

Public Accounts Committee

Oral evidence: Annington Homes: Armed Forces families, HC 974

Monday 14 May 2018

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Members present: Meg Hillier (Chair); Sir Geoffrey Clifton-Brown; Chris Evans, Caroline Flint, Gillian Keegan, Anne-Marie Morris, Lee Rowley.

Sir Amyas Morse, Comptroller and Auditor General, Joshua Reddaway, Director Commercial and Contracting, Jeremy Lonsdale, Director of Defence Value for Money and Richard Brown, Alternate Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1–170

Witnesses

[I](#): Justin King, Vice Chairman and Head of Portfolio Businesses, Terra Firma Capital Partners Ltd, James Hopkins, Chief Executive, Annington Limited, and Nick Vaughan, Commercial Director, Annington Limited.

[II](#): Stephen Lovegrove CB, Permanent Secretary, Ministry of Defence, David Goldstone CBE, Chief Operating Officer, Ministry of Defence, Graham Dalton, Chief Executive, Defence Infrastructure Organisation, and Catherine Little, Director General Finance, Ministry of Defence.

Examination of witnesses

Witnesses: James Hopkins, Justin King, and Nick Vaughan.

Q1 Chair: Good afternoon, everybody, and welcome to the Public Accounts Committee on Monday 14 May 2018. We are here today to look at the sale by the Ministry of Defence of Ministry of Defence homes to Annington Property Ltd, which took place some 22 years ago. We are obviously using the very important work that the National Audit Office has done looking into this project. We are also keen to look at what next, because there is a crucial stage coming up in terms of what the MoD and Annington negotiate going forward.

Overall, the deal has not had a good reputation. It is hard to think of a worse deal for the taxpayer, and we look at these things quite a lot. Just to summarise, in 1996, after a competitive bidding process, the Department sold 55,000 housing units—married quarters—to Annington on 999-year terms, raising an up-front £1.6 billion cash sum, and then rented the units back on a 200-year deal. We are 22 years in, so we are really at only a very early stage of that deal—the first stage, which takes us to 25 years in. A number of aspects of that are laid out in the Report. We are all on top of the Report, so we will not be repeating everything in there.

Before I ask Sir Geoffrey Clifton-Brown to kick off, I will introduce our first witnesses. We have: Justin King, the Vice Chairman of Terra Firma Capital Partners, the finance partner in this deal; James Hopkins, who is the Chief Executive of Annington Limited and I think one of the people in the room who was around at the time the original deal was done—

James Hopkins: Just after—20 months after. I arrived in July 1998.

Chair: Sir Geoffrey Clifton-Brown was a member of the Public Accounts Committee at that time, so I think you two are the only people in the room who have the very detailed knowledge of it, though I remember it being a very big issue at the time. And we have Nick Vaughan, who is the Commercial Director for Annington Limited. Welcome to you, gentlemen. We expect this session to last about 45 minutes, and we have had considerable interest from colleagues around the House—especially those with MoD property in their area.

Q2 Sir Geoffrey Clifton-Brown: Mr Hopkins, you and I were discussing this problem across the Committee in 1998. When you did this deal in 1996, did you ever imagine that you would be advising your clients that it was going to turn out to be such a good deal for them?

James Hopkins: We took a view that it was going to be a success, simply because, as much as anything else, it has been a play on house price inflation, and Nomura, who led the bid at that particular point in time, simply took a different view to everybody else. If you recollect at that



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point in time, house prices were actually falling and had fallen for the previous six years. They continued to fall for the next two to three years. I suspect one of the elements in the decision the Ministry of Defence made was de-risking the profile in terms of the capital values. But Nomura took a view that house prices would rise. That is the position we took, and that is how it ultimately has turned out. If you look at house prices, since 1996 they have risen by 280%.

- Q3 **Sir Geoffrey Clifton-Brown:** I do not want to look back too much, but there were certain trigger points in the deal. One was at the 15-year point, whereby if the Ministry of Defence had surrendered certain properties, they would participate in a percentage of the deal. Why do you think they did not surrender more? Why have they not surrendered more, even since the 2011 trigger point?

James Hopkins: That is a very good question. The profit share you are referring to, which was set for 15 years, ran out in November 2011, and in addition to the purchase price £161 million was paid directly to Treasury. I think there are a whole range of reasons why properties are kept empty, but that is probably best directed to the Ministry itself.

- Q4 **Sir Geoffrey Clifton-Brown:** I am glad it says in your letter that relations between you and the MoD are getting better and you are now talking to each other about possible future collaboration on a site-by-site basis. Can you confirm that?

James Hopkins: Yes, I can. The relationship is perhaps as good as it has ever been. We are having good conversations—

- Q5 **Chair:** As good as it has ever been sounds a bit muted. Would you like to give us some precise details about how it has got better? You say in your letter that it has—you say you are now engaged in constructive and regular dialogue.

James Hopkins: Absolutely. We are having a very constructive dialogue. Our conversations—and, in fact negotiations—are at the very early stage, so it is difficult to tell where they will actually go, but we are meeting every couple of weeks to discuss a range of issues, particularly in relation to the site review negotiation out in 2021. But yes, it is a very constructive dialogue, we are making progress and I am confident that we will continue to make progress.

- Q6 **Sir Geoffrey Clifton-Brown:** If you and I were negotiating as property people, one thing we would need is good data. The NAO Report makes it quite clear that the MoD data is not very good on exactly what the state and condition of all these houses on these 511 sites is. Do you as lessor have better data? Because if you do not have the data, how do you know how to negotiate with them?

James Hopkins: In terms of the condition of the properties, I cannot confirm that we have any better data than the Ministry of Defence. We simply do not have access to properties that are occupied by servicemen and women and their families.



- Q7 Sir Geoffrey Clifton-Brown:** You have two important things coming up. You have the rental renegotiation coming up in 2021, but before that you will presumably talk to the MoD about how both of you might potentially be able to benefit from this deal? If you and I were negotiating, we would talk on a site-by-site basis about which houses could be given up, which could be redeveloped and which could be sold. Can you give us a flavour of the discussions you are having with the MoD on those matters?

James Hopkins: To be clear, the site review in 2021 is merely a site review. The original lease sets out a review of 511 sites on a site-by-site basis. The 58% discount that the Ministry of Defence currently enjoys for the first 25 years of the deal is renegotiated on a site-by-site basis. That is all that it is. So far as the letter of the lease is concerned, there is nothing else to be negotiated at that particular point in time.

However, we have a long history of approaches to the MoD about better ways in which we could operate and better ways we could work together on a range of issues, such as voids, which you mentioned. We would hope that other issues were brought into that conversation at the same time.

- Q8 Sir Geoffrey Clifton-Brown:** But those sort of discussions have so far not been very constructive for either party, have they? Take the Witney example. They surrendered a number of houses and paid you £121 million¹ to actually build a whole lot more houses. They paid you the money, but those houses have not been built. Actually, that sort of deal hasn't been very forthcoming—certainly not from the MoD's point of view.

James Hopkins: No.

- Q9 Sir Geoffrey Clifton-Brown:** Those sorts of deals, if you and I were negotiating them—surrendering single houses or blocks of houses so that they could be redeveloped—must form a key part of what could be mutually profitable for both parties.

James Hopkins: There are a range of areas that we could discuss. Voids is typically one. At the moment, voids are running at 19% of the estate. We would like to be able to work in partnership with the Ministry of Defence, looking at ways we could help to reduce that.

Dilapidations naturally follows. Dilapidations have always been an issue for the Ministry of Defence. Sub-letting is a way that one could mitigate dilapidations, which we would be very happy to look at. In fact, that is already something that we do, but on a very small scale—on a couple of hundred properties at most—

- Q10 Chair:** Can you explain—sub-letting to whom?

James Hopkins: To the general public. If you have large numbers of voids, it is logical to sub-let those; rather than leave those properties empty, we can make use out of them. The more houses we can put back into the national housing stock, the better. That would provide a mechanism by which one could improve and refurbish those houses in

¹ Note by witness: In actual fact, the MoD paid £21 million.



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order to let them. By doing that, you are actually mitigating the dilapidations cost that might arise to the MoD before they hand properties back to us. That is another particular area.

Looking back, maintenance, for example, is an issue. In 2004, and again in 2014, we were deterred from bidding for the maintenance contracts. That is something that, again, we should probably be discussing and seeing how we could work together, as far as maintenance of properties is concerned.

Q11 Chair: When you say that, you are of course talking about the CarillionAmey contract, as was.

James Hopkins: As was.

Q12 Chair: Are you suggesting that Annington would want to have a hand in negotiating that contract?

James Hopkins: No, I am not suggesting that we want to have a hand in it. In 2004 we would have had an interest, but we were deterred from bidding for that particular contract. It is certainly something that we should discuss with the landlord, at the end of the day.

Q13 Chair: Is that something that Annington Homes has considered extending into—basically having its own repairs and maintenance service as it bids to take over the maintenance of the properties?

James Hopkins: Again, I would say to that that we did have an ambition to do that some time back. At the moment, we don't have an ambition to do that. We are extending our portfolio into the private rented sector, as a separate adjunct to the married quarters estate.

Q14 Chair: So you might think about that for that property?

James Hopkins: We will definitely be doing it for those properties, yes.

Q15 Sir Geoffrey Clifton-Brown: You have mentioned voids twice. The MoD have 7,259 empty properties, costing them £30 million in rent and maintenance each year. That seems curious, and there seems to be a little bit of a lack of communication. Surely it would make sense for both of you—for them not having to keep paying the rent and the maintenance and for you to have the properties back. Why have you not managed to have more of a discussion on this aspect?

James Hopkins: That is a question to also ask the Ministry. For our part, we have been keen to help them with the number of voids they have. It makes a lot of sense to have those properties back and, as I said earlier, to refurbish those properties, and to return them to the national housing stock. Of the 18,500 we have had back to date, almost all have been refurbished and sold to the general public, two thirds to first-time buyers and about a third to servicemen and women.

Q16 Chair: You are talking about going into the general rented sector. Would you envisage using some of the former MoD properties, to turn those into part of that sector of your business?



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James Hopkins: If they were in the location and of the right type, almost definitely, so long as they remained affordable.

Q17 **Chair:** Remained affordable for you to buy or for the tenants?

James Hopkins: For the tenants. I think that is one of the most important things in housing provision at the moment.

Q18 **Chair:** What would you describe as affordable, Mr Hopkins?

James Hopkins: Something that somebody on an average salary—in the region of £28,000—could afford on a monthly basis. I am not talking of expensive central London properties for thousands of pounds a month. This is something that would probably be in the region of between £600 and £900 a month maximum.

Q19 **Sir Geoffrey Clifton-Brown:** Perhaps once it becomes clearer where the rental negotiation is going the MoD will be incentivised to do some of these things. Can we talk about the rent negotiation? There is a chart in the NAO Report, which I am sure you will have seen, of various scenarios: figure 19 on page 42. You will see those lines. I am sure you know them backwards anyway without looking at that chart. Do you concede that there will continue to be a discount?

James Hopkins: Yes, I think there will continue to be a discount.

Q20 **Sir Geoffrey Clifton-Brown:** Do you concede that the likely discount—I think you have said this somewhere—is the 38% figure, which is the £294 million represented by the blue line on that chart?

James Hopkins: It is very difficult to precisely say at this point in time what exactly that discount will be. Clearly, the Ministry of Defence and Annington are starting from different positions. If you look at the 1997 Report, which I suspect is the only reference point that we all have, that attempted to describe the 58% discount. That was 10% due to the minimum guaranteed rent, 20% due to the bulk nature of the Annington deal and the MoD covenant, and 28% due to management and maintenance. The site review provisions themselves specifically exclude the MoD covenant and the bulk nature of the deal, and the minimum guaranteed rent would have fallen away. That is a starting point for where the whole thing goes.

The permanent under-secretary said at the last meeting that I attended in January 2017 that he expected the rents to come down. We are on record ourselves as saying that we expect them to increase. The NAO—in its own Report and from 1997—suggested that it would be 38%. You have some ranges in there. It does depend on the negotiation discussion we are having with the Ministry. It is too early to say ultimately where that will end up, but there will be a discount. In our view, we expect the rents will rise.

Q21 **Sir Geoffrey Clifton-Brown:** So you don't accept that the 38% discount is a likely figure?



