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10 DOWNING STREET

From the Private Secretary

MR. HATFIELD
CABINET OFFICE

RESTRUCTURING THE PROPERTY SERVICES AGENCY

The Prime Minister was grateful for Sir Robert Armstrong's minute of 6 March, which covered a report on the options for PSA's future role, and their implications for structural change.

The Prime Minister has decided to hold a meeting on this subject, and we will be in touch with you and others to find a time.

I am sending a copy of this minute to John Kerr (H.M. Treasury), Richard Mottram (Ministry of Defence), John Ballard (Department of the Environment), Paul Cann (Lord Gowrie's Office) and Sir Robin Ibbs.

(David Barclay)

12 March, 1984

Subject as noted

CONFIDENTIAL AND SENIOR STAFF IN CONFIDENCE

MR. BARCLAY

CF: May I have the record of the last meeting on this please?

PROPERTY SERVICES AGENCY

*Dms
12/3*

The Prime Minister discussed with the Secretary of State for the Environment and Sir Robert Armstrong this morning the papers attached to Sir Robert Armstrong's minute of 6 March. The Prime Minister agreed that the Secretary of State for the Environment should take whatever action he now considers necessary in relation to Mr. Alfred's appointment. I believe that the Secretary of State will tell Mr. Alfred on Monday 12 March that Mr. Alfred has lost his confidence.

In the light of this, the Prime Minister felt that there was no point in proceeding with restructuring PSA for the time being. This would have to await the appointment of a new Chief Executive. Nevertheless, there should be a meeting to discuss Sir Robert Armstrong's report of 6 March, attended by those who received copies of it. I have agreed with John Ballard that this meeting ought to be arranged in about three weeks, by which date Mr. Alfred's future should be clearer.

In considering possible successors to Mr. Alfred, the Secretary of State said that he was considering two alternatives - either that PSA should continue as a separate agency with a top manager who should report to the Secretary of State (not through the Permanent Secretary of the DOE) or the existing management with a specific Minister in charge (similar to the Minister of Works of former times). The Secretary of State was inclined to favour an outsider for the Chief Executive if the PSA were to remain a separate agency but said that he would be willing to consider a civil servant if a suitable one could be produced: Sir Robert Armstrong was inclined to favour a civil servant. It was agreed that the Secretary of State and Sir Robert Armstrong would discuss possible candidates further.

Could you please find a date for a meeting on ^{*Sir Robert's report*} ~~the subject~~ in about three weeks?

9 March 1984

R.R.B.



Ref. A084/696

PRIME MINISTER

At your meeting on 19 December 1983 you asked me to prepare a further paper as a basis for decisions on the Secretary of State for the Environment's proposals for restructuring the Property Services Agency. The attached report has been written in consultation with the Property Services Agency, the Treasury and the Efficiency Unit. It sets out four broad options for the PSA's future role, and discusses their implications for structural change.

2. There are three main questions for decision:

- (a) The future role of the PSA (paragraphs 7-23). There are two choices. Responsibilities can be centralised on the PSA as now (Option 1) or given to individual Departments (Options 2, 3 and 4). Services may be provided in house by civil servants or bought in from the private sector. All four options allow for further shifts of work to the private sector.
- (b) The treatment of defence work (paragraphs 24-26 and Annex B). The main choice is between shared arrangements for both civil and defence work as now and transfer of defence work (either estate management on its own or estate management and works) to the Ministry of Defence. But there are subsidiary choices. Defence work may be separated out organisationally within the PSA (the restructuring proposals). Ministers may decide that they want to transfer defence work (some or all) to the MOD now, or that they may want to defer decision to some future date.

And, in the light of the answers on (a) and (b):

- (c) The structure of the Property Services Agency (paragraphs 27-30). The choice is between leaving things as they are, the Secretary of State's proposals for dedicated civil and defence sections of the Agency, a slimmed down organisation with the removal of a management tier without



dedication, or moves towards separating out specific services or groups of services again without general split between civil and defence work.

PSA's Future Role

3. The key question is the future role of the PSA. It is difficult to judge how well PSA meets the central objective of optimising Government expenditure on accommodation needs. But we have clear indications that things are not right. The Advisory Board believes the management structure is confused; the Wardale-Touche Ross report revealed serious deficiencies in management systems and attitudes; the Treasury is unhappy with standards of financial planning and control; and some Departments complain that PSA is not sufficiently responsive to their needs. Morale in the organisation is low. In terms of the Government's own philosophy PSA is also an oddity, employing substantial numbers of civil servants on work for which there is in most cases already substantial capacity in the private sector.

