

Review of Westgate Redevelopment

Oxford City Council

Audit 2006/07

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Introduction

- 1 Oxford City Council is in the final stages of negotiating a deal with a private sector partner, the Westgate Partnership, which will result in redevelopment of the Westgate Centre. The redevelopment forms part of the wider plan for the redevelopment and regeneration of the City's West End.
- 2 The Westgate Partnership will surrender its existing lease and provide additional land to the Council. The Council will then grant a 240-year lease on the land. Once the conditions specified in the development agreement have been met, the Westgate Partnership will use the land for the development of retail and residential units and the provision of a redeveloped car park. In return, the Westgate Partnership will pay the Council an annual rental. The lease and associated agreements will:
 - meet a number of the Council's strategic and operational objectives;
 - provide the Council with an annual income stream; and
 - remove the Council's commitment to maintaining car parks.
- 3 The redevelopment was originally proposed in 2000 and plans were submitted. The application was withdrawn in spite of a High Court decision which overturned the Secretary of State's decision to reject the plan. The current master plan was submitted to the Council on 8 September 2004.
- 4 In November 2007, Executive Board accepted officers' recommendations which included granting authorisation to the Chief Executive to complete the Conditional Development Agreement (CDA), building agreement, head lease, collateral warranties and construction contracts which will establish the framework for the transaction and the subsequent development. The CDA was signed in December 2007. The agreement will become unconditional once a number of pre-agreed conditions are satisfied.
- 5 Given the nature and significant value of the transactions concerned and the legal decisions which the Council is required to make as part of this redevelopment, it is critical that:
 - adequate and appropriate project management arrangements are in place;
 - arrangements for considering the financial and legal implications of the project are robust;
 - decision making processes are robust; and
 - adequate and appropriate evidence is retained.

Background

- 6 Our Audit Plan for 2006/07 indicated that we would undertake a review of the Council's arrangements in respect of the Westgate redevelopment to ensure that:
- proper governance arrangements are in place;
 - arrangements are in place to ensure compliance with the Council's duty to achieve best value; and
 - the Council has adequate arrangements in place to manage and minimise its exposure to the risks of the project.

Scope and objectives

- 7 This project cuts across most of the areas of responsibility set out in the *Code of Audit Practice for local authorities (the Code)*. It is not, however, part of our role to provide advice or to act as advisers. The public sector audit regime as set out in the *Statement of Responsibilities of Auditors and Audited Bodies* requires that auditors should not, nor appear to, compromise their independence.
- 8 We will review and assess the adequacy of the Council's arrangements for:
- ensuring good governance eg project management, decision making process, considering the legality of decisions;
 - ensuring compliance with the general duty to achieve best value; and
 - managing the financial and other risks to the Council.

Audit approach

- 9 Our review involved:
- meetings with key personnel involved in the project as identified by the Director of Finance and the Strategic Director (Physical Environment); and
 - a review of key documents including reports to and minutes of the Executive Board and the Audit and Governance Committee, minutes of the Westgate Working Group, the brief for offer, guidance to members on participation in the planning decision and the risk matrix for the project.
- 10 This report considers the Council's arrangements for ensuring that the project is adequately managed and that the key risks have received appropriate consideration.

Main conclusions

- 11 The Council has established a project team supported by external consultants and a working party involving councillors to manage the project. However, because this project was unusual, it did not follow a formal project management methodology. The project was not subject to a high degree of external scrutiny and this has placed a high degree of reliance on the Council's reporting and governance mechanisms.
- 12 Project risks were considered in reports to Executive Board, but no formal risk management process was established. This omission could have left the Council exposed and is a shortfall which should be addressed for future projects.
- 13 The deal negotiated by and on behalf of the Council has protected income streams for the short- and medium-terms. However, the Council will need to establish internal management structures to ensure that income streams are optimised in the longer term. The Council should also plan to meet future commitments to major refurbishment works. The Council established arrangements by which its external adviser provided an assessment of the value for money of the proposed agreement.
- 14 The remainder of this report addresses the issues noted above in more detail.

Project management

- 15 The Council established a small internal project team comprising officers with skills in property, legal and financial issues. The project sponsor was the Strategic Director (Physical Environment) and the project manager is the Finance and Asset Business Manager. This team has been involved in negotiations with both Westgate Partnership and potential tenants including the John Lewis Partnership.
- 16 It was intended that all staff involved in the negotiations would be involved after the development framework was signed, but the Strategic Director has left the Council. It is important that the Council retains understanding of the agreement. This can be achieved through staff continuity. However, it would be more practical to provide 'route map' summarising the key terms of the CDA and the other framework documents.

