the industry standard benchmark, which is prepared by an organisation called IPD, last year average returns from UK real estate were just over 13%, of which about 8% or 9% of that would have been capital growth. That is for property over a whole range of different types. It is the less good, the average and the very good. We have benefited from an element of general market uplift but we have also benefited from the development pipeline we have. For example, as we have gone through that pipeline, in a good market you increase the value of those developments disproportionately compared to the market. For example, in IPD you will find the better performing funds are the ones that have had a higher exposure to West End development during that year. Consequently, we are always going to benefit or have the disbenefit of a poorer market to a certain extent.

Q23 Mark Garnier: None the less, if you do your developments wisely and cleverly, because anybody can make money in a rising market, everybody thought they were brilliant property developers in the boom of 2008—

Paul Clark: That is true enough.

Mark Garnier: —with "Changing Rooms" and all the rest of it prompting us to think we knew what we were talking about, but when the tide goes out you discover most people have not put their swimming trunks on. The key thing is—to use a metaphor perhaps a bit too much—are you wearing swimming trunks? The important question is: are you convinced that what you are doing is genuinely adding value, not that you are just being swept up in this positive wave of a booming market?

Paul Clark: Yes, I do, for two reasons. One is that, if you look at the downswing in the market in 2008, 2009, 2010, we consistently outperformed because we do have a resilient business model. We have chosen our four core sectors of the West End, prime regional retail outside of London, rural land, and our offshore interests carefully. In part they are our inheritance, but they are also partly the result of specific decisions we have made. It is a very lightly, almost invisibly geared business and our core areas are not only areas we think are resilient but they are also run to quite different economic drivers. They are quite diversified. During the course of the worst part of the property downturn, our underlying income from real estate assets did not drop. It slowed right down but it stayed in positive territory in terms of its growth.

Alongside that, we also have a total return benchmark, which is prepared specifically for us again by IPD. We do not use a standard generic benchmark because in many respects that will just tell us we are not much like the market. We have a benchmark that was established based on the sector split of our 2008 portfolio and, consequently, we get judged on two things. We get judged on the extent to which we have made sector-based decisions to move away from that 2008 structure, but also on the performance of our individual assets against the assets in the benchmark. Over the last five years, the standard IPD benchmark that we would track has come out at around 10.5% per annum. Our benchmark has come in at about 13.8% per annum and our overall performance over that period has been 16% per annum. If we are trying to distinguish what we are doing against the market—and it is never an exact science, it is a matter of opinion—we feel that that benchmark does offer some clarity as to how our behaviours are affecting our performance.

Q24 Mark Garnier: Do you think that is sustainable, this increase in revenue growth?

Paul Clark: We have set the business up. We have established a business model that means we have some confidence that we can continue to grow our net income line. Of course, we are going to be at the mercy of the market on occasions and, of course, the covenants of our tenants and so forth. We believe we have done what we can to put the business in a good position.

Q25 Mark Garnier: A little earlier the Chairman asked about your role of stewardship. Do you think the function you have, which is to manage the portfolio and to get a return, and the idea of stewardship could potentially be a conflict?

Paul Clark: No. Our approach towards whether you want to call it sustainability or stewardship or the durability of the portfolio is that, putting Windsor Great Park to one side because it has a very specific role within the Crown Estate Act, what we do is all intended to maximise long-term total return performance. To give you an example, over the last five years or so we have spent about £22 million on public realm improvements in the West End—whether that is on the Oxford Circus crossing or the way the traffic behaves around Piccadilly and St James's—because we believe that in taking that long-term, enlightened view we will improve the value of the real estate we own. Consequently, when we talk about sustainability or stewardship, it is directly aligned with making sure that we do not just outperform this year, we consistently outperform over an extended period of time.

Q26 Mark Garnier: I think that is fair enough, but you also talk about your strategic objectives. I was just looking at the six strategic objectives. Let us consider (5), "To measure, report and improve our total contribution to ensure that we create value beyond our financial return, acting responsibly, with sustainability built into everything we do", and then (6), "To be recognised and respected for delivering conscious commercialism, and for operating as one business, one team, with a common sense of purpose". Strategic objective (4) relates to the need "To ensure high levels of customer satisfaction", et cetera, and, "To encourage a high-performance culture and be known as a great place to work, so the best people want to join, stay and thrive". Clearly, a lot of that can be argued as being part of this very benevolent world that will result in better rents, better public realm and all that kind of stuff. But there are inevitably going to be times when trying to adhere to the letter of those objectives may well come into conflict with necessarily trying to maximise a return that you could get off a certain property. How do you resolve that when it happens and can you give an example of when that does happen? I bet there is at least one.