4. If Ministers want to reduce the number of civil servants employed on accommodation, all four options provide a possible future. The tests are cost-effectiveness and practicability. I would doubt whether the extremes of Options 3 and 4 would meet those tests. It is almost certain to be more economical to have the Government's main estate centrally owned and managed. Nor is it clearly established that more substantial or total use of the private sector for other areas of PSA work and more substantial untying of Departments in these areas would make for better cost-effectiveness. The only evidence we have comes from the work of limited experiments carried out over the last few years which suggest that private sector provision would probably be more expensive. Experience also suggests that it is not likely to be worth Departments building up their own expertise: it tends to create unnecessary duplication of resources and efforts.

5. Whatever view Ministers take, however, it is, as the paper makes clear, impossible to reduce the present in-house workforce quickly without compulsory redundancies - which would be



expensive and controversial - or one of the privatisation routes, which would also be controversial and possibly expensive too.

Treatment of Defence Work

6. Separate treatment of defence work (whether organisationally within PSA or by transfer to the Ministry of Defence) might be thought to clear the way for privatisation or more contracting out on the civil side, in the sense that defence work is more likely, because of security considerations or its specialised nature, to need in-house capacity. That is certainly true of some defence work, but there is no reason to suppose that the majority of defence work cannot be carried out (as indeed it already is) by the private sector. Some of us doubt the practicability of simply handing over the management of defence work to a contractor under a management contract: considerations of accountability and security apart, the sheer scale of the business is well beyond the scope of existing contractors. A stronger argument for separate treatment is that it would break PSA's existing workload into units of more manageable size. The advantages of that have to be set against the disadvantages of losing the ability to switch staff between the civil and defence sides (which might become more important as overall numbers decline).

Structure of the PSA

7. Ministers will make their own judgment about the extent to which planned restructuring will improve PSA's management and performance. The PSA believes that it will shorten management reporting lines, sharpen accountability and make it easier to change management attitudes. Others see the case for simplifying the management structure but believe this can be done without splitting the organisation on a customer basis. PSA has so far rejected the idea of cutting out one of the tiers of management without dedication on the grounds that, although it shortens lines of command, it would still not give a straight line of responsibility to clients. Others would argue that, although it is essential for clients to have a clear point of contact in the organisation, the client's basic interest is in the particular



service he is being given. On that argument clear responsibility lines for delivery of services are more important than single lines of responsibility to a particular client.

8. But the main question is whether restructuring will help or hinder the decisions Ministers take about PSA's future role.

9. PSA believes that a restructured organisation would be a better base from which to move towards the more radical options described in the paper. I would not want to argue with that judgment, but there is a question of timing. If Ministers want to see radical changes in the lifetime of this Parliament, then there is no time to restructure first. Restructuring will take two years to implement and a few years to settle down and show its full benefits; and the effort put in to making restructuring work would be diverted from work on more radical options.

10. It seems to me therefore that the choice has to be between:

- (i) going for one of the more radical options, and abandoning the restructuring proposals;
- (ii) the more evolutionary approach - restructuring and the removal of a management tier - proposed by the Secretary of State for the Environment and the Chief Executive of the PSA, which would allow the cost-effectiveness and practicability of more radical change to be tested over a longer timescale;
- (iii) abandoning the restructuring proposals and simply eliminating a management tier - an option favoured by the Treasury, I believe, but regarded by the Chief Executive of the PSA as likely to cause as much turbulence and dislocation as his own proposals.

11. If Ministers favour in principle going for one of the more radical options, I think that more work will have to be done before definite decisions are taken, with a view to establishing that the eventual economic benefits can be expected to outweigh the costs, turbulence and dislocation involved. It would be better for effort to be concentrated on that work than to be diverted into restructuring.

CONFIDENTIAL



12. I am sending copies of this note and of the report to the Chancellor of the Exchequer, the Secretary of State for Defence, the Secretary of State for the Environment, the Minister of State, Privy Council Office, and Sir Robin Ibbs.