Recommendation

R1 A 'route map' should be produced to ensure that the Council retains an understanding of the documents which establish the framework for working with the private sector partner.

- 17 To supplement internal skills, the Council appointed external advisers including:
 - CB Richard Ellis (CBRE) (financial and property advice);
 - Lawrence Graham (legal advice); as well as; and
 - other specialist advisers in specific areas eg property interests (Terraquest).
- 18 CBRE's was initially made in January 2000. However, when the project did not proceed further, no call was made on their advice. In November 2004, Executive Board confirmed CBRE's continued appointment. The appointments of other advisers were made in line with formal tender procedures.
- 19 The Executive Board on 1 November 2004 accepted a recommendation to establish the Westgate Working Party. Members of this group include officers on the project team, members and external advisers. The group was chaired by the Strategic Director (Physical Environment).
- 20 The Council's external advisers have been given considerable freedom to operate during negotiations with the Westgate Partnership. However, their work was directed and overseen by the Westgate Working Party and was conducted within a framework established and approved by the Executive Board including a Brief for Offer issued in May 2006 and Heads of Terms agreed in September 2006.
- 21 Since this project is effectively a 'one-off' the Council has not followed a formal project methodology. There is no formal project plan and no formal timetable as many aspects of the redevelopment are outside Council control, such as the progress of property negotiations by Westgate Partnership and the resolution of transport issues which have been the subject of negotiations between the private sector, the County Council and the Department for Transport. However, project progress has been monitored by officers and the Westgate Working Party. The Council has been made aware of progress on the project by reports submitted to the Executive Board at key stages during the process.

Governance

- 22 Since the redevelopment was restarted in 2004, the project has been the subject of a number of reports to the Council's Executive Board. These reports mainly related to key milestones when authorisation or approval was required. For example:
 - in September 2006, the Executive Board was asked to accept the Heads of Terms which were intended to set out clearly the legal and financial responsibilities of both the Council and the Westgate Partnership. The Heads of Terms document was not formally binding but provided a framework for the detailed negotiations which followed;
 - in October 2006, Executive Board was asked to authorise the Council's lawyers to draft the legal agreements and contracts based on the Heads of Terms;

- in November 2006, the Executive Board was asked to confirm that the Council was prepared to use a Compulsory Purchase Order (CPO) to facilitate the acquisition of land interests necessary to consolidate the site; and
 - in November 2007, the Executive Board authorised the Chief Executive to complete the CDA, building agreement, head lease, collateral warranties and construction contracts.
- 23 The Westgate redevelopment is unusual amongst the schemes in which the Council is involved both in its scale and the nature of the Council's involvement. The Council is both landlord and planning authority. The Council made significant efforts to avoid conflicts of interest between these two functions including issuing guidance to officers and members and ensuring that members were not involved in decisions in respect of both functions.
- 24 Legal issues have been considered in reports to the Executive Board. The Council has ensured compliance with relevant laws and regulations through the involvement of members of the internal legal team on the project and by appointing and consulting specialist external legal advisers, Lawrence Graham. Lawrence Graham provided a letter in September 2006 which confirmed that the Heads of Terms formed 'a satisfactory basis for drafting and negotiation of detailed legal agreements between the parties.'
- 25 In November 2007, Lawrence Graham confirmed that the changes to the Heads of Terms as reflected in the CDA had been accurately reported to the Executive Board and that the CDA as agreed was 'acceptable to Oxford City Council' and recommended that it should be approved for execution.
- 26 Other than review by the Executive Board, independent scrutiny of the project has been limited. In August 2006, the Audit and Governance Committee received a report by the Finance and Asset Management Business Manager which set out the governance issues relating to the Westgate redevelopment. However, there has not been an independent review of the project management or governance arrangements, for example by Internal Audit. Such a review would have provided the Council with assurance that project management arrangements were robust and operating effectively. It would also be worthwhile for the Council to conduct a Post Project Evaluation of the Westgate redevelopment project in order to identify any lessons in respect of governance and project management which could be applied to future projects.

Recommendations

R2 The Council should ensure that project management and governance procedures for future projects are subject to independent review.

R3 The Council should carry out a post project evaluation of its involvement in the Westgate redevelopment project in order to identify any lessons which could be applied to the governance and project management arrangements of future projects.