Paul Clark: I will give an example to start off with. We are just completing what we are calling a refurbishment but it is pretty much the gutting of a period building on Regent Street. In doing that, we are seeking and likely to obtain the highest standard of sustainability rating under something called the BREEAM rules for the office premises. This is a conversation that happens a lot in our office and the guys that want to do this will talk to me about it. It will cost more, that is absolutely for sure. In that example, I am quite confident that we will potentially give ourselves a broader tenant base, that we will at least get as much rent, if not more, and that the prospects for that rental position and rental growth going forward are enhanced by the quality of what we are delivering.

A lot of this comes back to reputation. Our commercial mandate absolutely has primacy in respect of the way we operate and I think our returns are evidence of that. We are not only outperforming the market but at the moment we are outperforming an elevated market benchmark, although there is no reason that our benchmark would constantly stay higher than the market because it is a factor of the sectors that we are in. Our ability to fulfil that commercial mandate is directly linked to our reputation, whether that is being able to trade in the capital markets with the counterparties that we want to or obtaining the partnerships and partners that we want to. When it comes to planning consents or when it comes to recruiting and retaining staff for that matter—which is a slightly softer issue—we believe that having a reputation for transacting and behaving in the way that we do has stood us in very good stead.

Q27 Mark Garnier: Alison, what are the consequences if a key performance indicator is missed?

Alison Nimmo: We have our main indicators, which are the financial ones agreed with Treasury. Those relate to growing our revenue, which we return to them as well as our total return targets, as Paul says, which is basically about outperforming our private sector peers. Those are the fundamental ones and they are the ones that we really judge people's principal performance on in terms of the individual bits of the business, and then the business as a whole in terms of performance-related pay. Then there are subsidiary KPIs, which are set out in the report; for example, basically looking at growing the business but reducing our carbon footprint, things like health and safety—all the normal ones that you would expect of any commercially well-run business.

Mark Garnier: The consequences of missing them?

Alison Nimmo: They feed through into people's scorecards and that has a direct impact on what people's scores are individually and as teams. That influences people's pay at the end of the day.

Q28 Mark Garnier: So it is down to individuals. The reason I ask is because, on the face of it, you are a highly commercial organisation but you are not driven by the normal influence you have from shareholders. Shareholders are ultimately the toughest masters. I suppose in a publicly listed company they just sell your shares, but shareholders seek returns. While I am sure the Treasury is a good steward of public money and is making sure that we do get the good returns, the dynamics do not work the same in the public sector as they do in the private sector, I suppose for a number of obvious reasons. What I am curious about is that I can see you can have performance-related pay, and there can be measures of that, but again, as we have seen in the banking sector, if that is not structured right, performance-related pay can lead to incentives that can create bad behaviour rather than good and virtuous behaviour. What I trying to work out is, aside from perhaps not getting as big a bonus as perhaps an individual member of staff or you as a management team were hoping, what are the other sanctions against you or what are the other problems that might face you if you fail to meet your performance indicators or your return on shareholders' funds, even though the shareholder is the Treasury?

Alison Nimmo: It is true to say that we do not have shareholders. Well, we have two significant shareholders in Treasury and the Monarch, but we do not have quarterly shareholder meetings and reports. That is where we do differ from the private sector market because it really is about that sort of long-term consistent performance. That is about growing revenue and keeping our costs under control. If you turn to the back page of the annual report and accounts, you can see how that has changed over a 10-year period where we have grown revenues very substantially. We have grown the underlying value of our assets. We have basically doubled the capital value of the business in 10 years. We have substantially grown our revenue line over £110 million over the 10-year period, but we have increased our net revenue surplus—so the profit we return to Government—by £80 million. On any rational look at the numbers in terms of our performance, I think you will see that we have outperformed our targets. Treasury are tough taskmasters, make no mistake about that.

Q29 Mark Garnier: I think this is the real question: what happens when it starts to go wrong? I can see that the fact that you have this relatively passive shareholder means that you have the opportunity to perhaps take some more long-term strategic views, and that kind of stuff, and I think that is probably a virtuous situation. When it starts to go wrong, what happens. It is great that you have it right, but what happens when you screw up? It is going to happen. What is there to incentivise you not to, to be diligent and to make sure that you are looking after all of our funds?