James Hopkins: It could be a correct figure, but I am not saying for certain that it is or isn't, because I simply don't know at this point in time, while we are having that discussion with the Ministry.

- Q22 **Sir Geoffrey Clifton-Brown:** It has to be completed in the next three years, by 2021. There are provisions in your purchase agreement for it to go to arbitration. It has to be on a site-by-site basis and it has to be on an open market—willing seller, willing buyer, AST basis—with the MoD having done FRI. We all understand those things. If each of those sites has to go to arbitration, this will be a very long and costly process for both of you. Have you discussed a way of doing an overall deal, possibly incorporating some of the things we have been discussing—voids, handing back a property and redevelopment on certain sites? There is surely a deal to be done overall on that sort of basis, isn't there?

James Hopkins: To be clear, the site review runs from 2021 to 2024, so we are still three years out. The nature of the discussion we are having with the Ministry at the moment is exactly that, and we are trying to streamline that process. As you quite rightly say, there are 511 sites in the site review, and if all them going to arbitration, it could cost tens of millions of pounds and could have both of us tied up in courts for years. That's not in either of our interests, so there is benefit and value to us both in an early settlement, and potentially a more global settlement if we can achieve that. That is the direction of the discussion at the moment. If along the way voids, dilapidations and other issues arise, we would very much welcome the idea of sweeping them into the discussion and discussing them at the same time.

- Q23 **Chair:** That is very interesting, because earlier you were saying that you are looking to extend into the private rental market. Would you be looking to do deals with the MoD, which would you allow to further develop certain sites to do that, or would you be looking for development for other opportunities? Is it mainly homes?

James Hopkins: We haven't specifically looked at that, but if that is something the Ministry of Defence wants to talk to us about, we would very much welcome that.

- Q24 **Sir Geoffrey Clifton-Brown:** Bearing in mind that we are talking about people living in these houses, and I have certainly had complaints from my constituents over the years about their condition, you are the landlord, if you like—the lessor. Are you talking to the MoD about raising the standards on every single one of the occupied properties? It seems to me that it is incumbent on all of us to try to provide decent housing for all of the MoD and all of our servicemen.

James Hopkins: That is a very good question, and I would agree with you on that—it is in all of our interests. The Ministry of Defence specifically excluded management and maintenance from the deal in 1996. We are not consulted on maintenance programmes, and we have difficulty ascertaining exactly what the condition of property is. Again, if that is something the Ministry would like to talk to us about that, we would very much welcome the discussion.



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- Q25 **Sir Geoffrey Clifton-Brown:** In a sense, it doesn't matter to you, because if they hand back any property they have to pay dilapidation, so it doesn't really worry you what condition the properties are in at the moment.

James Hopkins: Well, it worries me from the point of view of a landlord. In 1996, the management and maintenance of the property were separated from the freehold of the property, which is a strange construct by any imagination. As a landlord, one obviously has an interest in the properties that you own. We would have an interest in ensuring those properties are maintained in the right condition. You are also quite correct that, at the end of the day, the Ministry is liable for dilapidations if the properties are not returned in the same condition in which they were rented, which is known as good and tenantable condition. If they are not maintained, the MoD are liable for that; if they are maintained, they are not.

- Q26 **Sir Geoffrey Clifton-Brown:** You just said something I didn't understand. They have to be returned in the condition in which they were let in the first place, when you purchased them in 1996?

James Hopkins: Well, it is described as good and tenantable condition.

- Q27 **Sir Geoffrey Clifton-Brown:** Right. So actually their condition in 1996 is irrelevant?

Nick Vaughan: No. In 1996, it wasn't possible to do a condition survey of the entire portfolio, so the condition standard on which they have to be returned was set into the lease.

- Q28 **Chair:** What about the ghost properties? That is a way off, because it is 177 years or so before they come back—the ones that have been knocked down.

James Hopkins: Demolished and left.

- Q29 **Chair:** And the MoD is still paying rent.

James Hopkins: They will still pay rent on those as if those properties still existed.

- Q30 **Chair:** And when they come back to you? That's a long way off, I know—175 years. It is amazing to the taxpayer that the MoD is paying rent to Annington Homes on properties that are demolished. That is one of the many issues about this deal that astounds people.

Nick Vaughan: The vast majority of the properties that have been demolished have in fact replaced with new accommodation. New married quarters have been built, and those sites are being occupied by service families. If the MoD terminated the leases on those properties, we would get the new properties back. They would be replacing the ones we clearly purchased in 1996. You are absolutely right that where the MoD demolish and don't re-provide new married quarters, at the point at which they terminate the underlease, they will have to compensate us for the loss of



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that asset. We will get compensation at that point, and they will clearly pay rent until they terminate the lease.

Q31 **Chair:** To the value of the home.

Nick Vaughan: That's correct, yes.

Q32 **Sir Geoffrey Clifton-Brown:** We have discussed the parameters of how you could do a better deal between the two of you. You are now in a better negotiating position than you were. You are getting on swimmingly between you. What sort of timetable are we on? When will you actually renegotiate this rent review?

James Hopkins: We are actually doing that at the moment. As I said earlier, we are meeting every couple of weeks. The Ministry is keen, like we are, to ensure we get to that as soon as possible. Again, I would like to think that within 12 months we would have something substantive to be able to report back to you on.

Q33 **Sir Geoffrey Clifton-Brown:** As a property man, I find it a little difficult to see how you get to that position if you do not know exactly what the state and condition of these properties are. Maybe that is a question I should ask the MoD, but if they do not know what the state and condition of the properties is, they do not know what they will have to spend before they give them back to you. Therefore, they don't know how many they will want to give back to you. At the same time, the number of armed forces is shrinking. They are paying rent on these 7,500 empty properties at the moment. I do not know quite how the MoD is yet in a position to do a deal with you.

James Hopkins: As far as the site review is concerned, the condition is almost irrelevant because you assume that the condition is good and tenable. From that perspective it is what a hypothetical tenant would pay a hypothetical landlord for the same lease that the MoD currently enjoys. So there is a certain hypothesis about that.

Q34 **Sir Geoffrey Clifton-Brown:** But is it hypothetical? The average figure they have had to pay on dilapidations on returning these properties to you is £11,000, so it is not hypothetical.

James Hopkins: No, that is an actual figure, but, for the purposes of the site review itself, that would be the starting point.

Q35 **Chair:** One thing that has always puzzled me about this deal is that the average tenant is not going to be an average tenant. A service family living in the middle of an air base will be paying a different rent from someone who has got a free choice about where they live. So you have got a cap effectively on the market rents. Presumably you will factor that in to this discussion going forward.

James Hopkins: Absolutely that would be the case. A hypothetical tenant would pay a hypothetical landlord for a property or an estate, whatever



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the site happens to be or however many properties it is, in that particular location, so all of them will be different. It will not be a global figure.

- Q36 **Chair:** But you have got a restriction. There are certain sites that will be difficult to let to anyone else. Earlier you talked about the extension to the work that you want to do in the wider private rented sector and you talked about affordable homes. Have you bought any sites near existing MoD sites where you own properties?

James Hopkins: Not immediately, but we are redeveloping at Brize Norton.

- Q37 **Chair:** At Brize Norton itself or at sites nearby?

James Hopkins: At Brize Norton itself on sites that have been handed back to us. We are building 135 properties.

- Q38 **Chair:** Have you made any new purchases of land or built any new homes near existing sites that you have?

James Hopkins: Not as yet.²

- Q39 **Chair:** Is that in your plans?

James Hopkins: It could be in our plans, yes. It is not definitely in our plans because it will depend on the site and location.

- Q40 **Chair:** And you are committing today to those rents being what you described earlier as affordable rents for people on a moderate income of, say, £28,000?

James Hopkins: That is the objective.

- Q41 **Chair:** You would not—dare I suggest it?—build luxury homes at high rents that would then bump up the average rent for the MoD sites and the average rent in the area so that when you negotiate with the MoD, it will be even higher?

James Hopkins: No. I see where you are going. No, that would not be our intention at all.

- Q42 **Chair:** What guarantee have we got that your good intention in front of the Committee is something that the board and Annington Homes will stick to? Is it down to you personally? Where is the ethos coming from?

James Hopkins: As far as I am concerned, if I give you that commitment, each site that we buy will have an impact, obviously, but the rents that will be charged will be relative to the locality that you are in.

- Q43 **Chair:** If you are a registered social landlord or a charity, you would have something written in so that you actually had to deliver that. What guarantees are there that Annington will stick to what you have just said?

² Note by witness: In March of this year, Annington acquired a site from St Modwen adjacent to the retained and redundant MQE at the former RAF Uxbridge site. The site is being built out at present and will deliver 207 flats.



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You are here now, but in 20 years' time, certainly in 50 years' time, you will not be here, so how do we know that this will be something that Annington Homes sticks with?

James Hopkins: We are not a registered social landlord.

Chair: Exactly.

James Hopkins: We are a private landlord. All that I can do is give you an undertaking that that is one of our objectives. We want to try to produce affordable housing. I cannot promise that we will be able to do it in every single location, because that will depend on those locations, but that is what we would like to attempt to do—it is written into our business plan.

Chair: It is written into your business plan for now.

Q44 **Sir Geoffrey Clifton-Brown:** Mr Hopkins, on behalf of your client, what is your priority? Is it to get the empty properties and more properties back, so you can sell them off? Is it to make sure that the MoD pays you what you consider to be a reasonable rent and maintain them properly, so that you have a long-term relationship with the MoD?

James Hopkins: First and foremost, as the Chair said, we are 22 years into a 200-year relationship. Annington is a long-term investor and that is the way that we have always looked at things. Developing a long-term relationship with the Ministry of Defence makes a huge amount of sense. Working together to deal with voids and issues that affect those properties makes a lot of sense. The long-term relationship definitely is at the forefront of our objectives.

Q45 **Sir Geoffrey Clifton-Brown:** Mr King, we have not heard from you, but you are a controlling investor in all this. Will you have a say in how these negotiations on the rent are carried out? Or will you leave it entirely to Annington to work it out themselves?

Justin King: As James has just demonstrated, along with Nick, they have a grasp of the detail. Therefore, all that is delegated to them, as a process. Ultimately, it is the shareholders who make the decision. Terra Firma is the bridge between the company and the shareholders. I am here as the representative of the shareholders. It is a shareholder decision—it is of that significant a scale. As would be the same for any public or private company, it would have to get shareholder approval. As you would expect, generally we have that conversation ahead of the game, not behind.

Everything that James is doing he is fully empowered to do, and everything that he has said I would endorse. To your last point about the reassurance about affordable housing, when we refinanced the business last year, we raised £550 million of new equity for the business. That was, among other things, specifically for the purpose of backing the development of a private rental business in Annington, which currently is around 1,500 homes.



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That strategy was articulated to and backed by those investors on the basis that it was affordable homes in that £600 to £900 a month range—family units as opposed to multiple unit sector, which is where a lot of the money is going in private rental at the moment in the UK. It may not seem reassuring to you, but £550 million carries a lot of weight in terms of driving the strategy of the business. It was raised specifically on that basis.

Q46 Chair: Are you saying that Terra Firma is one of the driving forces behind the move into private rented homes at an affordable rate?

Justin King: Our role as investment managers is to agree with management the strategy of the business. Typically, where we have a long-term management team, such as James's, they bring the strategy to us for approval. In other situations where there were new people, you would tend to bring new people in to execute a strategy you have already defined. As you might imagine, with 19 years in the hot seat, we are backing management.

Q47 Chair: Going back to Sir Geoffrey's point about the negotiations, it is in your interest, if you are standing up for shareholders, to get as much profit as you can out of the contract for the next period with the MoD. The discount rate is a pretty critical issue. Do you have any views on what the discount rate is that your shareholders are looking for, to make sure that they are making as much as they can out of the deal with the MoD?

Justin King: As I said, we completely endorse everything that James said—it is one element of the negotiation. We have put into public, which we had to as part of the refinancing of the business, a view that the rental levels would go up. That is the view of the company, but as Sir Geoffrey just spent a good deal of time exploring, there are lots of other aspects to this negotiation, which we are completely happy to engage with. Like most negotiations, if you focus only on one aspect of it, usually you end up butting heads. There are lots of other aspects of this deal that we can talk about.

Q48 Chair: Which bits of this current system have worked well for Annington? We probably know some of that, but perhaps you could lay it out. Which elements would you like to change? Mr Hopkins, you have gone through some of those, but you might want to go into a bit more detail on which bits are ripe for change in the negotiation.