Risk management

- 27 Key risks in respect of the project have been considered in reports to the Executive Board. The risks considered include the financial impact of the transaction, the impact of default by Westgate Partnership and the impact of 'show stoppers'. Each risk is mitigated to arrive at a conclusion on whether the risk is significant.
- 28 However, the Council's arrangements for evaluating and managing significant financial and operational risks could have been better developed. There is no single risk matrix for the project. The financial impact has been quantified for some risks but not all. It is not apparent how likely the risks are to materialise. Nor is it clear whether the mitigation reduces or removes the impact of these risks.

Recommendations

R4 Officers should identify and document the ongoing risks to the Council resulting from the Westgate redevelopment and the Council should ensure that the implications receive due consideration.

R5 A risk matrix should be drawn up for all future projects including the significant risks, their potential impact and the likelihood of them occurring. Mitigating factors should be explained and the residual risk established. The risk matrix should indicate responsibility for any relevant actions. The matrix should link to the Council's overall risk management processes.

Impact on financial standing

- 29 During negotiations, the Council has worked to ensure that its financial position is protected by negotiating a minimum income guarantee. In 2005/06, annual income from the existing Westgate shopping centre was £449,000 and gross income from car parking was approximately £2.6 million. Together, these amounts represented approximately 2 per cent of the City Council's gross income. During the construction period, which is expected to last nearly four years, the Council will receive a guaranteed annual income of £3.25 million indexed. This amount is consistent with current income from car parking and ground rent on the existing shopping centre. It should also be noted that once the conditions of the development agreement are met, the Council will cease to be liable for maintenance on the existing car parks on the site.
- 30 Once the retail units are operational the Council will receive 10 per cent of rental income, but the guaranteed minimum rental of £3.25 million will continue for ten years. Given that the centre will provide additional retail space and that retailers are keen to move into Oxford, it is possible that the Council's share of rental income will exceed the minimum guarantee.

- 31 In September 2006, CBRE considered the terms of the agreement and recommended 'that Oxford City Council proceed[ed] with the transaction as outlined in this letter'. In November 2007, the adviser reconsidered its advice in the light of revised terms and altered financial climate and recommended again that the Council should proceed.
- 32 To protect the Council's interests, a shop letting agent will be appointed by the Council at Westgate Partnership's expense. The letting agent will be responsible for ensuring that rental income is optimised, not necessarily maximised. The Partnership has also agreed to adopt 'open book' accounting for the redevelopment to allow the Council access to relevant financial records.
- 33 Although the Council will be able to call on specialist external advice in respect of shop lettings, this advice will only be available for the initial letting period of two years after completion. The Council should establish a client management function to ensure that it continues to receive the appropriate level of income from the redeveloped scheme. This client function should be supported by systems for monitoring the receipt of expected income and accounting for rental income to ensure financial reporting is accurate.

Recommendation

R6 The Council should set up formal arrangements for monitoring and managing the relationship with the Westgate Partnership and for monitoring and recording income received.

- 34 Officers stated that delays in the progress of the scheme did not have an impact on the level of income received because income continued to be received from the existing scheme and because once the redevelopment commences, the Council's income will be guaranteed. It is possible that more timely progress may have resulted in an earlier transition to the operational phase during which higher income levels are possible, but the impact has not been quantified.
- 35 Minimum income guarantees will protect the Council's income in the short- and medium-term. The Council is not expecting to issue 'pump-priming' funds to the developer, but it will have to make a commitment to fund maintenance requirements. Minor improvements will be funded by a deduction from gross rental income. A sinking fund, also financed by deductions from gross rental income, will be established to finance more major alterations, but any unused balance will revert to the Council after 20 years, when it will be expected to contribute to major refurbishment works. This is a reasonable requirement, given that the Council will be protecting its ongoing investment in the premises.

Recommendation

R7 The Council should consider how funds will be set aside to meet the requirement to contribute to major refurbishment works after 20 years.

- 36** The CDA includes a provision that the Council will share any 'profit' on capital value of the development above 6.25 per cent of developer's threshold - the value of the annual net income as a proportion of development costs. The Council's advisers consider it is unlikely that the developer's return will exceed this level. However, the Council will benefit from an increase in the value of its capital assets from the current level of £9.75 million shopping scheme and £14 million for the car park to an estimated £60 million for the redeveloped scheme.
- 37** The Council has received £750,000 from Westgate Partnership to fund project costs and in particular the costs of external consultancy support required by the Council. In September 2006, the Council confirmed that it would use its powers under section 122 of the Local Government Act 1972 to make a Compulsory Purchase Order (CPO) to acquire the remaining property interests and therefore facilitate the redevelopment. The developer has agreed to indemnify the Council against any costs incurred in applying the CPO, including the acquisition costs of any properties purchased.