Alison Nimmo: We have a very talented, expert team at The Crown Estate. Paul and Rob drive key bits of the business.

Q30 Mark Garnier: Would you be sacked? Would you lose your job? Would you lose your bonus? Would you have your salary reduced? What happens? I am sure you are all brilliant, but what happens when it goes wrong?

Alison Nimmo: I think I would say it is the same for any business. For example, Paul and Rob are driving large bits of the business and they have very specific performance targets. A very significant number of the financial ones go right back to our core financials.

Q31 Mark Garnier: When they are missed, what happens?

Alison Nimmo: They have a base package, LTIP and an annual bonus. The last two of those are impacted directly by the performance of the business. It is not just financial performance, it is other elements, as you would expect of any private sector business. If you stand back from all of this, I have a very talented, hard-working team in The Crown Estate. We are outperforming the market but on any measure our pay is behind the curve, particularly for some of our commercial people. The London market, as you know, has been going like a train for the last couple of years. If there is anything, my single biggest worry is our ability to attract and retain the best staff. We have a much more complex business, a much bigger and successful business. We want to continue with our success and at the heart of that is having the right team with the right expertise.

Chair: We have to move on.

Paul Clark: Could I just offer a reflection on that?

Mark Garnier: Sure, if that is okay with the Chairman.

Paul Clark: The Crown Estate is a pretty demanding place to work. If you look at the team that I have working for me, we have had quite a bit of turnover and quite a number of people have left The Crown Estate. Not a lot of them, but we have lost people through performance issues. While there is a financial penalty to all of us for failing to meet financial targets, we all have individual scorecards. We all have things required of us, and if you do not achieve that there are mechanisms within The Crown Estate that will deal with it. Everybody will have periods in their career where things do not go quite right, but if people are consistently underperforming across a range of their scorecard tasks we have had periods in my part of the business when there has been a reasonable amount of turnover in order to get the team in the condition that we want it. Happily, at the moment we do have that, but we have not been slow to deal with issues of underperformance in the business.

Mark Garnier: That is very, very helpful. Thank you very much indeed.

Q32 Chair: Both of you said that you are outperforming the market. Some of the information required to assess that is in the report. I would be very grateful if you could put together something for this Committee, which is as comprehensive as possible, to justify that remark and that may involve other areas of statistical analysis.

Paul Clark: Yes, we can do that.

Chair: We may subject it to some form of independent scrutiny because I think this probably needs to be done.

Paul Clark: We can do it most easily against the listed sector, where a lot of our competition are, whether it is sovereign wealth funds or funds like that. It is easiest done against either benchmarks in the listed sector.

Q33 Chair: You come forward to us with what you think is appropriate. Have you had your benchmarking independently reviewed?

Paul Clark: It is prepared for us independently by the Investment Property Databank.

Q34 Chair: That is not the question I asked. Once that is done, benchmarking is quite an art, particularly in the property field. As you said earlier yourself, this is something where there is room for argument and dispute. My question is: have you had it independently reviewed?

Paul Clark: It has been audited internally by a combination of our own internal auditing and we use—

Q35 Chair: But not externally. Have the board discussed external auditing of the benchmarking periodically?

Paul Clark: We have discussed the nature of the benchmark and the extent to which it should be reviewed and changed, but there has not been a specific discussion about external benchmarking.

Q36 Chair: Perhaps I could put that on the table as something that might be worth considering. The NAO take a look at your accounts but they have not done a value for money study. Perhaps that should go to the chief executive as a question. Have you ever had a discussion with them about that?

Alison Nimmo: We have not, no.

Chair: Well, maybe that is something for us to consider and take up.

Q37 Steve Baker: Good afternoon. Page 11 is titled, "Defining value beyond financial return. Our total contribution". Under "What next?" it says, "We are working towards total contribution becoming one of our key performance indicators". When do you expect total contribution to become one of those things that guides the decisions that you make?

Alison Nimmo: We are working on total contribution being a key part of the report and accounts for this current financial year.

Q38 Steve Baker: If total contribution is going to start guiding what you do—which I think is implicit in the reply that it will guide what you do—how will you reconcile your commercial objectives with the desire to meet targets that go beyond a financial return?

Alison Nimmo: In terms of our performance, the primacy of everything we do comes back to our commercial performance, as Paul said, save for Windsor. That is a separate bit of the statute, if you like. Everything else we do comes back to commercial performance and the core purpose of The Crown Estate is about commercial return.