James Hopkins: I will refer to Nick on some of the detail, because he has also been at Annington for 20 years alongside me. Clearly, house price inflation is one element. Capital growth is one element that has worked particularly well for us over the past 20 years, as I mentioned earlier. There are a range of other elements that fall into this.

Nick Vaughan: James has articulated the focus on voids, as has Sir Geoffrey, but I think there are a number of other areas, predominantly about assisting the MoD with its estate rationalisation planning—you talked about that a little earlier. The UK armed forces have a target of



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giving up 30% of their facilities, and we would very much like to play a role in that if we can, alongside dealing with the housing, which will clearly be severely affected as that estate rationalisation goes on. As Justin said, as part of the conversations it would very much make sense of us to have a dialogue around that.

There are other issues around the family accommodation plans, FAM, that are being drawn together. There is a role for Annington to play in that, in terms of the size of the housing estate that will be needed, and the various options that are being looked at for how service families might be offered a range of accommodation. Clearly we have our thoughts on the PRS market, and how we might develop that.

There must be ways of us jointly exploring what happens with the housing stock that is surplus to your requirements and can be returned. We have aspirations to make it available for affordable housing. I think you have aspirations in the MoD to encourage people to move out of service family accommodation. These are all issues that we ought to be exploring together.

We have, in the past, put a number of proposals to the Ministry of Defence around a number of these options, including re-provision of accommodation, site swap, and new build. At Brize Norton, which Sir Geoffrey alluded to, it was hoped that an estate of 200 houses would be built, and we were hoping to play a part in that. Sadly, at the moment we are cracking on with building out our 135 houses but, as James said, many of those will be made available for affordable rent in the locality. There are lots of areas, and they ought to be part of the dialogue we are now having with the MoD.

- Q49 **Sir Geoffrey Clifton-Brown:** This is exactly right, isn't it? We have talked about voids, and about raising the rents and discounts and so on, but this rationalisation must be a really profitable area. It could be swapping houses on an individual basis, on a group basis, or even an entire site basis. How much of the discussions that we have been talking about with Mr Hopkins involve this sort of estate rationalisation?

Nick Vaughan: We haven't had those debates as yet with the Ministry of Defence. We would very much like to. We have not got to that point in our discussions with them. In the past, we have put a series of proposals to the Ministry of Defence focusing on those kinds of areas. We have re-provided those proposals recently, and I know they are being looked at. Dialogue is really happening on those, and we now hope that they will be brought into the negotiations.

- Q50 **Sir Geoffrey Clifton-Brown:** We will obviously press the MoD on that. Mr Hopkins, isn't there a problem here for the MoD? Their timelines are not aligned in terms of the rent renegotiation, the families' accommodation timeline, and the DIO timeline. The stars are not aligning at the moment. Is this a problem to you in your negotiations?

James Hopkins: I don't think it is, because I think the Ministry of Defence is trying to align those. We are talking now about an early site

review negotiation. That is exactly what we are trying to do. I have no doubt that there are other elements that will drop into that, as Justin and Nick have alluded to—other aspects of the estate—broadening that discussion. In relation to DIO, I could not comment on that, but I get the distinct impression that there is a view to try to ensure that FAM and the site review negotiation are aligned.

- Q51 **Chair:** It could be argued that you are in a very good position because, as Sir Geoffrey says, the stars do not align at the moment. Surely that puts you in a strong position, as a provider on site, to be in pole position to purchase any MoD surplus land in the negotiations.

James Hopkins: Yes, it would. That has not come up at the moment, and certainly land that has—

- Q52 **Chair:** That is quite a good bargaining chip for you. You are there, on site, ready to go.

James Hopkins: It would certainly be something that we would welcome talking to the Ministry about.

Sir Geoffrey Clifton-Brown: Can I ask you one last question, Mr Hopkins? After that, I have one more question for Mr King, and then I will have finished; the Chair might have other questions. You wrote a letter to the Chair on 8 May 2018. In the last paragraph on the second page, you say that, "It is worth noting that taken together the payments made by Annington to the Government and the savings of rent paid by the MoD compared to open market value, the deal has yielded nearly £6 billion to the taxpayer". How do you arrive at that figure?

James Hopkins: If you look at Annington, it is the single largest provider of family accommodation to the Ministry of Defence. It was in 1996 and it still is, with almost 39,000 properties. The 58% discount over that period of time compared with the open market value has been just in excess of £4 billion, and we are rolling into that the profit share at the same time. That is your lion's share of where that money all comes from.

- Q53 **Sir Geoffrey Clifton-Brown:** That discount was expected at the time of the deal, in fact was built into the deal, so it is not really a saving to the MoD, is it?

James Hopkins: It helps to put the thing into context and that is quite important when one is looking at this. That 58% discount, what does it actually mean in real terms? Well, that is £178 million a year to Annington, which is an awful lot of money, for 39,000 properties, which is an awful lot of properties, which is £4,500, give or take, per annum per property, which is something like £380 per month per property. You can run that through any comparator website you like in the country and you will struggle to afford a two-bedroom property in 99% of the country. It is a very affordable arrangement. I think it is relevant to be able to try to compare it to what an alternative would have been—not the only alternative, because an alternative would have been not to hand the property back to Annington. But compared to FAM, where one of the



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options is to encourage people to purchase properties through some kind of subsidy or to rent in the open market, it is still very affordable.

Q54 **Chair:** You are comparing theoreticals that are not yet firmed up in FAM with the MoD owning its own properties.

James Hopkins: I am just trying to provide a context.

Chair: That is one of the reasons we tend not to use numbers. They were sprung upon us in a well-crafted letter.

Sir Geoffrey Clifton-Brown: We all know the old expression, "There are statistics", and so on.

Chair: We will give you a mark for trying.

Q55 **Sir Geoffrey Clifton-Brown:** I have a last question for you, Mr King. On behalf of your shareholders, what instructions are you giving to your managers, Annington Homes? Is it that you want to take as much capital out as possible—in other words, you are trying to encourage the surrender of property? Is it that you want to try to get them to do the best deal possible by this estate rationalisation? Or is it that you want to be in there in the longer term, growing your capital by having a reasonable relationship with the MoD and providing decent housing, and with reasonably increasing rents? Is it short-term capital out or is it long-term capital appreciation?

Justin King: It is the last of the three, as you described them very clearly. The funds that own the business, which are essentially two discrete funds that are set up only for investment in this business, are not, as is often the case in private equity, time-bounded funds. They are open-ended. Obviously, different investors have a different view of the length of time they will stay invested in those funds, but we have a long-term view of the business.³ Ultimately, that is what has created the value thus far—essentially, capital appreciation. But, and it is quite a big but, from our point of view, the voids and the quality of the maintenance of the properties are against our interest as the owners, just as they are against the interest of the taxpayer in terms of paying for those voids. In terms of dilapidations, it is a cosy real estate word, but what does it really mean? It means that the properties are not of an appropriate quality for the armed forces that live in them. That is what £11,500, when they are returned, means. They are £11,500-worth of cost short of good market quality. Although we are financially protected as and when they are returned, it is not in our long-term interest to have our property deteriorate in terms of its quality. It is vital that those issues form part of the negotiation—

Q56 **Sir Geoffrey Clifton-Brown:** I am very grateful for that, because it

³ Witness Correction – 15/05/2018 – "The technical nature of the legal entities through which the investors in Annington invest means they have a set term but are capable of extension. I am confident that due to the long term nature and view of these investors and the long term nature of the asset into which they have invested, that the term of the investors' investment in Annington will be extended".



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means that you will be interested in these properties being maintained properly and that the servicemen who occupy them will get a reasonable home.

Justin King: Quite so.

Sir Geoffrey Clifton-Brown: So are you pressing, through Annington, for detailed quality of information on the state and condition of all those houses? Are you hoping that it would be on an open-book basis so that each of you could agree what the state and condition of every single house that you own is?

Justin King: Well, as James said, technically it is not necessary to know any of that for the negotiation that is formally described in the contract.

Q57 **Sir Geoffrey Clifton-Brown:** But you just told me that you are more interested in the state and condition.

Justin King: We absolutely want to see this negotiation broaden. It slipped across the table and perhaps did not stick. This is starting three years before it has to. I think that is an incredibly encouraging sign, because the process in the lease only requires it to start in 2021, for the subsequent three-year cycle. We take great heart from that—there is a willingness to engage early, not just on what the contract says has to take place but on all the issues you have been exploring over the last half-hour or so.

Q58 **Sir Geoffrey Clifton-Brown:** But given that you are interested—I am really pleased that you are interested—in the state and condition of the houses, would it not make sense for you and the MoD to have an open book on the information, so that both parties knew exactly what state and condition every single house on the estate was in?

Justin King: Yes, but I guess you encounter two difficulties with that. The first, of course, is that that would put a number on where the dilapidations are today and potentially raise the question of money that would need to be spent to get them up to that quality. The second goes to—I am sure the MoD will speak to their negotiating position later—the MoD's desire to ensure that there is an opportunity to get value for the release, whatever the number is, from the voids. We are not suggesting, I don't think, that all the voids could be released. Every report I have read has said there is a need for voids for operational flexibility and so on, but I think that at 19%, the National Audit Office concluded it was at about twice the level that the MoD themselves thought it needed to be at.

Q59 **Chair:** Mr King, earlier you talked about the very firm support from your investors, as shareholders, for the proposal by Annington Homes to become a larger private landlord, working particularly on affordable homes. What is the argument in terms of sustainable return? You could go for higher-end properties and make a lot more money more quickly, but presumably you have done some analysis of the market to work out that there is a good, steady return in the price bracket that Mr Hopkins was talking about.

Justin King: We have a particular view of the market, partly born of our history, because, as James noted earlier, the vast majority of the releases thus far have been sold, once refurbished, as affordable housing. There was perhaps a misperception, if you go back 20-odd years, that this was going to be a lot of land that could be redeveloped for greater value. In truth, the vast majority—the high nineties per cent.—have been sold, refurbished, into that affordable space, so we have learned a lot about that marketplace.

We observe that the private rental market is very focused on the bottom end of the market, so multiple units, flats, the student market—likewise, that has attracted a lot of money—and we think our expertise in affordable homes, because that is our history, has a lot of application in the housing market. I could bore for Britain about why we think that is a part of the market that is not yet served. We have all seen the figures about how much less likely the average 30-year-old today is to own a property than the average 30-year-old of 20 years ago. It is that part of the market that interests us and is, we think, where the greatest opportunity lies. And you will, in large part, have to develop that stock yourself, because it is not stock that has been created by the marketplace thus far.

We have 1,500 homes in our private rental business today. I think that makes us the No. 4 player—four or five.

James Hopkins: We are certainly in the top 10 or 12.

Justin King: Which tells you that it is a relatively small and undeveloped market thus far.

Q60 **Chair:** Which is interesting. You are basically becoming a big institutional investor in housing, so my next question, to Mr Hopkins, is what kind of tenancies are you going for? Are you going for assured shorthold or for longer-term tenancies? Is this is a market as Mr King has described—he sees his shareholders getting a good, steady, regular return?

James Hopkins: This will entirely depend on the tenant itself, but in certain circumstances tenants want longer-term security, so if there is a possibility to look at leases that extend out to three years or more, that is something that we, and the market, should be doing.

Q61 **Chair:** So you are going to be bidding on that?

James Hopkins: We will be, yes; very definitely we will be.

Q62 **Sir Geoffrey Clifton-Brown:** Given figure 10 on page 27 of the Report, it looks as if the majority of your estate is concentrated on the line south of the Severn to the Wash. Ipso facto, it is the more expensive property and therefore there should be a rationale to do some estate rationalisation and provide affordable housing. There should be lots of incentives for you and the MoD to do these sorts of rationalisation deals.

James Hopkins: Absolutely; I totally agree with that. As you say, 80% of the stock lies below the line of the Wash to the Severn, which would be considered to be the most affluent areas in the country, but our average



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selling price is around £235,000 for the existing stock, which would still be, in that area, incredibly affordable.

- Q63 **Sir Geoffrey Clifton-Brown:** Given that incentive, if no other, why has this rationalisation not taken place on a much greater scale already? Is it simply because you have not had a good enough working relationship between you? You have had 20-odd years of the deal so far.