RIA

ROBERT ARMSTRONG

6 March 1984

CONFIDENTIAL

PROPERTY SERVICES AGENCY: STRUCTURAL CHANGE AND FUTURE ROLE

Note by the Cabinet Office

Ministers asked at their meeting on 19 December for more information on the relation between changes in the structure of the Property Services Agency (PSA) and possible changes in its role and objectives. This paper, which has been prepared in consultation with the PSA, the Treasury and the Efficiency Unit, describes the part now played by the PSA (excluding the Crown Suppliers) and its relation to the Government's general objectives, and considers four options for its future role and their implications for the current restructuring proposals. The restructuring proposals themselves are summarised at Annex A.

PRESENT ARRANGEMENTS AND GOVERNMENT OBJECTIVES

2. The Government spends around £1½ billion a year on its accommodation needs, some £1 billion on defence and some £½ billion on civil needs. The present arrangements give the main responsibilities on the civil side and significant responsibilities on the defence side to a central agency, the PSA, which has the three-sided role of disinterested friend, setter of standards, and direct provider of services. The PSA has substantial in-house capacity to carry out this role, but since 1979 has contracted out an increasing amount of work to the private sector. Its 25,600 staff provide a range of services to Departments and other public bodies - supervision of and execution of minor works and maintenance (8,000 and 12,000 staff respectively - virtually all of the latter are industrials), design, commissioning and supervision of major works (2,400 staff), estate management (950) and general professional advice (500). The remaining 1,800 staff provide central support (finance, establishments and computing services).

3. The broad arrangements are:

a. Office and general accommodation

i. The PSA runs the estate and decides when to buy, lease or sell. It is responsible for all major new works and also for most minor works and maintenance. Under the Property Repayment System (PRS) it recovers the cost of the latter from Departments through a standard charge, which also covers average market rents and rates.

ii. Departments are responsible for formulating their own accommodation requirements (eg location and type of accommodation) subject to standards laid down jointly by the PSA and the central Departments. They are also now responsible for most minor works and maintenance costing under £500 (£1,000 from April this year).

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b. Specialised accommodation (courts, prisons, museums, laboratories)

i. The PSA is responsible for all new works and in some cases (eg courts, laboratories) also owns and maintains specialised properties on Departments' behalf.

ii. Departments are responsible for formulating requirements for new works and for seeking PES provision. In some cases (eg prisons) Departments are also responsible for maintenance and minor repairs.

c. Defence estate

i. PSA is responsible for carrying out all new works and maintenance. It also advises the MOD on the management of the defence estate, including acquisition and disposal.

ii. The MOD is responsible for formulating its requirements for new works, drawing up specifications jointly with the PSA, and for seeking PES approval. MOD owns the estate and is responsible for all decisions on use, acquisition and disposal.

c. Repayment clients

PSA also provides some services on a repayment basis to other bodies within the public sector.

4. The Government's objective is to provide accommodation arrangements which cost the taxpayer as little as possible consistent with maintaining the value of the assets, while allowing the Government activities they serve to be carried out efficiently and economically. There are two other tests which stem from the Government's economic policies. One is that work should not be carried out in the public sector if it can be done equally well and cost-effectively in the private sector. The other is that assets should in general be held in the public sector only if they are essential to the economical and effective working of Government.

5. How well the present arrangements measure up to these requirements is not easy to assess. On the plus side there are some good opinions of the PSA and a few objective measures:

Size of estate. The total office estate has been reduced by 4½ per cent since 1979 which, given the inevitable timelags, compares quite well with the 8 per cent reduction in numbers of non-industrial civil servants. In London, where reletting is easier than in the provinces, the office estate has fallen by 11 per cent over the same period. The PSA has also reduced the amount of vacant office space it holds from 5.8 per cent in 1979 to 4.7 per cent in 1983.

Productivity. PSA's non-industrial staff numbers have fallen by 18 per cent since 1979 against a real terms increase in workload of around 20 per cent. Of the reduction only about 7 per cent is attributable to contracting out.

Costs. Cost comparisons with other organisations are very difficult. But a 1982 official working group (whose membership included the Treasury, as well as an outside accountant and quantity surveyor) concluded that in-house design costs were up to 20 per cent lower than present scale fees. In-house costs for maintenance supervision, lease renewals and rent renewal work also seem to be lower than quoted rates outside.