In the way that we do that, we look to drive—and we try to bring it to life in the report—all sorts of wider benefits. Paul talked about Regent Street and the public realm benefits. We do not do that work because we like nice, wide pavements and great lighting and events like the fireworks in Regent Street. This is all about building the brand and the place making and creating that long-term value. There is a significant benefit that flows from the core business. Total contribution in its simplest form is about measuring that broader value that we bring. It is not the broader value driving how we trade off profit; it is the other way round. I would almost call it "super profit" from the way we go about doing business, which we think is a smarter way of doing business, that long-term investment in our portfolio. Total contribution is just a way many leading businesses are trying to show in their annual report the totality of what they do, so not just looking at the numbers but looking at that wider benefit and the indirect benefits that flow.

Q39 Steve Baker: I am aware that pursuing wider benefits is part of any director's responsibility. I have been a director myself. Can you give us some examples of where total contribution is being used by commercial firms? You mentioned that the leading firms are doing it.

Alison Nimmo: It is part of the approach to integrated reporting. Some of our direct competitors or peers like Land Securities and British Land are going down this route and large companies like AstraZeneca.

Q40 Steve Baker: Okay, I will have a look. Do you think that there is a possibility that you are trying to apply prices to things that are not available in exchange?

Alison Nimmo: We are trying to be very clear in the total contribution where we can put a monetary value on things and then we are just very clear about where we cannot. It is about trying in some respects to decouple some of the impacts. It is about informed decision making, about how we make better decisions and about, I suppose, how we sweat our assets and create more positives and then manage the negatives, so things like carbon—

Q41 Steve Baker: I am sorry to interrupt, and I am sure those things are all very laudable, but what I am driving at is this: I think anyone with a shred of humanity would agree there are many things in this life to which you cannot attach a price. The love of a mother for her child and such like are just not available in exchange transactions despite the fact that any of us would see them as almost infinitely valuable. What I am concerned about is that you seem to be trying to attach a price to things for which there is no price because they are not tradeable. Is that something that is going on in the underlying method of what you are doing?

Alison Nimmo: No, and I think that is a very valid criticism. Windsor would be a good example of that. What price do you put on this wonderful royal park, 3 million visitors every year, the 1,000 year-old ancient oaks, ancient landscape, and the well-being impacts? One of those 1,000 year-old oaks does not have any value on a balance sheet until you chop it down and turn it into firewood—

Steve Baker: Which you are never going to do.

Alison Nimmo: —which we would never do. That does not mean to say that those broader considerations should not have some impact on how you do business and influence how you do it.

Q42 Steve Baker: I am trying to understand why you are trying to make a move from a qualitative statement of what you are doing and why, and why it is valuable, to a price for that thing which allows you to put a number next to it as if it was available in a market to be traded. Why are you trying to make that move from the qualitative to the quantitative?

Alison Nimmo: We feel that where we can do it—and a lot of this is evolving—it is important to try to do that as a way of helping inform the way that we do business and some of those decisions. Primarily, we are about that commercial performance. I suppose a good example would be, again, coming back to Regent Street, where we can basically leverage the relationships we have. Our Recruit West End has now placed 1,000 young people into jobs in and around Regent Street through our apprenticeship programme on our development projects. Just because we cannot put a pound sign on such things does not mean to say that we should not do them and try to do them in the way that we, all of us, do business.

Q43 Steve Baker: I am sure we are agreed that there is a wide range of things that you do that we all value, which you should continue to do and improve doing. I suppose, if I were to cut to the chase, what I am getting at is this. This problem of trying to apply a price to something that is not bought and sold is one of the old problems of planned economies where capital is owned by the state. I am rather concerned because from what I am hearing, you are trying—you and certainly the New Economics Foundation, and I am very fond of them and I am aware of their approach—to dig up some of the old, dead ideas of the hard left about how you try to make a planned economy work with state ownership of various things that are not bought and sold, try to put prices on them and then adjust your conduct in order to make that number, which has no meaning, mean something. Is this an issue that you have considered, in going down this path, or are you just trying to be practical and not ideological at all?

Alison Nimmo: As a business, we are trying to maximise the long-term value to UK plc of what we do but, Paul, maybe you will be able to convince Mr Baker a bit more in terms of that link between our commercial performance and that broader impact we have.