James Hopkins: I totally and utterly agree with you. Going right the way back to 1998, I would be happy to provide you with a file of the opportunities that we have looked at over those years. For a whole variety of reasons, those have never been taken forward. Only one was taken forward, where the Ministry approached us in areas where they did not have sufficient housing stock, and we went to the market and bought stock and leased it in bulk to the Ministry of Defence. I think that is 764 properties. That is the only opportunity; otherwise, there were a couple of hundred properties that we sub-let for them. If you asked me to describe the last 22 years, I would agree with you that it has been a missed opportunity. There are a lot more things we could have done. If you look at the NAO Report, it identifies that one of the objectives from the 1996 sale that the Ministry has probably failed in was the missed opportunity to build a relationship and work much more closely together, which was one of their key objectives in 1996.

Sir Geoffrey Clifton-Brown: Let's hope that going forward you can both improve on what you have done in the past.

- Q64 **Chair:** Sir Geoffrey talked quite a bit about the stock condition. When we looked particularly at the questions on rents and maintenance that came out of that hearing, the Defence Infrastructure Organisation has done some stock condition, maybe up to 90% of properties. There was some information from that. Did you get access to that information? Do you expect to get access to that information in negotiations?

James Hopkins: We have not had access to that information. I am not sure that we were aware that as much as 90% had been done, and we have not requested that information.

- Q65 **Chair:** I am speaking from memory, so maybe I will check with the Ministry afterwards. How many people do you have in your negotiation team, Mr Hopkins—people who are either now in the team or will be discussing this with the MoD?

James Hopkins: To be honest, I have not counted that, but if I counted the entire team across all functions, I would think we would be close to 40, 40-odd.

Nick Vaughan: The team assembled to help us, yes.

- Q66 **Chair:** And presumably you are using outside consultants as well.

James Hopkins: We are using outside consultants.

Nick Vaughan: That includes them.



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Q67 **Chair:** So you have some good firepower on your side. Perhaps I should not use that phrase in an MoD context when it is about housing.

James Hopkins: I would say we are organised.

Q68 **Chair:** Finally, I asked earlier which elements you would like to change and which have worked well. I don't think you quite answered the point about what worked well. You have not done badly out of this deal, to put it mildly, so what has gone well for you? It is interesting, as we talk to the MoD about negotiating the next phase, to understand what has worked well for you and your shareholders.

James Hopkins: What has worked for us is ownership of the estate, because of the capital growth. That is where the value has come from, and £1.67 billion has ended up as a £7 billion portfolio. We have almost identically tracked the housing market, so that has worked well for us. There are a lot of things outside of that that could have worked well, because otherwise we collect the rent and then, when properties have been handed back, we have devised a very good mechanism for refurbishing and selling those properties in the open market. We can still do that.

Q69 **Chair:** Are you and your team paid bonuses as well as your basic salary?

James Hopkins: I am paid bonuses on an annual basis.

Q70 **Chair:** How are they calculated? Are they calculated on the value of the portfolio? What is the rationale for that?

James Hopkins: On my performance against targets: normally managing costs, disposals, revenues and so forth.

Q71 **Chair:** So not directly on profit?

James Hopkins: No.

Q72 **Chair:** Thank you very much indeed for your time. The transcript of this and the next part of the session will be up on the website, uncorrected, in the next couple of days. I urge you to look at that. Our Report will be out in due course; I say no more than that at this point. Thank you very much, and please make way for the next witnesses. You are very welcome to stay if you wish, but we understand you may not want to—although, if you are about to negotiate with the MoD, you may want to stay and hear what they are going to say.

Examination of Witnesses

Witnesses: Graham Dalton, David Goldstone, Cat Little and Stephen Lovegrove gave evidence.

Chair: Welcome back to the Public Accounts Committee, on Monday 14 May 2018. As I said earlier, we are looking at the Ministry of Defence's contract with Annington Homes—somewhat infamous in Government



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circles—and the NAO have gone through that in detail. The Committee previously looked at this in a number of ways, including when it was first established. I am going to introduce our witnesses and, Mr Lovegrove, I have got a couple of questions about general matters for you, if that is all right, before we kick into the main business.

From my left to right we have Cat Little, Director General, Finance, at the Ministry of Defence. Welcome back to you. We have David Goldstone, Chief Operating Officer at the Ministry of Defence—welcome; Stephen Lovegrove, Permanent Secretary at the Ministry of Defence; and Graham Dalton, from the Defence Infrastructure Organisation, where he is the new—well, fairly new—Chief Executive. It is the second time you have been in front of us.

Graham Dalton: Not so new.

Chair: Not so new now—that is good to know. It is on your watch now.

This is such a long time ago; I should just comment that somebody said “Will we all be sitting here in 25 years’ time and saying this transaction was good value for money for the taxpayer?” That was one Sir Geoffrey Clifton-Brown, or at that time just humble Geoffrey Clifton-Brown, as he was not then a knight. He showed prescience, and he is here today so I shall ask him to come back to you on that in a moment.

Before we go on to the main session I wanted to ask you, Mr Lovegrove: the Secretary of State has gone up to Barrow-in-Furness today to cut a ribbon or unveil a plaque, or whatever—I am talking about the £2.5 billion investment in submarines. From reading the press reports, it does not sound like that is totally new money.

Stephen Lovegrove: That is right. The seventh Astute-class submarine was always planned for. I think the speculation had been that we were not going to go ahead with it, but we are going ahead with it, so that is where the money was.

Q73 **Chair:** Okay, that is fine. And the F-35: we were going to have a briefing with you tomorrow about an update on the F-35. That is not now happening so I was wondering if you can give us any brief update on where things are with the F-35.

Stephen Lovegrove: I am afraid I don’t remember that there was an F-35 update tomorrow.

Q74 **Chair:** We as a Committee were expecting to be at the MoD tomorrow morning, but it doesn’t matter whether we are there or not; I was just wondering if you have got any update on the F-35.

Stephen Lovegrove: The F-35 position is effectively the same as it was the last time that we spoke. Since we did that I went to the States and we agreed with the team over there that it would be helpful if some of them were to come to the UK and to brief both this Committee and the House of Commons Defence Committee on some of the slightly more sensitive



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areas of the project. That, I think, is the most meaningful kind of development since we last talked about it.

- Q75 **Chair:** Certainly, some members of this Committee were out in Washington earlier this year, having discussions with our American allies, I suppose, on this issue. We look forward to learning more about it privately, but I just wondered—there is no update as of the last time you were in front of us.

Stephen Lovegrove: Not meaningfully, no; everything is on track for this first batch, as we discussed before.

- Q76 **Chair:** Turning to Mr Dalton, just before we go into the main session, I think it was when we last met, but certainly it was also with your predecessor, we were talking about transferring leadership of the work and the programme to individuals directly employed by the MoD, rather than using consultants. How far has that programme reached, and how big is your negotiation team, as we move into negotiation over the Annington deal?

Graham Dalton: There are two parts to that. The first, the strategic business partner contract, will terminate not later than 30 June 2019, so we are about halfway through a transition process. In two of the key roles I now have civil servants in place—finance director and commercial director—supporting some of the other civil servants in the team.

- Q77 **Chair:** Are they career civil servants in those jobs, or are they people with commercial and finance experience from elsewhere?

Graham Dalton: One has commercial and has come from the full, raw private sector, with asset management and facilities management expertise for big commercial corporations; the other, the finance director, has long, wider public sector expertise, particularly with agency-type arm's length bodies.

- Q78 **Chair:** Are you having success in recruiting the calibre and experience of individual you need, with the commercial nous to do these roles?

Graham Dalton: Those two—I am very happy with them. I probably would have liked a stronger field, but I certainly have two good appointments. As we go further down into the organisation it is harder to attract.

- Q79 **Chair:** What kind of pay scale—just give us an idea of what we are looking at?

Graham Dalton: If I come down to the senior civil service 1 scale, that is quite a broad range. It starts from about £65,000 and goes up to just over £100,000. For commercial staff there are some exceptional arrangements. It is combination of money and profile in the marketplace, and where defence is within that profile.

- Q80 **Chair:** When you say “profile”, is that about defence or the Defence Infrastructure Organisation and its history?



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Graham Dalton: It is a bit about defence, which is not well known in wider industry. Certainly in the industry I come from—the construction industry—defence has had a fairly low profile for quite a long time. It is much lower than rail, highways, energy, which have had much stronger and more obvious grounds for people to go to. We are having to build our visibility in the sector as well.

Q81 **Chair:** You say you are halfway through. Are you confident that you are going to get the right calibre of people in place by next summer—in about a year's time?

Graham Dalton: I am determined that we will get the right calibre of people in place and in time.

Q82 **Chair:** If you don't, what is plan B? If you can't get the right calibre of people, what are you going to do?

Graham Dalton: I have a plan B and C, but it is about being tactical. You would have to then start going to short-term contracts, or whatever. These are roles where we have people in place at the moment, so there are a few options. It is not easy, but we will manage to work our way through the transition.

Q83 **Chair:** We were commenting before the hearing that we seem to keep going in a full circle. One minute there are in-house civil servants, then they are outsourced, then we go back to in-house civil servants. Will you stick to this path now, so that we build up expertise within the civil service to do good negotiations for defence?

Graham Dalton: I'm not sure if I can answer that completely directly. My experience of having been around this interface for probably the past 20 years is that it is down to performance. If you perform when running a delivery body, and the external environment is about right, you get on and deal with it. My highways experience with the Highways Agency was that it built its reputation after some sessions in front of some of your predecessors, Chair. We eventually set up Highways England, which was slightly further at arm's length and empowered to go and do the job. You are only as good as the last major capital project, the last winter, or the last exercise. You must be a consistently good performer.

Q84 **Chair:** And you also have the challenge that the commands will be dealing with infrastructure as of about now. Is that right?

Graham Dalton: The commands are now taking the spending decisions. I am still the delivery body—I am an advisory and delivery body. I liken it to being a landlord with a bunch of tenants who thought that I was not spending enough on their estate and were competing for the money, and I am now an adviser. Effectively, I am changing the DIO into an estate services business while we work with it to develop its needs, give advice on the condition of the infrastructure, encourage it to look at utilisation, agree a plan and then deliver that plan. We have just finished our first year in shadow of running a committed plan for the year, and that is starting to get a bit more discipline from both sides about planning the work and then working the plan.



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Q85 **Chair:** That is quite interesting, and we will come on to the interface with the defence estate. Some of the commands have quite strong views about elements of that being sold off, but we won't get into that at this point.

Stephen Lovegrove: Chair, may I respond to the point about the team? The question was about whether or not we have the right kind of negotiating team facing off against Annington at the moment. I am perfectly satisfied that we do at the moment. We have property specialists, legal firms, investment bankers, and UKGI, which was formerly the shareholder executive involved. There is a good, solid well-resourced team to do the kind of overall deal that you were talking to the previous witnesses about. Obviously, if we did have to go into a site-by-site assessment, we would have to change the nature of that team, but there is quite a long way to go until that might become necessary.

Chair: There is much to unpick in this session, so I will ask Sir Geoffrey to pick up from 20 years ago, and start the session proper.

Q86 **Sir Geoffrey Clifton-Brown:** Let us start with you, Mr Lovegrove. In January 2007, you said to the Committee: "In my opinion the deal done in 1996 was a bad one for the taxpayer." Has it got worse or better since then?

Stephen Lovegrove: I think it's about the same. With hindsight, the deal represents a very significant transfer of value from the public sector to the private sector. That is good for Annington and its shareholders, but there is no question that the public sector has not had a particularly good ride out of this deal.

Q87 **Sir Geoffrey Clifton-Brown:** Stripping out the hindsight on property values—which to a degree were foreseeable at the time, in the discount rate you employ—has the rest of the deal been a good or a bad one for the MoD?

Stephen Lovegrove: I am not sure, with respect, that you can actually strip out the point about property value, or indeed rent. I would have expected a deal of this type to have incorporated protections for the public sector, in the event that there were potentially super-profits to be made out of the underlying economic environment. That is relatively well-known financial technology—it is the kind of technology that we have in place in the Hinkley Point deal, which we have spoken about on a couple of occasions in this Committee. You have profit shares, you have retained equity positions potentially, you have caps on returns and you have all manner of different mechanisms by which you would be able to make sure that interests over a very long period of time—these are very long deals—don't get completely misaligned. The economic conditions and assumptions that were in place in 1996 no longer obtain, and the public sector by and large has been on the wrong end of that particular set of changes. There were mechanisms then that could have been put in place to make sure that that wasn't the case.