Contracting out. Substantial amounts of PSA work are contracted out to the private sector - all of construction, 80 per cent of maintenance and 50 per cent of design. Overall 80 per cent of PSA's annual expenditure is spent directly in the private sector.

Fuel consumption on the civil estate has been reduced by 45 per cent since 1972 against a national average of about 10 per cent (and 30 per cent on the defence estate where the funding responsibility rests with MOD).

6. But on the minus side, there are other, mainly subjective points:

Size of PSA. The number of civil servants employed in PSA to meet the Government's accommodation needs (although 40 per cent lower than 1972) is still very substantial. PSA employs 4 per cent of all civil servants and ranks sixth amongst the Departments or separate parts of Departments listed in the manpower count. Some people question whether the Government needs such substantial in-house capacity when many companies in the private sector keep only a very small central capacity and contract out the rest.

Financial planning and control. The Treasury, who look to the PSA to ensure that accommodation needs are met efficiently and economically, say that its present performance, particularly in financial planning and control, does not measure up to what is expected.

Quality of service. Some Departments find the PSA slow to respond to their needs and believe they would get a better answer if they were able to take more of their own decisions, or if the PSA were forced to compete for their business with the private sector.

OPTIONS FOR CHANGE

7. In considering options for change the two basic questions are those which face any large organisation with a need for accommodation services: whether to provide in-house capacity or

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to contract out and whether to centralise responsibility or to place it on individual parts of the organisation. The main considerations are likely to be cost-effectiveness and manageability. The answers are not necessarily straightforward. An in-house organisation may for example be a cheaper option in terms of the direct cost of the services but the Government may take the view, as many private sector companies do, that its overall performance may suffer if it takes on activities outside the mainstream of its business. Similarly common service arrangements may give all the theoretical cost and efficiency advantages of shared overheads and expertise, flexibility and single-minded management of assets, but produce an organisation which the management believes is too large or too diffuse to be managed effectively.

8. Various suggestions for changes in the arrangements were made in the course of earlier Ministerial exchanges. They can be conveniently grouped under four main headings:

OPTION 1: A better status quo (PSA as now but more contracting out).

OPTION 2: PSA in competition (untying by Departments).

OPTION 3: PSA privatised.

OPTION 4: No PSA.

Each option has a different set of advantages and disadvantages. But they are not mutually exclusive and none of them precludes separate treatment of PSA's work on the defence side. This aspect is discussed further in paragraphs 24-26 below and Annex B.

OPTION 1: A BETTER STATUS QUO/MORE CONTRACTING OUT

9. Under Option 1, PSA's basic role would remain as now but it would contract more work out to the private sector where appropriate and sensible. This would be consistent with developments of PRS to give further marginal shifts of responsibility to Departments.

10. The scope for further contracting out varies according to the particular PSA service. The PSA already contracts out all construction work. Of the other services:

i. Maintenance. Over 80 per cent of maintenance work (by value) is already contracted out and PSA works direct labour forces have fallen by 40 per cent since 1979. If in-house capacity were limited to work with special requirements such as security, continuous shift working or speed of response, where contracting out may not be practicable or cost-effective, the works labour force could fall from 10,300 now to around 8,000 or less (with the majority of work concentrated on the defence side). Using natural wastage only that figure could be reached in about five years.

ii. Design. The PSA contract out about 50 per cent of design work. There are certain kinds of design work on the defence side where there is no private sector expertise or where there is a case for having the continuity of knowledge or expertise provided by an in-house team (eg feasibility studies for Trident). There is also a basic minimum of work - the PSA say this is about a third of all design work - which the PSA need to do to give them the ability to assess the quality of work they contract out, maintain their own expertise and give proper advice to customer Departments on the composition of their programmes. If the introduction of fee competition amongst outside consultants this year reduces the apparent gap between in-house and out-house costs there could therefore be scope for further reductions in design staff. PSA's present planned reductions would increase the percentage of work contracted out to about 60 per cent.

iii. Estates work and maintenance supervision. In-house costs for both activities seem to be cheaper on the basis of past assessments. But there is a possibility that larger-scale contracting out than so far anticipated could lead to different conclusions. The numbers involved in commissioning and supervision of major and minor works and maintenance are certainly substantial.

11. This option could reduce PSA in time to perhaps less than half its present size. But it would be slow time if natural wastage only were used (natural wastage produces a net annual reduction of at most 5 per cent) and the net cost to Government could on current evidence be higher.