Q44 Steve Baker: Before you do, if I were to reflect on what you have told me, you have told me that you are going to steer the business according to profit and loss and the commercial imperative, but you have also told me that you are trying to price things that cannot be priced, knowing that they cannot be priced, in order to somehow—and you have called it "super profit"—produce this supplementary way of guiding your actions. You have already told me that you are going to trump that way of guiding your actions in order to meet the commercial objective. I am trying to understand what is really going on with total contribution and why taxpayers' money should be spent funding the New Economics Foundation to reopen the old problems of state socialism. That is really where I am going.

Paul Clark: Other than to say that we have not sat down and come at it from a Marxist perspective—

Steve Baker: That is a relief.

Paul Clark: —all I think I can add to it as the investment director is to say that when we try to put a value on some of the things we do around our portfolios, we do look at the effect that we believe that action will have on our total returns. How do our behaviours affect our ability to continue to outperform? Part of that comes down to reputation. A good reputation is essential for commercial outperformance. I would agree with you that you can put numbers on certain things but, at the end of the day, you have to know your business and believe that what you are doing is adding value to the business. It becomes a judgment for the management.

Steve Baker: I feel sure you are going to continue down this path and I will look forward to seeing you next year, I hope, very much, should I be here.

Chair: I hope you will be, Steve.

Q45 Rushanara Ali: Can I turn to the topic of affordability and affordable homes? I know that my colleague Andrew Love will be coming in as well following up on his previous questions in the last hearing. To start off with, Ms Nimmo, could you say a bit about what The Crown Estate's role is in providing affordable homes?

Alison Nimmo: We have no direct role. It is not within our Act or our remit specifically to provide affordable housing. It is not part of what we do.

Q46 Rushanara Ali: It is not? There is no strategy for doing so?

Alison Nimmo: No, no direct strategy. As part of other things that we do, we might provide some affordable housing. For example, in our strategic land portfolio when we get planning permissions, it may well be a requirement—like a section 106—to provide affordable housing but it is very much a by-product of our commercial activity. Then in other parts of our estate, in terms of maybe some of our rural farmland estates, we do have some protected tenancies but those are very much the exception rather than the rule.

Q47 Rushanara Ali: Right. In terms of new builds, if you are seeking planning permission, there are requirements to provide a certain number of affordable homes, are there not?

Alison Nimmo: There are.

Q48 Rushanara Ali: You do not have a strategy for that when you are building; you just make an agreement with the authorities concerned?

Alison Nimmo: For example, in Westminster, as part of delivering on our commercial portfolio in the West End, as part of an overall agreement and planning permission, we would then have an obligation to provide residential accommodation and then, as part of that, some affordable housing. Unlike some of our commercial peer group, we have taken the view to then deliver that affordable housing. Our most recent development in Ogle

Street, in Fitzrovia, is a good example of that. We delivered that through Peabody. In terms of our core purpose, it is not specifically to provide affordable housing.

Paul Clark: On average, it is about 40% of the residential element of a development. For example, in the West End, out of round about 75 units that we have, either just built or we are building, which are connected to our commercial developments, around about 40% of that is affordable. We do not have any particular expertise in building it or managing it, so we reach an agreement with a housing association. Alison has given the example of Peabody, which produced the most recent one.

Q49 Rushanara Ali: How do you define affordability? In the case of London, is it 60% or higher?

Paul Clark: Generally, that is a matter for the housing association. We determine what percentage is going to be affordable, but exactly how they are used is a matter for the housing association that is going to own and run them subsequently.

Q50 Rushanara Ali: In your annual report under the rural and coastal portfolio, The Crown Estate secured planning permission for over 1,200 homes in five different locations, with planning decisions pending for another 1,800. Can you say a bit about how many of those are affordable? Is it 40%?

Paul Clark: On average, we have a pipeline for the next five years that is around about 8,000 homes potentially, subject to planning, and on average it would be 40%.

Q51 Rushanara Ali: Are there any particular ones where it is less than that?

Paul Clark: It will vary. I cannot give you specifics on that at the moment. What I can say is that, as we all know, each one is a matter for negotiation with the local authority. On occasions there are other things that local authorities are interested in, whether it is schools or infrastructure or parkland. You would need to look at the whole package when determining the appropriateness of the affordability level.

Q52 Rushanara Ali: Turning to the Ogle Street build, you provided 21 affordable homes there. Can I check whether that was to obtain planning permission? Would you have done it if you did not need to?

Paul Clark: No, it was directly linked to our planning consents on Regent Street.