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In terms of the nature of the deal itself, most of the risks and responsibilities, absent the property and rental values, remained with the Department. So was it good for the Department in a sense? We would probably have to look at some of the other arrangements that we put in place, the CarillionAmey type of arrangements, to work out whether or not the running or maintenance of the estate has been kept to the right kinds of levels, but the main function of the Annington deal is the transfer of property market risk—therefore, in this instance, reward—to the private sector, with no caps.

- Q88 Sir Geoffrey Clifton-Brown:** The NAO Report in 1997 or 1998 set three objectives, the first of which—we heard a lot about this from the previous witnesses—was to reduce the number of vacant homes. The number of vacant homes is currently running at 19%, exactly the same as it was before the deal, and yet the deal predicted that it would be half that amount. Why are there still so many vacant homes?

Stephen Lovegrove: I would point again at a quite high level of abstraction to this fundamental misalignment. We had a situation up until 2011 where there was a profit share. That dropped away. Figure 15 of the NAO Report makes it very clear that around that time the number of hand-backs—therefore, the avoidance of voids—started to drop away as well. If it is the case—which it is—that the average cost to the Department of handing back a void is about £12,000, the Department has to take a view as to what overall is better value for money, with all of the other pressures on the departmental budget that we have spoken about many times, and whether or not that is the right kind of thing to do as opposed to placing that money at the service of another Defence priority. There are other reasons why the void rate is not 10% but still 19% or 20%, principally to do with the subsequent decision about coming back from Germany and the requirement to keep some more housing stock to be able to manage that churn. But at a more profound level, in simple financial terms, in a cash-constrained environment, the incentives for the Department to hand back the voids are not very high, when we know that we will have to pay on average £12,000 each time we do so.

- Q89 Sir Geoffrey Clifton-Brown:** I am glad you mentioned the incentive in the first 15 years of the contract, up to 2011, to hand back the properties and gain a share of the increase in value. Presumably that was put in by your predecessors negotiating the contract, to incentivise the MoD to hand back surplus properties. Why did it not do so?

Stephen Lovegrove: It did do so but, unfortunately, it fell away after the first 15 years. This is a 200-year sublease on a 999-year lease. We are now in a position where it did fall away in 2011 and the incentives fell away alongside that.

- Q90 Sir Geoffrey Clifton-Brown:** The second of the objectives the NAO set out in its Report was to improve the quality of management. Why are there still 7,259 empty properties on which you are paying rent and maintenance of £30 million?



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Stephen Lovegrove: If I may, this may be a moment to hand over to Mr Dalton.

Graham Dalton: I think that comes back to the same question about the number of void properties and the management of it. I would argue that there has been some incentive to do better management, because the condition—the quality of the occupied properties—is universally above the decent homes standard, and generally well above, for the estate that is tenanted.

Q91 **Sir Geoffrey Clifton-Brown:** Can I just challenge that statement? My colleagues and I are still getting quite a lot of complaints from servicemen about the quality of their accommodation. If your statement that everything is wonderful and they are above the decent homes standard is true, why are we still getting a significant number of complaints?

Graham Dalton: I don't want to sound like I am trumpeting it too much. The decent homes standard is a threshold for private rented, social and local authority housing, and the like. It provides a benchmark, which is equivalent to, and better defined, than good and tenable repair, which the panel were talking about beforehand. Defence Ministers have quite rightly taken the decision that no service personnel should be in any accommodation below that standard. That puts the level of accommodation above the whole of the UK housing stock. That does not mean it is luxury accommodation—far from it.

Q92 **Chair:** That is in theory, but Sir Geoffrey is asking how much it really is. A lot of colleagues around the House—quite a large percentage of this estate—have been in touch with us ahead of this hearing, to detail to us the problems that service families are still facing in some of this accommodation.

Graham Dalton: The criteria for the decent homes standard are around the kitchen, the bathroom, the basic physical structure, the heating and/or insulation and the insulation. It is a threshold criteria, which the houses are above when we let them and put personnel in. That is the policy that we have. Quite a few of the houses in the void stock are below that threshold. That does not make them luxury and comfortable houses, and there are some that are still tenanted, which either weren't at the standard at the time they were tenanted or have fallen below it while they have been occupied. Our policy is to try to do improvements when there aren't tenants in the house, because of the disruption.

Q93 **Chair:** You say tenants, but some of them are on leases, aren't they?

Graham Dalton: When I say tenants, I am talking about service personnel allocated a house and living in the house.

Q94 **Chair:** But they are not actually tenants in the same way that some of them are, so they don't have the rights of a tenant.

Graham Dalton: No. I didn't want to infer that they were.



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Q95 **Chair:** If Ministers, as you say, are committed to ensuring that service personnel have good quality homes, has any consideration been given to turning them into proper tenants with tenancy agreements, and therefore with the legal clout to do something about this? We heard before, in previous hearings, that the chain of command does not arise in this situation, so it is not about that. They could be tenants. Those service families, when their serving member is overseas or in theatre, would then have the rights of a tenant to demand certain improvements, which they currently cannot do.

Graham Dalton: It is not something that we have discussed, certainly in my area—I am not sure whether it has been discussed in a wider policy area—in the time that I have been here. We work closely with the likes of the service family federations, and we try to set in our contracts the response times that are as good as we can get, particularly for when things go wrong.

Q96 **Chair:** On the policy point, has this at all been a consideration?

Stephen Lovegrove: I am not aware that it has, and I think the reason for that is the peculiar terms and conditions of serving personnel who have to be ready to be deployed at a moment's notice. The quid pro quo for that is that housing is provided to a certain type of standard for them, pretty much regardless of where they are in the world.

Q97 **Chair:** It can be, but it is enshrined in their terms and service conditions rather than in law.

Stephen Lovegrove: Correct.

Q98 **Chair:** So there is no consideration to putting this on a legal footing.

Stephen Lovegrove: I am not aware that we have entered into a discussion internally about that. Clearly, the future accommodation model is a way of approaching the kind of question that you are asking: to have service personnel more fully integrated into the rest of the UK property market, either as a tenant or as a property owner.

Q99 **Chair:** That is not quite what I was asking.

Stephen Lovegrove: In terms of the MoD's arrangements with its serving personnel and the accommodation, we do not have that. I can write to you with further details if you would like.

Q100 **Chair:** If you go back and unearth that there have been discussions, it would be very helpful to know about that.

Stephen Lovegrove: I will do that.

Q101 **Sir Geoffrey Clifton-Brown:** Given that in the private sector, landlords are getting increasing stick for not keeping their properties up to decent homes standards, how many complaints a year are you getting from your service personnel that homes are not up to those standards? Is the number increasing or decreasing?



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Graham Dalton: I am not sure that I am recording complaints just for that reason. Figure 14 in the document shows the numbers of properties at the highest two conditions, which are at mid-90%. It shows that it is not correlating with satisfaction, which is also a function of rent paid, and maintenance and repair follow-up as well.

The complaints that we get tend to be for multiple reasons—not necessarily against the overall standard of housing, but for things not working or for things not being repaired in time. I have here targets on the help desk run by the maintainer: last month it was about 44,000 calls coming through to the help desk. Of those, 94% of calls were answered in time—within 50 seconds—and were followed through.

Level 1 complaints are relatively small numbers—from recollection they are a single-figure per cent. They are handled very promptly by CarillionAmey, our contractor, directly. If they are not resolved to satisfaction, the service personnel come back to us and we handle those independently. A very small number of those turn out to be upheld. If they are, we now have a compensation scheme in place for a voucher payment system for the inconvenience or disruption caused. That is about the service overall.

Q102 **Chair:** I don't want to go too far down this path, as we have bigger things to discuss, but we have covered a lot the concern that one service family were without a working boiler. It may not be that the whole property is problematic, but that was a big problem for them at the time. Carillion are not in CarillionAmey, because they no longer exist, so have you been able to use the opportunity to renegotiate with them about meeting their targets? However badly they perform, they still seem to survive and stay in position. When we looked at this last time, there was not really an incentive for them to improve.

Graham Dalton: Technically, it is still called CarillionAmey and the liquidator owns a part of it. The position is that that contract is either just above or just about hitting its contracted targets right the way through. That is what Defence agreed to contract on five years ago, at the time of the deficit. I completely accept that the lived experience does not meet expectation across the piece. In many of those cases it is about coming out to make something safe, which is not necessarily the same as fixing it. They are hitting those contract targets, so in terms of managing a contract and contract levers, they are meeting the contract specifications and we work with them to try to make it better and better. I do not have enforcement that I can put on them.

Q103 **Chair:** But if they were tenants, they would have more rights.

Graham Dalton: That contract is being taken over. We expect it to be taken over completely by Amey in the very near future. I spoke to Amey's chief executive only last week, who gave me a heads-up on where they are in that process, which is reasonably well advanced. I am satisfied that Amey can run it for the duration of this contract, which is less than two years. Our effort is going into successor contracts, and we are looking



closely at the specification for those. In the commercial strategy that I and my team have put together since I was last with you, we are looking at a different commercial strategy to go to the market, so that we do not have one single provider but two or three providers, or maybe even four packages across the country. Then you get not only contract benchmarks, but reputational performance; you drive up performance that way as well, and you have resilience in the event of contractor underperformance or failure.

Chair: If it works, that is heartening news, but it is still a way off for the people living in accommodation now.

Q104 **Sir Geoffrey Clifton-Brown:** Given that the people who live in this accommodation are pretty loyal sort of people, that they do not complain unless they are absolutely forced to and that they do not tend to complain outside their chain of command unless absolutely forced to, why are so many complaints still ending up in MPs' correspondence?

Graham Dalton: I can only surmise why. I recognise the very poor servicing period that many people went through, particularly in the first couple of years of the current maintenance contract. Once you've got a reputation like that it takes a long time to recover from it. I surmise that that seemed to be the route to go to. I certainly know that my accommodation team are absolutely tracking complaints. It is a benchmark in normal management reporting that they are worked through and that we take them seriously and look for the themes within them.

Q105 **Sir Geoffrey Clifton-Brown:** Lots else to cover, so let's start with one or two of the other aspects. You heard that the shareholder was concerned about the number of vacant properties. What can you do to bring that number of vacant properties down? It surely makes sense; at the moment, that 7,259 is roughly 20% of your total holding of 39,000. Is it really necessary for MoD operational reasons to keep that level of vacant properties?

Graham Dalton: No, it is not necessary to keep that level. We have declared a normal operational level of about 10%, which is much higher than something like a housing association would have, but we have a churn—a tenancy turnover of about 30% at a time.

Q106 **Sir Geoffrey Clifton-Brown:** So you could get that figure down from 7,259; you could halve it from 20% to—

Graham Dalton: There are a number of things that properties are vacant for. They are not all necessarily the same 7,000 houses. Of the order of half of them are in a cycle through and they will be vacant for a while, and the void ratio is a snapshot taken at the end of each month. That gives a number, but it is not necessarily the same properties. Some of them are. We are holding a few because of where they are; we have a number of properties that we do not need but are on operating bases, within the wire, so we are not able either to hand them back unencumbered or to sell them on the open market because of where they are. We are holding



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properties because we have the rebasing coming back from Germany and we know we will need them over the course of the next 18 months.

We are holding properties for the sites that we know will have greater concentration of personnel under the better defence estate strategy—the sites that are not being closed but are having units and functions put on to them. The nature is, whether we own the property or Annington own the property, or some other way, once we have given them back it is binary. There is a ratchet on it; the property has gone back and we cannot then recall it, so before we hand one back we have to be absolutely certain. I expect a trajectory that goes from just under the 20% you referred to down to around 15% over the next couple of years, but it will take the completion of the estate optimisation strategy to really know.

Q107 Sir Geoffrey Clifton-Brown: That varied. At the beginning of your answer you were saying you were going to get it down from 20% to 10%. You are now saying you are going to get it down from 20% to 15%.

Graham Dalton: The 10% is the routine operational part. That is the threshold that has been the presumption for a long time. The next group, up to the 15%, contains, if you like, the rattle space for estate optimisation, where I know I'm going to be putting extra people in, for the returnees from Germany and so on.

Q108 Sir Geoffrey Clifton-Brown: Even if you can get it down that 5%, that is still another £10 million or so that you would save in rent and maintenance, so why aren't you giving those properties back immediately?