OPTION 2: PSA IN COMPETITION/UNTYING AND TRANSFER OF RESPONSIBILITY TO DEPARTMENTS

12. Under Option 2 Departments would be responsible for a wider range of their accommodation needs and would also be free to choose PSA to provide services or to go direct to the private sector.

13. On the civil side, development of the existing PRS system is already making some changes in the respective responsibilities of Departments and the PSA. But this option involves a more radical shift of responsibilities and has a potentially major effect on PSA's role and objectives, depending on the basis and range of services on which PSA is assumed to compete for business. The options for services range from transferring responsibility for maintaining buildings Departments occupy - on something like a repairing lease from PSA - to more radical untying which would allow Departments to go outside PSA for new works and property requirements.

14. Changes in departmental responsibilities could also include the transfer of all responsibility for defence estates and works to the Ministry of Defence (see paragraphs 24-26 below and Annex B).

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15. Whatever the responsibilities transferred, PSA's role and the basis on which it could compete could take two forms:

- a. PSA could bid for every contract and be required to take up any business which the private sector did not want or which Departments did not want to take on themselves. In that case PSA would as now aim to meet Departments' needs at the lowest possible cost to the Government and could retain its other role as Departments' disinterested friend and adviser.
- b. PSA would only bid for business which gave them a chance of profit. In that case the service would be run on a trading fund basis with an agreed target rate of return. In this case PSA would simply be another competitor for a Department's business and Departments would need to look elsewhere in Government for expert and disinterested advice.

Under both options PSA would need to change its basis of accounting to enable it to quote a "price". At present it simply recovers cost actually incurred.

16. The advantages of this option are that it would expose PSA to outside competition and would put the choice between using in-house or outside capacity in the hands of Departments who would have no practical reasons for preferring to use PSA rather than the private sector. The tests would simply be cost to the Department and quality of service. Its disadvantages are that the perceived cost to individual Departments might not in all cases adequately reflect cost to Government as a whole and that it would weaken central controls on departmental spending (a point picked up in a December 1983 PAC report in relation to the transfer of responsibility for the Diplomatic Estate to the FCO). The impact on Civil Service manpower is difficult to assess. Tight manpower controls could certainly prevent Departments building up large "PSAs" of their own. But Departments would need some capacity to let contracts and monitor performance and under sub-option b. there would also need to be some central expert capacity to watch the Government's interest. Resource planning and pricing for PSA would be complex and difficult. Under sub-option a. it would be virtually impossible to match PSA's capacity exactly to its new market. In some cases too the wider Government interest might require PSA to quote a below cost price to maximise use of PSA staff and resources.

OPTION 3: PSA PRIVATISED

17. Option 3 is the privatisation of all or some of PSA's present assets and services. Services could be grouped together as a trading activity, with or without their accompanying assets, and, after a necessary period to establish a trading record, sold to the private sector on the lines envisaged for the Royal Ordnance Factories or via management buyouts. Alternatively work now carried out by the PSA could be managed under contracts let after competition, with former PSA staff being re-employed by the contractors, if that were part of the contract.

18. As with Option 2, there are several possibilities:

a. Privatisation of specific services without assets (eg PSA Design, PSA Maintenance).

b. Privatisation of the property function and services. Services and properties might be put into a new company or companies which would compete for both Government and other private sector business. Departments might initially keep their existing occupations on leases from the new company, but in time would be free to go to the market and buy or lease the accommodation best suited to their needs.

c. Franchising. Private sector companies could be invited to bid for a block or blocks of PSA work at fixed prices for a period of, say, five years. This approach could involve either the management of existing PSA units for a fee or the performance of their functions, perhaps using former PSA staff, for an all-in price. The contractor would of course want the right to hire and fire such staff.

19. The main advantage of this option is that it would provide a quicker way than natural wastage of reducing PSA's workforce and, in theory, an easier - though still controversial - way than through compulsory redundancies which offered no prospect of continued employment. It would also ensure the availability of some initial continuity of service expertise to the Departments that wanted it. But it raises the same questions as Option 2, of which this is in many ways an extension, and some of the questions on Option 1. On current evidence outside services (whether provided by a privatised bit of PSA or an existing company) are likely to be more expensive, unless the injection of new privatised PSA services into the existing market, combined with more Government business, changed the market's structure sufficiently to make it more competitive and bring fees down. Central control over spending on services would also be weakened with the loss of PSA to look after the wider Government interest. The Government would of course retain expenditure and standards control to ensure that accommodation and estate needs were being met as economically and effectively as possible, but such controls would be blunter without PSA as an instrument. Departments would also need some expert capacity of their own as under Option 2, the amount depending on the risks they were prepared to take.