Q53 Rushanara Ali: Great, thank you. Just a few more questions. The Crown Estate agreed to provide 1,050 new homes in Bingham, Nottinghamshire, but there were recent reports of a proposal to cut the number of affordable homes quota from 300 to 200 affordable homes. It was stated that it was well below the national benchmark. How many will you provide? Will it be 200?

Paul Clark: I am not sure I can give you the detailed answer to that but I am sure we can follow up with something. As I said, these are always a matter for negotiation in respect of the whole section 106 and affordable position in the round.

Q54 Rushanara Ali: What would be the projections if you were doing 300 versus 200 in terms of savings that you would make as an organisation?

Paul Clark: It is difficult for me to give that for that development here and now, but I am sure we can provide some more background on that.

Q55 Rushanara Ali: If you could, we would be grateful for that. Turning to your appearance at the last Select Committee hearing, it was indicated that The Crown Estate often attached conditions to the sale of affordable homes to ensure that any new homes would not dilute affordability. How would you monitor these conditions and how would you enforce them? Ms Nimmo indicated earlier on that there was not really a strategy but that there was an undertaking.

Paul Clark: There was an undertaking in one specific transaction, which was the sale of four housing estates—which again I am sure you are familiar with—around London to Peabody in 2011. One of the conditions of the sale was that Peabody are required to provide us with an annual update in respect of their letting activity because they are under an obligation to let nine out of 10 vacant units to key workers, the nature of which is defined in the agreements, at affordable rents. That varies from 60% to 80% depending on the type of tenancy. We get an annual reconciliation of that from Peabody, which we check. I think from memory, because it is four years ago now, that it is a three-year rolling average that we have in the obligations.

Q56 Rushanara Ali: Can I say that in the last meeting, Ms Nimmo, you stated that that discussion and that process led to a happy ending. A number of areas were affected, Cumberland Park, Millbank, Lee Green and Victoria Park in my constituency. There are still outstanding issues. There are still a number of residents who are struggling. A number of colleagues and I met with Peabody recently and there is a good chance that their rents will increase. When you are making those sales, to what extent are you putting in the safeguards to make sure that the rent levels do not go up and that key workers do not end up being priced out of the market?

Alison Nimmo: I think Paul has given quite a full answer on that. As part of the sale process, we have to get best consideration but it is within all the circumstances prevailing. We were very clear to keep the protection that the tenants have so they were in a no worse position on the transfer. Tenants who were protected were protected under the new arrangements with Peabody. As Paul said, in terms of those commitments on key worker housing, those covenants still reside with The Crown Estate.

Q57 Rushanara Ali: The rents are likely to rise between 5% and 9% and that is going to put a lot of tenants in difficulty. Peabody has also stated that they have inherited some properties that need work, which will require investment. They also have a shortfall in terms of finance. If they are to maintain the rent levels in order to ensure that people do not get priced out, that is going to put them in quite a challenging position. Do you feel that you have a role in future to make sure that you do more over a longer period of time to make sure that there is a genuine process of making sure that tenants, particularly those who are key workers, can continue to live in the properties that you are selling off? Do you feel that there is more you can do?

Paul Clark: I think we were very comprehensive at the time we completed this transaction. It did receive a good response from a whole range of stakeholders, including the tenants at the time. From the information we get back from them annually, Peabody, as far as we know—it is four years on now—are applying The Crown Estate's rent regime. That has not changed. I genuinely think that—

Rushanara Ali: There is another ongoing process and they are doing consultation. It is likely that rents may well rise. I just wanted to understand.

Paul Clark: It would have to be within the envelope. I am aware; we do follow the story. It is within the envelope of the agreement they reached with us because they cannot do anything under the conditions. I genuinely think it says more about what has happened to the London housing market in the last four years than the construction of the deal in 2010-11.

Q58 Rushanara Ali: You could have predicted the London housing market to some extent, couldn't you, that it was on the rise?

Paul Clark: I think that is quite a tough ask, to be honest. We did our level best to balance all of the conflicting obligations that we had at the time, in terms of our commercial mandate, our reputation and the engagement with stakeholders. We went to two consultations at the time, which I am sure you remember. We reached an arrangement that was well received across the board. Peabody, from all the information we have four years on, have not breached any of those conditions that were set, but the London housing market has changed quite markedly over that period.