Graham Dalton: As the permanent secretary said, for some of those it comes down to a straight, "Have I got the cash to spend now, paying dilapidations before I can hand properties back, or do I spend it on condition improvement of the properties we are letting to personnel?"

Q109 Chair: Can I take you back 20 years? This was Sir Richard Mottram, Mr Lovegrove's predecessor: "We have historically neglected the investment in our married quarters estate and we need to put that right... all the time we are identifying houses and putting them to one side to be upgraded." Nothing much has changed, has it?

Graham Dalton: I was not around the service estate 20 years ago.

Q110 Chair: But do you agree that, depressingly, that could be said today? It was said 20 years ago in the Public Accounts Committee.

Graham Dalton: These are not luxury homes; they are homes that we put service personnel in.

Q111 Chair: Everyone keeps saying that, and we are not suggesting that they are going to be luxury homes, but they should be decent.

Graham Dalton: We fitted 3,000 bathrooms and 3,000 kitchens last year. We spent £10 million on major capital upgrades, which includes external wall insulation—



Q112 Chair: You have done that, but my point was that Sir Richard Mottram was acknowledging a problem there. I grew up in Portsmouth; I knew people living in married quarters in the 1970s and 1980s, and they weren't good then. I don't know when there was a paradise, a wonderful moment when everything was perfect—perhaps the moment they were built. And we are still in a time of problems. We still do not have good-quality accommodation, and you still have this challenge, of course, that when you give it back, you have to pay the dilapidations, so no one is winning. The residents—they are not tenants—are not winning. The MoD is not winning. The taxpayer is not winning. The only people who win are Annington Homes when you do have to hand the properties back and you are paying the dilapidations figure. And we haven't even got into the full detail of the Annington deal yet.

Stephen Lovegrove: Chair, I do not disagree with anything that you have said. This is not a situation that any of us is remotely comfortable with. You heard, I think, from Annington and its shareholder earlier that the aim of the negotiation, to their mind, in the coming months is to—as I say, this is a very, very, very long-term deal. We must try to find contractual mechanisms that do not exist in the deal that was signed in 1996—contractual mechanisms that align the interests of the landlords and the tenants in order to be able to make a bigger dent in this problem than we have done to date. That is really at the heart of what we are trying to do at the moment.

Q113 Sir Geoffrey Clifton-Brown: Mr Lovegrove, you heard from Annington Homes that they want to provide more affordable housing. Surely it is a national scandal, when the nation is crying out for affordable housing, that you are sitting on these empty homes and doing nothing with them. Surely it ought to be a top priority, notwithstanding the dilapidations, that if you don't need them, you should give them back.

Stephen Lovegrove: Of course it is a priority. We have lots and lots of targets to contribute to the Government's overall affordable housing targets, and it is a priority, but there is a variety of things that we have to balance when we make those kinds of tactical decisions.

Catherine Little: Can I pick up on the financial and affordability point? There are two big financial risks that we are factoring into the financial baseline that supports the Modernising Defence Programme. One is obviously a range of scenarios for what might happen with rental adjustments. Of course, we don't know what the answer to that will be yet, but we have an idea of what the range might look like. The other factor is dilapidations. That 5% reduction that my colleague, the chief executive of the DIO, talked about equates to about £20 million, so there is just a practical thing about us factoring it into our affordability assumptions and into our financial planning.

I suppose the second thing is that in the negotiations that are currently taking place, we want to find a mutual benefit, for both Annington and us; and dilapidations—how we spread the cost and how we look at when we pay the dilapidations—is obviously an area that we would want to explore



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so that we can unlock mutual benefit, for both Annington and the Department.

Q114 Sir Geoffrey Clifton-Brown: Ms Little, you are very good at figures, so let me put this question to you. You have just given a £20 million dilapidations figure. You will save £5 million a year in rent and maintenance, so in four years you have paid the dilapidations off and you have no further liabilities. Surely that is a good deal by anybody's standards, but particularly when the nation is crying out for affordable housing.

Catherine Little: I entirely agree with you. You are also very familiar with the range of other things that we could spend that incremental pound on. Quite simply, in our financial risk planning we do not have enough money to pay for every single investment that we would like to make, nor to buy out all the financial risks that the Department faces, so we have to make prioritised decisions.

Having said that, £20 million, in the scale of our financial challenges as a whole, is not significant. It will be something we will look at as part of the modernising defence programme.

Q115 Sir Geoffrey Clifton-Brown: But it is just going to get worse, isn't it? The discount is going to drop and the rent, as we have heard, will increase. The liability for empty homes will get worse.

Catherine Little: I entirely agree.

Q116 Sir Geoffrey Clifton-Brown: So why don't you do something about it now?

Stephen Lovegrove: That is the purpose of the negotiation that we are having with Annington at the moment. It would be much better to enshrine in new contractual arrangements some long-term, properly aligned incentives and interests, and to allow that process to work through over a long period of time.

Sir Geoffrey Clifton-Brown: So let's talk about that, Mr Lovegrove. This is the heart or the meat of this whole discussion, if you like. You heard the Chair and me discussing with Annington Homes that there are lots of things that you can do between you to actually improve this deal, but it doesn't seem as though it is happening. Voids is just one part of it. What about estate rationalisation?

As a property man—I declare my interest as a chartered surveyor—I think there must be lots of opportunities, as I was describing to Annington Homes and as they were describing back to me, where the landlord and yourselves can actually operate together for mutual benefit. I would have thought that there could be hundreds of millions of pounds of mutual benefit.

Stephen Lovegrove: I hope that that is the case. I think you heard from previous witnesses that the relationship between the Department and Annington has improved greatly in the last couple of years. We very much



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hope that, during the course of the discussions, we can start making some progress on the kind of arrangements that were described. We initiated those discussions four years ahead of the moment at which we needed to start getting into this formally, in order to make the kind of difference that you suggest.

Q117 Sir Geoffrey Clifton-Brown: All of this stuff and all of these negotiations are predicated on good information. The NAO Report tends to indicate that you haven't got terribly good information on the state and condition of every single one of those houses, let alone the 511 sites. What are you doing to rectify that situation?

Graham Dalton: I think we have pretty good management data on each of the properties. We inspect them and check them each time the occupants change. The data we don't specifically hold is specifics around local market rental data. That tends to get refreshed every five years as it goes through a local rent cycle.

Sir Geoffrey Clifton-Brown: So you have good data on the state and condition of the houses. In this negotiation, you will need to have that local market rental data that you are talking about. Let's talk about the renegotiation, because everything else follows from the renegotiation, doesn't it?

Q118 Chair: Can I just be clear—are you talking about the wider rental market in the local area?

Graham Dalton: The rental market specific to the areas of each site.

Q119 Chair: So it is in the town, rather than behind the wire?

Graham Dalton: Yes.

Q120 Sir Geoffrey Clifton-Brown: I asked Annington whether they accepted that there would be a discount, and they said yes, there would be. The two of you will argue about the size of the discount. It is unlikely that it will be 58%, but it is also unlikely that it will fall to nothing, so it will lie between those two areas. How are you actually going to conduct this negotiation? The purchase agreement provides that every single site, if necessary, has to go to arbitration, which will clog up the arbitration courts for years to come. How will you actually conduct the negotiation?

Graham Dalton: As James Hopkins was saying earlier, I can confirm that we have been meeting regularly—every two weeks or thereabouts. We are trying to identify a mechanism by which we can get to a negotiated settlement that meets the MoD's needs and Annington's aspirations and that avoids the need to go through every single site on a site-by-site basis.

Chair: I think the NAO wanted to correct something. Mr Lonsdale?

Jeremy Lonsdale: I just wondered if we could explore the opening sentences of paragraph 4.8, where we say: "The Department does not currently have the information it needs to make choices about what to do with each of the sites."



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Chair: You just said, Mr Dalton, that you have good stock condition.

Jeremy Lonsdale: The first couple of sentences seem to be quite clear.

Q121 **Chair:** Was Mr Dalton one of the people who agreed the report, as well as Mr Lovegrove?

Graham Dalton: This is about choice of what to do with each of the sites. We know what the properties are. We are managing them, and we do an inspection at each handover. We know whether the property is of decent home standard—sorry to come back to that one—because if it is not, we do not allocate it to personnel. We do not then turn that into, and hold data for this at the moment, how that compares with local market rent. You might want to do that if you are going to make choices about whether you are keeping that or some hypothetical case of providing some other source of accommodation or housing.

Q122 **Sir Geoffrey Clifton-Brown:** So, Mr Dalton, if I was trying to negotiate with you the rent over an individual house, that would be the prime information. We would want to know what the state and condition of the house is, but we would also want to know what the other local comparables are. How are you going to be able to negotiate with Annington in the absence of that information, and what are you doing about getting that information?

Graham Dalton: At the moment, we do it by using what we call “beacon units”, which are single exemplars. Each year, for four years, we do a tranche. We have just come to the end of the most recent tranche. We identify the beacon units, compare those with market rent, and apply that to others on the site.

Q123 **Chair:** Comparing it with market rent now is all very well, but I don’t know if you do any comparisons with police housing—other housing that was owned by the public sector that has been sold off because there was a desire to rent privately in areas that are now so unaffordable, particularly below that line on the map that we were talking about earlier, that it is not sustainable in the long term. You could not predict that. We could not have predicted that—if we had, we would have all invested in that property no doubt.

There is a challenge there: you get rid of an asset, even if it is an imperfect one, under the current arrangement, you exchange it for private rented, and in the future those personnel will not be able to afford that private rented sector property. You are making comparison with today’s prices, but without any projections.

Graham Dalton: I am talking about the process within the agreement with Annington, because the MoD still takes the market rent risk. The discount is against the market rent. We do the assessment of market rent on sample houses. For the sites review, we will have to do it for all the houses, rather than just an individual one. Then the principle is whatever that discount may be. I am not sure it is capped; we are ambitious and we think we have a good case. You are right that that will be a very high volume of work. I think by the time we have got through the first handful



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of sites, a few of the principles will start to repeat across many others. I do not think it is quite as cataclysmic as it might sound.

Q124 **Chair:** Who will you be getting to do this work? Have you got an army of surveyors out there? Do you want them to knock on your door right now?

Graham Dalton: I don't at the moment, but if we have to trigger this from 2021, if we fall back to the default that is in the existing agreements, we will have mobilised a much larger team, and I will need to pay for it. It will be a mixture of staff and hired expertise.

Q125 **Sir Geoffrey Clifton-Brown:** As a chartered surveyor, I do not know how you are going to negotiate unless you do have this information. You know what the current rent is, and what the discount is, but without knowing what the proper open market, less the discount, rent is, I do not know how you are going to negotiate.

Graham Dalton: If it falls to the default—

Q126 **Sir Geoffrey Clifton-Brown:** But you're hopefully not going to default. You are all getting on so well together now, you are discussing all sorts of state rationalisation, giving back vacant properties and everything else to try to improve the deal.

Graham Dalton: Frankly, that is the nub of the discussion we are having at the moment. We do not have an answer—we certainly have not agreed an answer—on how we would do it that would satisfy us both.

Stephen Lovegrove: Sir Geoffrey, at this stage it is about extrapolating from the beacon units.

David Goldstone: Yes, we have the beacon property values, which are regularly established. We have all the condition information. I think there is an in principle discussion that is being held that can explore ways of reaching a future settlement that will avoid the need for the site-by-site from 2021 onwards discussion. What you are hearing from Mr Dalton is that there is enough information to do that and to get into that in the coming period. If we get into the site-by-site, we are going to need to resource up, but because that is 2021 we think we have got time to plan for that. We are not in that position at the moment.

Q127 **Sir Geoffrey Clifton-Brown:** This is a tricky question. You are involved in the middle of a negotiation, and it doesn't seem to me that you have built any additional money into the MoD budget to cater for an increase in rent or a reduction in the discount.

Stephen Lovegrove: As Mr Dalton said, we believe we have a very good set of arguments, informed by our experts, to say that the discount should be at least what it is at the moment, and higher. The nature of the discussions with Annington will be in part about that. No doubt they will be in part about many of the other aspects we have been talking about in this session and the preceding one. We certainly don't accept at this point that it's 38%, 0% or 58%. We believe we have got a good job.

Q128 Chair: But there's a range. You must have to be planning to fund the worst-case and best-case scenarios.