20. Sub-option b. has the additional advantage in theory of providing some immediate receipts from asset sales. On the other hand all the evidence suggests that it is cheaper for the Government to own the property it occupies. To sell property and then rent it back at high prices is likely to be a very bad economic deal. In so far as it might be worth while to realise assets by selling property, the Government is more likely to raise bigger sums by selective disposal, than by attaching a very mixed (and esoteric) portfolio of assets to a trading company with no certain future in the long term. This sub-option would therefore only be worth considering seriously if Ministers believed that

the private sector would be so much better at managing the assets that the efficiency savings would outweigh any cost penalties.

OPTION 4: NO PSA

21. Option 4 would be the total shift to individual Departments of the responsibility for meeting their accommodation needs with a presumption in favour of private sector provision.

22. Under this option Departments would directly own or lease the property they occupied and take all decisions about future acquisitions, disposals and improvement, subject only to general expenditure and standards control laid down by the centre (which might be provided by the equivalent of a division in the Treasury). They would look to the private sector to provide the bulk of accommodation services, or provide capacity in-house if that were considered more cost-effective. All Departments would need some expert capacity to allow them to let contracts and monitor performance. Large Departments (DHSS, MOD, etc) might provide such capacity themselves. Small Departments might look to large Departments (on a repayment basis) or form their own small common services organisation.

23. This option is essentially Option 2 carried to the extreme and it has the same advantages and disadvantages in larger measure. A workable scheme could no doubt be devised, but there would be losses of central control, losses of the bargaining power the Government can exercise on the market as a bulk purchaser, and a risk of the reappearance of some of the existing PSA numbers in departmental packets around Whitehall. The PSA also point out that such thorough decentralisation of property services is almost unknown in large corporations in the United Kingdom private sector. The Government could not get to this option overnight without draconian measures, and without serious disruption of existing services. But it could be the end result of Options 2 and 3.

THE DEFENCE ESTATE

24. The idea of giving more responsibility to Departments (Options 1-4) is of course equally applicable to defence work. A transfer of defence works and estates responsibilities to the Ministry of Defence can, as noted earlier, simply be regarded as a sub-option of Options 2 and 3. Similarly, some defence work can be carried out by the private sector - indeed much already is. But the restructuring proposals assume and the MOD themselves believe that defence works and estates are different in scale and also, despite some similarities, in kind from most civil needs and that a case for separate treatment can be made.

25. Annex B, which has been prepared by the PSA in consultation with the MOD, sets out the basic arguments for and against transfer back of works and estates responsibilities to the MOD. The main arguments for transfer are elimination of some duplication of effort now and a closer match between defence needs and

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accommodation services. The main arguments against transfer are the advantages of independent and critical management, and those of pooled resources and flexibility of deployment. The case for keeping works within PSA is perhaps better supported than the case for keeping estates management work in which MOD already plays a substantial role.

26. For the purposes of this paper, the main points of relevance seem to be:

i. A decision to transfer defence work to MOD assumes that the scale of defence needs and the special nature of some of the work justifies special treatment, and that defence needs on their own are substantial enough to produce the usual benefits of common service arrangements.

ii. If however PSA's assumptions about the scope for and advantages of switching manpower between civil and defence works in some cases are right (and these are inherent in the decision to keep some cross-working between and common services for civil and defence sides under the proposed restructuring) there is some risk of increasing the cost of provision and also of increasing the numbers of civil servants engaged in its management.

iii. Very much more substantial contracting out of defence work after the transfer could, as on the civil side, only happen quickly if Ministers were prepared to take radical steps to reduce the current staff numbers (eg by compulsory redundancies or by negotiating transfers of PSA staff to private sector contractors), which would themselves be controversial and difficult and could lead to some disruption in service. If Ministers decided on a transfer now, initially at least existing PSA staff would have to transfer to MOD.

iv. Such contracting out would, on past experience, be more expensive than current costs, even though the balance of cost advantage might shift towards the private sector. The more thinly spread the in-house organisation, the harder it is likely to be for it to provide a cost-effective service. Without the ability to switch between civil and defence work some PSA offices or ex-PSA offices would probably not be viable.