Q59 Mr Love: Let me press you a little on that. The envelope that you are talking about I presume is the 60% of commercial rents as the limit that Peabody can put the price up to. When you got best consideration, presumably you have a better consideration at 60% than you would have had at 50% and 40%. What responsibility do you accept for setting it at 60%, recognising that central London has a very specific and different rental market from any other part of the country?

Paul Clark: We would accept full responsibility for the transaction we struck. There is a variety of ceilings, depending on the type of tenancy, between 60% and 80% in the transaction. It is four years on now so I may not be able to remember all of the details, but we stand by the deal we struck at the time. We take responsibility for it.

Q60 Mr Love: Do you recognise that that is effectively pricing a large number of the tenants in those estates out of the marketplace? There has been a petition of 2,000 residents. There have been demonstrations. There have been meetings. There has been gnashing of teeth. The consequence of setting it at 60% has been very negative for quite a lot of people, key workers and people on low incomes.

Paul Clark: We did all we could at the time in terms of the two extensive consultations that we undertook, which did frame the eventual transaction because we started off the first consultation with a belief, which we still hold, that we were ill suited to be owning and managing this type of real estate. We had about 1,200 homes, which made us a small provider of this type of housing.

Q61 Mr Love: I understand that you were ill suited, but somebody could say the reason why you set it at 60% of market rent is to get the best consideration for The Crown Estate, not the best interests of the tenant going forward. How would you respond to that criticism?

Paul Clark: I would say two things. First, I am pretty sure that 60% was the ceiling. I think that was a number we made up. I will stand corrected if I am wrong four or five years on, but I think that was a number we were using. That was part of our rental policy, so we did not change the rental policy. We have had quite a long discussion about our commercial obligations, our reputation, and consultation and stakeholders. We had to balance a whole load of competing interests here. It was a complex transaction. It was one we thought a lot about. It is very difficult in hindsight, but at the time everybody believed we had struck a sensible deal to a good landlord—they are very highly regarded in their field—and that we had done a good job of balancing those different obligations that we have.

Q62 Mr Love: Can I come back to the issue of building affordable homes? You have indicated that, according to the statute under which you operate, you have to act as a commercial developer. To what extent do you recognise an obligation—and you have talked about that in previous answers—to provide affordable accommodation in any development?

Paul Clark: We have a commercial mandate to which we have to give primacy; that is what the Crown Estate Act tells us to do. But we have also talked a lot about our broader stakeholder stewardship and sustainability obligations. We recognise that our reputation goes alongside our ability to outperform commercially. Consequently, we are always ensuring that we meet our obligations under affordable housing provision in respect of the planning system, but that is not principally what we do.

Q63 Mr Love: To what extent do you recognise a responsibility to the local communities in which you are building? The two areas that we have talked about comprehensively today are rural areas and London, and both of them are suffering from affordable housing crises. To what extent do you recognise some responsibility to them to provide the level of affordable accommodation requested by the local authority?

Paul Clark: We recognise an obligation to all communities in which we transact across the board, across a whole range of different issues, whether it is the quality of the public realm—

Mr Love: This is public land we are dealing with. Public land owes a responsibility to local communities to ensure that you live up to the obligations that are placed on agreements with the local authority.

Paul Clark: We recognise an overall obligation to the communities that we work within to make sure that we are good owners of real estate. Principally, we must fulfil the requirements of the Crown Estate Act, which is to obtain best value. In doing that, we recognise that, as long-term investors who are concerned about our reputation, we have to do that in the right way. We are absolutely concerned across a whole range of things, whether it is public realm or the quality of the buildings we produce or the way we behave, that we must be good corporate citizens.

Q64 Mr Love: I want to come back to best value and, indeed, national benchmarks that we have talked about earlier on. Before I do that let me ask you: how do you respond to the criticism that The Crown Estate regularly fails to meet affordability targets? There are developments littered up and down the country where you are asked to provide 20%, 30% or 40% affordable accommodation and you pushed that down and down, all on the basis of best value and profitability.

Paul Clark: I do not recognise it as a valid criticism. On average, in our pipeline—and this is not built yet—we would expect there to be 40% of affordable housing within the planning consents that we obtain. We are not house builders, so we do not build these developments out, but we have a reputation for engaging early and often with the communities that we are working within, and for producing good schemes on the back of that, because they are informed by what it is the communities want. It is not just affordable housing in those cases. It is a whole range of things, whether it is infrastructure or schools or parkland and open spaces. Consequently, I do not recognise that description of us, but I do not think it is fair either because we have a very clear commercial mandate.