Catherine Little: To go back to what I touched on earlier, obviously we are trying to ensure we have contingency to manage as much financial risk as we can afford. One of the things we are calculating at the moment is the range. We can see what the worst-case scenario is, we have a very sensible offer of what a mid-point might look like from the NAO, and of course we will be developing our own views. My intention in our latest version of the financial plan is to assure ourselves that there is some contingency put aside should that risk materialise. What I alluded to earlier is that I obviously can't afford every single risk materialising in the worst-case scenario.

Q129 Chair: Can I be clear about this? Of course, there will still be risks that fall to the Department, but if the discount is different and there is a higher cost to the MoD, will that be passed directly to service families living in that accommodation?

Catherine Little: No, it won't. This year, we have put in place arrangements to delegate all other infrastructure budgets to our single services, but we have not done that with SFA and housing budgets, because we think it is right that the Department manages that risk.

Q130 Chair: Just to be clear, it is not that you will move to a higher rent at some point because of this. You will have a rent review, like the one that has recently happened, but will it be completely separate to the Annington negotiations and deal?

Graham Dalton: Rent for service personnel?

Q131 Chair: Rent for service personnel went up a few years ago after a long discussion, and there is a risk that the cost to the MoD of renting these properties will go up. Ms Little said it won't be passed directly to those service families, but there will be another future rent review. Surely those figures are not unconnected.

Catherine Little: Could I just clarify that? The additional cost, depending on where we end up with the rental adjustment, is of course a financial risk that the Department needs to manage. I believe there is an independent review of what rent is passed on to service personnel. That is conducted as part of the work of the armed forces pay review body. We would, of course, put forward evidence that will help to inform that decision. There are two processes: first, us managing the financial risk; and, secondly, how that might impact on service personnel.

David Goldstone: The Department has the risk of the delta—the difference between the two—and the net. Without getting into the detail of the negotiation and what happened, there are strong arguments for thinking that the underlying principles of why a significant discount applied in the original deal would still apply now.

There is still a very large estate with a Government covenant behind it—effectively the best covenant a contract could have. The MoD is still taking



a lot of the risks of managing and maintaining the voids and dilapidation—all the factors you talked about—on the current position. All those factors would still apply at the moment, but we might be able to negotiate a better, more aligned agreement, in the way you all described, that incentivises both sides to get better value out of it. For all those reasons, we think there is a genuine negotiation about the level the discount ends up at out of the negotiation. It is not foregone; it will come down.

Sir Geoffrey Clifton-Brown: Can I test with one of you—maybe Mr Goldstone, maybe Mr Lovegrove—how far and how wide those negotiations are going to go? It seems to me that you have got three essential factors. You have got the general rent you are going to pay, which encompasses the market rent and the discount; you have got the number of properties you might be able to hand back; and you have also got estate rationalisation. Would that estate rationalisation extend to negotiating about other land within the MoD estate so that the property owner could accommodate or accumulate realistic sizes of land to develop sensibly a number of affordable houses?

David Goldstone: On the estate optimisation programme that is under way, it was a programme that kicked off about 18 months ago with a 25-year profile through to 2040 to try and reduce the estate by about 30%. So we are 18 months into a 25-year aspiration to reduce the estate significantly. The principles about how we would rationalise and principles about the release and return of properties absolutely can be part of that negotiation over the coming months, as we have said. I think it is much less likely we will be in the position of saying, “Site A will be rationalised in a very precise timescale”, if only because as we get into estate optimisation we understand the detail better. Those sorts of proposals require reinvestment elsewhere to re-provide facilities, and the timing and sequencing of that to enable a site to be freed up and disposed of. Very often planning applications will be needed to maximise the value. The sequencing at an individual site level is quite complex. The principle of how we may well be able to do that in better partnership with Annington over time is the sort of thing I am sure we can explore in the way we have said that will better align incentives going forward.

Q132 **Sir Geoffrey Clifton-Brown:** You have three really big things going on in relation to the estate at the moment. You have got the families accommodation model renegotiations, the DIO negotiations, and negotiations with Annington. The three stars are not aligning—or are they? —so that you can begin to rationalise this estate and reduce the cost.

David Goldstone: It is worth mentioning the delegation of the budgets for the estates to the frontline command which, as my colleagues have said, is a really important change as well. That, within the defence family, puts the incentive in the right place for having an optimal estate for the capability requirements for the armed forces. That is the other factor. Putting the principle of delegation to the frontline commands as owners of their budget and owners of their estate is a really helpful development that is happening in parallel.



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Q133 Sir Geoffrey Clifton-Brown: Mr Goldstone, you didn't know, but for a very short period of my life I worked for Defence Estates, and I found that this type of arrangement was disastrous because the commanders on the ground did not have the commercial knowledge, and the knowledge of how to run housing, and they therefore made decisions that were uncommercial. So surely this change will be less financially advantageous than what you were doing.

David Goldstone: If that was the case, that would be true.

Q134 Chair: I think Mr Dalton described it earlier.

David Goldstone: I think Mr Dalton made the point that we have got a defence infrastructure organisation that is now established to provide that support and expertise, whose role will now be to support frontline commands in making those informed decisions and making those on the basis that, as far as we can, will be optimal to achieve the estate, and that is part of that answer.

Q135 Sir Geoffrey Clifton-Brown: Mr Dalton was very careful to say that he was an adviser, and we all know that advisers' advice can be overridden. If the commanders on the ground are the people who are going to take charge of this now, surely the commercial incentive—

Graham Dalton: As it stands, I am a monopoly provider of estate services. There is a very strict protocol that if one of the services, one of the commands, wishes to get something done directly itself, it has to be with my explicit agreement, and we have put in the technical and quality controls over it. This is about getting the decision making with a limited amount of money, and ownership by the user of the estate, on how that money is used to their best military advantage.

Stephen Lovegrove: It is, Sir Geoffrey, part of an incredibly important theme in the modernising defence programme at the moment, which everybody at the table is very seized of, which is functional leadership across Defence. We want to make sure that there are procedures, standards, professionalisation and approvals, all of which are shared and enforced across the whole of Defence, by and large driven to a certain extent from the centre, without trying to tread too much on the principle of delegation. The two areas that we are going for first are the financial profession and the commercial profession. The kinds of concerns that you outline are very real to us. We are very conscious of the danger of allowing local commanders to run riot. We are building in right across the whole of Defence, in a variety of different disciplines, the kind of controls that you would expect.

Catherine Little: If I could just emphasise—I mentioned that this was a transition year—because of all of those risks, we are managing affordability and the skills risk, and making sure that we have the capability, the governance and the decision making to manage how we transfer those delegations in practice. Every month, we are obviously keeping a very close eye on how that is working. We have got our first quarterly review of the infrastructure delegation's process coming up in



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June. This is not something we have done lightly. We think it is the right thing to do, but it has been handled and mitigated, I think, carefully.

Q136 Sir Geoffrey Clifton-Brown: This Committee will obviously be taking a close interest in these subjects. May we get an idea from you about time lines? First, on the renegotiation, what is your expected time line to have done that?

Stephen Lovegrove: I think this goes to the previous questions you were asking. If we are not in a position where we can feel confident that we can get to a comprehensive agreement, we will need to start putting in place staffing arrangements that would allow us to successfully discharge our obligations underneath the much more onerous site-by-site process.

Q137 Sir Geoffrey Clifton-Brown: So what's the time line on that?

Stephen Lovegrove: My feeling on that is that that will be roughly the middle of next year—I would not like to put timing pressure on myself in a negotiation, but putting those in place will not be an absolute—

Chair: Absolutely. We understand.

Stephen Lovegrove: It's not going to be an absolute time—

Chair: No civil servant ever gave us an absolute time, but we understand in this case—

Q138 Sir Geoffrey Clifton-Brown: But it is an important time because you have to move to the next stage of the negotiation. You are saying that if you have not reached a certain milestone by this time next year or a little bit more—15 months' time—you will need to move to the next stage of the negotiation, which is for Mr Dalton to employ more staff.

Stephen Lovegrove: We will need to put in arrangements to resource—anticipating this 18 months away—comprehensive site-by-site rent review. It would need resourcing to put in place, so we would start spending money one way or another, whether recruiting, or contracting or procuring advisers and so on, to make sure we are properly resourced, to have equal firepower on either side of the table if we get into rent reviews.

Q139 Chair: But equally, as Sir Geoffrey has highlighted, you might need people who will be able to discuss site swaps or other land purchases in a vicinity. So there will be a degree of site-by-site discussion anyway. There is a danger—a reality, I suppose—that if you look at it across the whole of the piece, there might be some sites that on the face of it seem to be at a discount because there is a deal done on that, versus the discount on the rent, versus another site. How are we going to be able to keep an eye on it, from our perspective, so that you are not selling the taxpayer or service families down the river and that you are, overall, getting good value? If you do do a land swap, it won't all necessarily be on the same date at the same time.

David Goldstone: No. When I said we need to resource up maybe, as the permanent secretary said, from the start of that process, the middle of



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next year, that is not to say that we haven't got a comprehensive team in place for the stage of development that we are at at the moment. We have got the in-house team. We are supported, as we have said, by UK Government Investments in relation to the financing aspects, and by an extensive team from Jones Lang Lasalle in terms of property advice, and we have legal advice engaged. So if there are site-specific issues or approaches to sites, we have got the appropriate expertise to draw on during that negotiation, effectively cliented from the Defence Infrastructure Organisation, with in-house knowledge as well.

Q140 Chair: How would you keep an eye on the money? If a site is sold—to do a deal on the rent, you sell off some sites at lower than you might get if you put them on the open market—is that something that might be in your negotiation?

David Goldstone: Individual deals would obviously have to get approved. We would have to be satisfied of value for money, that we were managing public money—

Q141 Chair: You can't reveal your negotiating hand, Ms Little, but "Managing public money" is a public document and I am sure Annington has already been crawling all over it. What room for negotiation have you got? When we were discussing this, we were wondering whether there will be any arguments about procurement rules, preferred bidder status or anything like that.

Catherine Little: At this stage, "Managing public money" and the procurement rules give us the wiggle room that we need. The key for me is how we go about assessing value for money in the round when—your point—there will be parcels and this will be done throughout a period of time. It goes back to some of the basic principles of pay-back periods, return on investments—good old sound investment decisions. We haven't yet agreed at what level that will happen in the Department, but I think that given the complexity and importance of the subject, it is likely that the Investment Approvals Committee will take oversight of it.

David Goldstone: It is worth saying that the DIO is an operating part of the Department. It is not completely separate, so those decisions will be part of the normal Department approval.

Q142 Chair: You could argue that they have you over a barrel: they own it; you have the lease. They are coming up with their figures already, of 38% discount rather than 58% discount. You have this rather optimistic 80% out there; we are not quite clear where that has come from. It is your figure, but I do not know if there is anything behind it—you might want to tell us that in a minute. What real clout do you have? In the end, you have to do a deal; you have a deadline after the first 25 years.

Stephen Lovegrove: Two observations: we are absolutely determined to get the best deal that we possibly can for the Department, the taxpayer and the serving men and women.

Q143 Chair: That's what they said 22 years ago, although one member of the



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Committee highlighted that your predecessor, the former permanent secretary, many times hid behind ministerial decisions and that, "one is left with the impression that at the time your Ministers were a cross you had to bear"—I am sure you won't be drawn on that.

Stephen Lovegrove: I certainly do not echo that view.

Q144 **Chair:** That was Mr Williams on the Committee, and he continued, "and today they are a shield you are glad to shelter behind. I have never heard you refer to Ministerial decisions so frequently before." Do you have the freedom to make decisions that will be better than those made last time?

Stephen Lovegrove: We will do the absolute best that we possibly can in this negotiation, recognising that, in my opinion, this is a flawed deal and has not been a good deal for the taxpayer. This is our opportunity to try to get it better. I hope you will forgive us if we do not reveal in front of the Committee all our negotiations.

Q145 **Chair:** It's all right; we'll have you back.

Stephen Lovegrove: Exactly, ex post facto. We fully expect to be quizzed very closely on what we have managed to negotiate, in what in hope will be the next year. I hope we do not get into the site-by-site negotiations.

Q146 **Sir Geoffrey Clifton-Brown:** Can I try to tie down these tight timelines? We have a timeline on the negotiation and when you need to recruit staff for that. You also need to recruit staff on the DIO side. What is the timeline for that process to be completed?