RESTRUCTURING AND THE OPTIONS

27. All four options provide the opportunity substantially to reduce the Civil Service manpower now employed to meet the Government's accommodation needs. But there could be cost penalties and there are considerable difficulties in getting there quickly. Any major change in PSA's role would involve transitional disruption and cost, and any change which involved the loss of Civil Service jobs would produce trouble with the trade unions which could disrupt essential services to Government.

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No substantial reduction could be achieved quickly without compulsory redundancies or transfer of people and jobs to the private sector through privatisation. Natural wastage alone would reduce PSA manpower to only half its present size by the end of the century. If Ministers wish to pursue any of the options therefore they need to be satisfied that the current restructuring proposals, which are themselves strongly opposed by the unions, which cost some £12 million to implement and which PSA accept will cause some transitional disruption, are either fully justified in their own right, or on the critical path to the chosen option.

28. Clearly to incur the costs and turbulence of restructuring PSA now would not be consistent with a decision eventually to dismantle it under Option 4. But there is a difference of view about the relevance of restructuring to Options 1, 2 and 3.

29. The PSA argument runs as follows:

i. The restructuring proposals are primarily designed to make PSA more effective and to give a better service to Departments. The Chief Executive and the Advisory Board believe that they can be justified on that basis alone, but also believe that they would move PSA to a position where Options 1, 2 and 3 could be pursued more effectively. While recognising the call on management's time, they argue that it is easier to change managerial attitudes at a time when structure is changing and people are going to new posts.

Option 1

ii. DOE Ministers have been pursuing vigorously the scope for contracting out since 1979. If Ministers now decide to push this harder still, PSA management needs to be capable of assessing the benefits of contracting out different kinds of work, and of concentrating in-house capacity where it is clearly essential. The split between defence and civil work and the introduction of commercial style accounts will make this easier.

Option 2

iii. If Ministers decide to move towards Option 2 a client-based organisation and commercial accounts would again be helpful. PSA would itself perform better because of its simpler management structure, and services to civil and defence clients would be more readily identifiable. The role of the proposed property manager would be particularly important because he would have responsibility for overall estate management and for ensuring that the "repairing leases" granted to Departments imposed cost-effective maintenance requirements.

Option 3

iv. Option 3 would be similarly consistent as a development of Option 2. In particular the operation of a property

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manager with responsibility for a defined portfolio of civil properties or even a civil controlling tier with associated district works offices would be candidates for transfer into the private sector with the people involved.

30. The counter arguments are:

i. The restructuring proposals would take a substantial amount of PSA management's time over the next few years. At the same time PSA will be putting in better management systems, improving the working of the new PRS system, and seeking to change management attitudes as recommended by the Wardale-Touche Ross report. The PSA will find it difficult to run so many changes at the same time and with equal success. To add the extra work and problems involved in pursuing the radical Options 2 and 3, and even the less radical Option 1, looks quite unrealistic.

Option 1

ii. Under Option 1, PSA would be looking closely at the scope for further contracting out of work. That in itself would be controversial with the trade unions. It is also arguably more useful to look at the relative costs of providing specific services (whatever the customer Department) than at the cost to a particular client of a package of services, not all of which may be capable of being contracted out. Better management information systems are the key requirement, and, on this argument, restructuring secondary.

Option 2

iii. That argument applies even more strongly under Option 2 in which Departments are allowed to untie from PSA for some services.

iv. The detailed work necessary to put this option on to a workable basis would need substantial management time and effort, which would, if restructuring went ahead, be heavily occupied.

v. More significantly the restructuring proposals themselves cannot hope to reflect the pattern of work and reduced quantity of PSA work - both in terms of responsibilities and of the execution of responsibilities - which may result from untying but are as yet unknown.

Option 3

vi. Similar arguments apply to Option 3. A restructured PSA may, as PSA management believes, eventually provide a good base from which to privatise some or all of PSA's services. But time and effort spent on restructuring would

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not be available for simultaneous implementation of privatisation. If Ministers decided to go for privatisation via trading companies for example (ie 3a.) the sensible course would seem to be to start reorganisation on these lines now.