Q65 Mr Love: I understand that, but The Crown Estate is different from a commercial developer. It owes a responsibility—maybe not legally but in reputational terms and morally—to the people with whom it is reaching agreements, whether it be local community or local authorities. Let me come on to the whole issue about benchmarking and best value. What flexibility is there within best value and benchmarking? You mentioned earlier on, and the Chairman repeated it, that these definitions are subject to argument and dispute. What flexibility is there within that to suggest that you get best value for a site but also live up to your obligations to provide affordable accommodation?

Paul Clark: I think when we were talking about the idiosyncrasies of benchmarking, as much as anything that was about the value that we brought against what the market produced for us. Principally, in this case we are talking about our strategic land portfolio. We are talking about land we own within our rural portfolio on the urban fringe, which we bring into the planning process and, in the normal course of events, would obtain a residential planning consent for. We do that for commercial reasons. It is a principal driver of the performance of our rural portfolio. We do not just want to get one planning consent; we want to be able to get planning consents over and over again. It is a core part of our business. Consequently, it is absolutely in our interests to be good corporate citizens, to engage early and often and to ensure that we are seen as a good partner to have. If you have The Crown Estate that is trying to bring forward a scheme in your area, then that is a positive. I think our reputation overall is pretty good in that respect.

When it comes to obtaining best value, when we sell on a site with planning consent, for the most part—there are always elements within a transaction where you are not comparing apples with apples, so you have to look at an offer in the round that you receive for a piece of real estate—we go to what we believe to be the best and most deliverable proposal that we have.

Q66 Mr Love: Your outperformance of the market, according to your earlier explanation, is based on the development in London, in Regent Street, and the surrounding area. To what extent can you use the performance of your London portfolio to offset any limitations on the profitability of some of the rural and other sites where affordable accommodation is at a premium?

Paul Clark: Not at all. Each bit of The Crown Estate's portfolio has to deliver into The Crown Estate what it is required to deliver. They all have slightly different roles to play because they produce a slightly different profile of returns, but they are all there to stand on their own two feet.

Q67 Mr Love: The explanation you have just given is because of this issue about best value for any site, but surely best value includes a contribution. I am not suggesting that you calculate the best value to make a loss on a site because there is too much affordable accommodation, but surely there is a reputational issue and an obligation for you to calculate it in such a way to maximise the affordable accommodation because of the need in the areas where you are developing.

Paul Clark: If we were a developer with one or two sites, I am sure we would take a very different approach to being a landowner across the country with lots of sites. There is no doubt we do more in terms of consultation. It is broader. It goes on for longer. I believe we are considered, for the most part, to be good partners by the local authorities that we deal with. It is fair to say that there is a balance between our commercial objective and the reputation that allows us to continue pursuing that and outperforming. Fundamentally, we are in the strategic land business in order to maximise our returns but over the long term. Of course, that depends on your reputation.

Q68 Mr Love: Let me ask you one final question. If you make a comparison, because of the good relationship that you have with the local authorities because of the blue chip image that The Crown Estate has, is the portion of affordable accommodation, as a result of negotiations over planning gain, substantially better for The Crown Estate than it is for an ordinary commercial developer? In other words, are local authorities much more cynical about the relationship with an ordinary commercial developer than they are with The Crown Estate?

Paul Clark: I think it is hard to give a direct answer to that. Generally, we are producing about 40% of affordable—

Q69 Mr Love: I am surprised you use that figure because my understanding is that that is an average figure for central London. Where I am, in outer London, it is less than 40%. Indeed, in some rural areas it is down as low as 15% to 20% because the land value is not that great.

Paul Clark: That is an average expectation across the pipeline that we have over the next five years, which is in the region of about 8,000 homes.

Chair: Okay. Thank you very much for coming to give evidence to us this afternoon. The Crown Estate is a reformed and, in many ways, transformed institution from the one that I first encountered when I was in the Treasury 30 years ago. It is very important that we hold you to your statutory responsibilities and it is with that in mind that we have asked you for some further information in the meeting this afternoon and on the basis of that we will take some further scrutiny forward. Thank you very much for coming in. I am sorry, Mr Hastings—you may be pleased—that you have had a relatively quiet afternoon.

Rob Hastings: You do not need to apologise, it is fine.

Chair: I am sure sooner or later we will feel the need to take a look at your part of The Crown Estate's operations.

Alison Nimmo: Thank you, Chairman. We will send the information that you have requested on as soon as we can.

Chair: Okay.