David Goldstone: Mr Dalton said at the start that we are managing a phased transition from the existing arrangements, to bring in a civil service-employed senior team at DIO. A lot of progress has already been made on that. We are deliberately doing that in a phased period over the next few months, so that there is no disruption to the ongoing business. We have existing arrangements that are working perfectly well in the existing set-up. I think there are about 11 posts currently provided under the contract. We will replace those progressively over time.

Q147 **Sir Geoffrey Clifton-Brown:** So what's the timeline?

Graham Dalton: By the end of June 2019.

David Goldstone: June 2019 is when the contract expires and we will have it all completed in that time.

Q148 **Sir Geoffrey Clifton-Brown:** It is about the same sort of timeline as needing to make decisions on the negotiation team. The two things tie in together.

David Goldstone: We said that it is around there, but it is not precise. The third contract is a very precise date.

Q149 **Sir Geoffrey Clifton-Brown:** The third thing going on is the future accommodation model, which you need to consult on and discuss with



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MoD families. What is the timeline on that?

David Goldstone: The decision to take that forward was made at the end of last year. Effectively, pilots are being launched towards the end of this calendar year. Those pilots are likely to go on for about three years. That is going on in parallel with whatever process we proceed with with Annington, and it has multiple benefits that are not only about the conversations we are having here about the Annington deal.

The model is about opportunities to give service men and women greater choice, more options and greater flexibility, to effectively access the benefits of the wider market, which generally they do not. It may well have financial benefits and in time reduce our demand for properties under the Annington agreement, but there are major benefits in terms of the offer to service personnel that we anticipate. That is subject to pilots that are being taken forward later this year. They will run for a period and the firm decisions about how it is taken forward are down the track.

Q150 **Chair:** We began to look at that; in fact, I think the National Audit Office drew inquiries from Members at the end of 2016. We are now in the middle of 2018 and pilots have not even started yet. We have been watching this quite closely, as you might be aware. The future accommodation has been very slow going.

David Goldstone: Like others, I have arrived relatively recently since the original decisions were made. But this is quite novel, and has a number of implications regarding the offer to service personnel. There are a lot of financial consequences in terms of potential—

Q151 **Chair:** But it is pretty critical to your discussions you are having with Annington. It is absolutely vital. You can assume a future accommodation model is going to deliver people buying as owner-occupiers, but when they move to different bases they will still need accommodation. That model can be assumed to work, but it might not. If property prices in certain areas increase beyond the reach of a basic soldier, there will still be a problem. What are you doing to project all these issues—cost, flexibility and desire? It may be that a general can buy a house, but a squaddie cannot.

David Goldstone: I don't think it was ever anticipated that the timescales would completely align in the sense that we would have a resolution about FAM in advance—

Q152 **Chair:** Was it never anticipated, or was it just not thought through enough, so that the model arose completely separately?

David Goldstone: The point is that we will have the negotiation with Annington in the way that we have discussed, and that will have an outcome and we will have an ongoing view about the level of discount on market rents. That may well inform what happens. If it moves in a certain direction, it may be that the benefits and value-for-money case for FAM are increased—or not. That work will inform how we take forward FAM, rather than FAM having to be resolved beforehand. We don't feel that that is a constraint to either taking forward the negotiation with



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Annington or progressing with pilots on the future accommodation model. We will have the negotiation on the estate as it is. FAM is only being piloted. There is uncertainty about how that goes forward, and there are a lot of consequences in respect of the accommodation offer and the financial issues that will be worked through before there is a firm decision.

Q153 Sir Geoffrey Clifton-Brown: I am struggling with your answer, Mr Goldstone, because it seems to me that almost whatever happens in the Annington negotiations, you ought to be doing the right thing by your servicemen. Whatever that right thing is—whether it is giving them subsidised mortgages so that they can go off and buy their own homes, or allowing them secure tenancies on their existing MoD homes because they have to move around the world from base to base—it seems to me that the service personnel get the rough end of the deal in all this.

David Goldstone: As I think I said at the start of my previous answer, I think FAM is being introduced to improve the offer to service personnel. It is the benefits around choice, flexibility and the range of options that would be available that are driving the introduction of FAM. It may well have financial benefits as well, and it may well have consequences in relation to the Annington agreement, but its core objectives are about the benefits to service personnel. In a way, the question you are asking is, “Should we have thought of it previously?” Maybe we should, but it has been thought of now and it is a proposal that is being taken forward into pilots later this year, for all the good reasons you have just described.

Stephen Lovegrove: It would be entirely fair to say that, over the coming period, we have some quite complex projects that we are taking forward in the built infrastructure of the Ministry of Defence. We are going to have to exercise quite a high level of management skill to make them all land correctly.

Q154 Sir Geoffrey Clifton-Brown: How can I have confidence in anything you are saying today, since you have had 22 years of this deal and it has been managed pretty disastrously? How can I have any confidence going forward that things are really going to improve?

Stephen Lovegrove: I would reiterate what I said at the beginning. I think that the deal that was struck in 1996 did not—and could not—align incentives between Annington and the MoD. This is our opportunity to recognise that fact and put in place contractual arrangements that do so, for the rest of the 180 years that this deal has to run.

David Goldstone: Can I add another point? I got involved in large commercial transactions in government relatively soon after the Annington agreement was reached. The transformation in the capacity of major Departments such as the MoD, and the Government corporately in the commercial space, I think means that things today are completely different from then. You have heard about the work that is happening in MoD. It is a big part of our modernising defence programme to re-strengthen again the commercial function, which is already much stronger than it would have been at that time. That is part of what is happening



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across government around commercial organisation, which is much stronger, has much more commercial expertise brought in and is much more co-ordinated across Departments. It is a major strand around the functional leadership push we are making, and I think we have much more capability than what I saw 20-odd years ago when I first—

Q155 **Chair:** I think we would acknowledge that there have been improvements since 20 years ago, but you are still in the middle of a bad deal, and you are trying to negotiate a better deal.

Sir Geoffrey Clifton-Brown: I don't know whether you were in the room for the previous panel.

Chair: They were.

Q156 **Sir Geoffrey Clifton-Brown:** You heard the previous panel say they have got an entire file of opportunities they tried to negotiate with the MoD, and they were rebuffed every time. About the only one that has ever got anywhere is this project at Witney. How can the Committee have any confidence that this will change?

Stephen Lovegrove: This team that you have in front of you has been in the Department for two years. Annington also said that, in the last two years, the relationship has improved beyond all measure. That should be something you can take at least some comfort from.

Q157 **Chair:** We are very hot on accountability, and it's a bit depressing to read our report and the NAO Report from 20 years ago. Apart from two exceptions, none of you were there, and you won't be here in 20 years' time. When you go home at night, Mr Lovegrove, do you worry about this? Do you worry about getting it right? Do you think about what the consequences are? Are they weighing on your conscience?

Stephen Lovegrove: Yes, absolutely. I joined the civil service in 2003 as one of the first members of the Shareholder Executive. The reason why the Shareholder Executive was set up was to be able to do this kind of deal better than it had been done in the past. The Shareholder Executive is now UKGI, which has an embedded unit in the Ministry of Defence. That is my initiative, as are many of the other appointments around this. I am absolutely determined to do the absolute best we possibly can for the taxpayer and our serving men and women. There is a slight sense of "Well, you wouldn't start from here"—

Q158 **Chair:** Certainly—an understatement.

Stephen Lovegrove: We agree. But do I worry about doing the absolute optimum we can collectively as a team? Yes, I do.

Q159 **Chair:** So will you have these deals, like at Brize Norton, where you demolish properties but still pay rent on them?

David Goldstone: We would certainly like to align incentives better, so that sort of situation—

Q160 **Chair:** Hopefully that is a way of saying yes, you won't be doing this any



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more.

David Goldstone: Of course.

Q161 **Chair:** You are using big words to say simple things. You have also got a site with 80 properties that have been left empty since 1996, which you are still paying for.

Graham Dalton: Since I found out, I have been round there and seen the site. There are reasons why it has been like that for a long time. It was in the middle of a former base, which was closed. It was effectively landlocked inside a redundant, mothballed RAF base. That development is now building out and is part of the discussion with Annington. We haven't progressed very far on that one, but we are looking at the options, with Annington or independently, about what we will do on that site, first, for basic liability, but also to address the wider opportunity—this comes into spend to save—to invest to provide better-quality accommodation for service personnel who have to work in central London, at a lower cost to Defence. That is the sort of initiative I want to put forward.

Q162 **Sir Geoffrey Clifton-Brown:** Mr Lovegrove, you made great play earlier about the dilapidations bill that you might have to pay. I referred to Ms Little on the figures. There did not seem to be an overwhelming desire in the negotiation to sort out longer-term liabilities by doing a short-term negotiation—the sort of the things that I was talking about, such as giving up the properties. Can I be absolutely assured that in these negotiations things like continuing to pay rent on ghost houses that no longer exist will be negotiated out, and that, whatever it costs, you will just deal with it and move on?

Stephen Lovegrove: We will certainly seek to address those things in this negotiation.

Q163 **Sir Geoffrey Clifton-Brown:** That's great. Final question for you, Mr Dalton: can you assure us that your management structures will lead to fewer complaints about housing to Members of Parliament?

Chair: There's a new KPI for you.

Graham Dalton: I will do my utmost. My head of accommodation is not very far from me in this room, and she will be noting it down to help me to achieve that.

Q164 **Sir Geoffrey Clifton-Brown:** So I shall put down a PQ in a year's time and ask how many complaints there have been.

Graham Dalton: I'll take that as a legitimate challenge.

Q165 **Chair:** You will certainly be hearing from us if there is a problem, through this Committee or otherwise. I should just quote here Dr Andrew Murrison, the MP for South West Wiltshire. When I was asking colleagues what they felt about it in their area, he summed up the issue by saying, "It was a rotten deal that has enriched a few businessmen at public expense, and to the detriment of service families." We are heartened by your comments about the way forward. I just wanted to ask a couple of



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very specific questions on some particular points. On water bills, has the MoD stopped people getting water meters in their homes? Or do you try to charge them? Mr Dalton, do you know anything about this?

Graham Dalton: I'm not sighted, so—

Q166 **Chair:** In Kirton-in-Lindsey near Scunthorpe, there has been an issue where service personnel can request water meters, but the MoD, I think, wants to charge something like £700 to have one installed. It may be Severn Water—

Graham Dalton: I'm not aware of that particular case. Water to the service house is generally provided through a PFI contract.

Q167 **Chair:** And service charges—we have had a bit of evidence about that. Obviously sometimes there will be shared areas that require servicing. Is it a common approach to have service charges on top of rent, or is that normally something that the MoD would expect to pick up when it is on a defence estate?

Graham Dalton: I think common areas are maintained at MoD expense. The rent is paid in accordance with the schedule of charges for the accommodation: as ever with the principle, there is often the odd one—

Chair: It is just that someone had asked me specifically about those points, and I thought that while you are here in front of me, I would ask about them.

Sir Amyas Morse: Can I just go back to your first answer? As your voice died away, I heard the words "PFI contract". Are you saying that putting in a water meter might be charged as a variation on a PFI contract? Is that why it might cost a lot of money?

Graham Dalton: No, I am saying that water and sewerage is provided under three PFIs with Aquatrane. I do not know what the schedule of charges is, and I do not know the circumstances of that—

Q168 **Chair:** Will you write to us on that?

Graham Dalton: I would be very happy to provide that—

Q169 **Chair:** If what the Comptroller and Auditor General is suggesting is the case, that is pretty shocking.

Graham Dalton: We are not dealing with a normal water company arrangement, and of course we need to—

Q170 **Chair:** But the danger is that it is like putting a bit of grey paint on a ship—it costs a lot more money. Put something behind the wire and suddenly the cost goes up.

Graham Dalton: But we should also make sure we are not doing something that will then encumber a subsequent occupant of the building that they may not wish to follow through—it is in the interests of all the occupants, not just one.



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Chair: Certainly for the family accommodation, I can see the arguments both ways.

Thank you very much for your time. As ever, the transcript will be up on our website in the next couple of days uncorrected. Have a good look, because I am sure both sides of the negotiation will be reading it with a fine-toothed comb—factual corrections only. Our Report will be coming out in due course, but given where the negotiations are at—or are not yet at—we will obviously be returning to this. We will be expecting updates every time you are in front of us, Mr Lovegrove, but we will probably have a separate hearing to update us on this issue as well. Thank you very much indeed for your time.