Accounting

- 38** Once the transfer agreement is confirmed ie it becomes unconditional, the Council will need to account for impairments on existing assets and for the acquisition of new assets. Officers have considered the disclosures necessary for accounting for these transactions but the final valuations will not be available until the transfer takes place. The timing of disclosures should also be considered, whether they impact on 2007/08 or future years.

Recommendation

R8 Officers should prepare draft disclosures and discuss them with external audit at the earliest opportunity.

Option appraisal, strategic fit and value for money

- 39 The Westgate redevelopment is the key project in the wider redevelopment of the City's West End. The Council has considered how this scheme fits with its strategic and operational objectives. When the redevelopment was considered by Executive Board in November 2004, it was put in the context of the Council's vision of:
- improving the living and working environment;
 - making Oxford a safer city;
 - providing more affordable housing;
 - creating local prosperity and sustaining full employment;
 - improving transport and mobility; and
 - maintaining financial stability.
- 40 The Council considered a range of options for the Westgate site including 'do nothing', partial development and redevelopment of the whole site. The whole site redevelopment option was preferred because it offered greater scheme viability and met more of the Council's objectives. Given the selection of this option, it was unlikely that there would be more than one bidder, because the Westgate Partnership held a 150-year lease on the existing centre (expiring in 2136) and because it owns other interests on the site. Therefore, on 1 November 2004, the Executive was asked to confirm the decision made by the Strategy and Resources Committee on 7 September 1999 to proceed with negotiations with a single private sector bidder.
- 41 Given that there was only one bidder, it was critical that the Council established arrangements to confirm that the agreement represented value for money and that best consideration had been received in return for granting the long term lease on the site. The Council's case is set out in the report to Executive Board dated 9 October 2006 and in the advisers' review of Council's arrangements for ensuring that deal provided 'best consideration' which are attached as appendices to the report. CBRE provided a letter dated 22 September 2006 which states that the Heads of Terms represented the 'best consideration attainable' and thus satisfied section 123 of the Local Government Act 1972.
- 42 In a letter dated 16 November 2007, CBRE confirmed that the terms at that date still represented 'best consideration attainable for the development of the Council's interest...in accordance with section 123 of the Local Government Act 1972'.
- 43 In the context of the negotiation of this arrangement, the Council have sought and obtained an independent view on the value for money of the transaction.

Appendix 1 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R1 A 'route map' should be produced to ensure that the Council retains an understanding of the documents which establish the framework for working with the private sector partner.	3	Legal Services Manager and Asset Manager	Yes	None.	September 2008
Governance						
9	R2 The Council should ensure that project management and governance procedures for future projects are subject to independent review.	3	Transformation Board	Yes	Procedure to be reviewed and amended.	July 2008
9	R3 The Council should carry out a post project evaluation of its involvement in the Westgate redevelopment project in order to identify any lessons which could be applied to the governance and project management arrangements of future projects.	3	Westgate Officer Group	Yes	Conditions of development agreement have not all been satisfied.	Depends when agreement comes into effect.
Risk management						
10	R4 Officers should identify and document the ongoing risks to the Council resulting from the Westgate redevelopment and the Council should ensure that the implications receive due consideration.	3	Westgate Officer Group	Yes	Review once development agreement comes into effect.	Depends when agreement comes into effect.

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Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
10	R5 A risk matrix should be drawn up for all future projects including the significant risks, their potential impact and the likelihood of them occurring. Mitigating factors should be explained and the residual risk established. The risk matrix should indicate responsibility for any relevant actions. The matrix should link to the Council's overall risk management processes.	3	Westgate Officer Group	Yes	Included in project brief outline business case documentation which was revised in November 2007.	Implemented
Impact on financial standing						
11	R6 The Council should set up formal arrangements for monitoring and managing the relationship with the Westgate Partnership and for monitoring and recording income received.	2	Head of Property	Yes	No need until the conditions of the development agreement have been satisfied. Officers monitor current Westgate income on monthly basis.	Depends when agreement comes into effect.
11	R7 The Council should consider how funds will be set aside to meet the requirement to contribute to major refurbishment works after 20 years.	1	Head of Property	Yes	Consider arrangements to monitor and manage reports backlog to get advance warning of repairs liability. Keep all funding options under review for Council's future liability. Include commentary in 'route map' referred to at recommendation 1 above.	September 2008
Accounting						
12	R8 Officers should prepare draft disclosures and discuss them with external audit at the earliest opportunity.	3	Head of Finance	Yes	Initial work undertaken to prepare draft disclosures. Final will not be required until agreement comes into effect.	Depends when agreement comes into effect.