RETURN OF DEFENCE WORK

31. Restructuring in its present form does not produce a complete split between the defence and civil sides. There would still be some cross-working, some common services and staff interchange. A decision to return PSA's defence works or estates to the MOD either now or at some future date therefore also affects the decision on restructuring, whether or not the return is accompanied by one of the radical options for reducing the size of the PSA.

32. If Ministers decide to return either defence works or estates to MOD now there are two possible approaches. They could go ahead with the proposed restructuring as the first stage of the necessary separating out of work. The organisation would then need to be adjusted at some future date to allow complete dedication and to take account of MOD's own thinking. Alternatively the plans could be reviewed now by MOD and PSA and adjusted to allow transfer at a single move. The arguments for the first course are that a postponement would produce further uncertainty, further weaken staff morale, and increase the trade unions' opposition. The arguments for the second are that a two-stage approach involves two periods of disruption and the risk of some abortive reorganisation.

33. If Ministers do not want to decide now to return defence work to the MOD, but do not want to rule a decision out, similar arguments apply. On the one hand Ministers would have an organisation with defence work already largely separated from civil work. If a decision were taken at some future date to transfer the work to MOD and if the organisation was in line with MOD's thinking, the amount of abortive work as far as defence needs are concerned should be small. On the other hand Ministers would need to be satisfied that a further reorganisation to meet the needs of civil Departments satisfactorily would not impose significant further costs and disruption.

March 1984

PSA RESTRUCTURING PROPOSALS

The main elements of the proposals are (under a single Chief Executive, and with a common PEO, PFO and professional support services):

- a. To divide the management organisation into two, one responsible for work for defence clients, and the other for work for civil clients (the Civil Property Directorate or CPD), thus providing, for each client group, a single line of management control. There would however be some cross-working between the civil and defence sides at district works office level (with about 17 per cent of civil work being carried out by defence DWOS).
- b. To reduce the number of management tiers by one by merging the 10 Regions and 34 Areas into 28 new Controlling Tiers.
- c. To develop the way the civil estate is managed; in particular to create locally based property managers responsible for all aspects of the maintenance and management of defined properties.
- d. To introduce "commercial style" management accounts incorporating property based delegated budgetary control systems.
- e. To change the organisation of the major design offices within the context of the two client based organisations.

DEFENCE WORKS SERVICES AND ESTATE MANAGEMENT: PROS AND CONS OF
TRANSFER TO MOD

I. BACKGROUND

The Defence Estate covers some 246,000 hectares (600,000 acres) in the United Kingdom and 125,000 hectares (300,000 acres) overseas (the figures exclude land over which rights less than occupation exist) with a great variety of usage including airfields, storage depots, firing ranges, dockyards, radar sites, barrack complexes (including 80,000 married quarters, messes and clubs) and research establishments. Title is held by the Secretary of State for Defence and all costs are chargeable to the defence budget. Management, however, is shared with PSA in a complex way.

Works Services

2. For Works Services, running at somewhat over £1,000 million a year divided roughly equally between capital works and maintenance, the position is broadly as follows:

- a. for major capital works the allocation of financial resources and the justification of the broad requirement are MOD responsibilities; the specification of the detailed requirement (because no clear line can be drawn at this stage between requirement and implementation) is a shared responsibility; and the placing and supervision of contracts a PSA responsibility;
- b. for minor capital works the requirement is the responsibility of MOD financed by allocations from Defence Vote 4 by PSA to officials in the UKTO, who work with the Services locally, under parallel delegations of authority;
- c. maintenance is, in principle, a PSA responsibility but since MOD controls the funds available, responsibility is in effect shared.

Estate Management

3. There is quite a different division of responsibility in relation to the management of the Defence Estate. MOD is financially accountable for all transactions and responsible for the size and shape of the estate, for decisions on what land will be acquired and retained and for what purpose, and for decisions on what land will be disposed of. MOD depends on the PSA, however, for advice on land transactions, for day-to-day management and for the acquisition and disposal of property. These transactions involve expenditure of some £70 million per annum and an income of some £13 million; apart from property disposals which have realised £160 million in the last three years. No significant acquisitions are contemplated except for some training land which is in short supply (the acquisition of land in the Falklands is exceptional and does not affect the main argument).

MANAGEMENT IN CONFIDENCE

4. About 450 PSA staff are employed on estate management tasks. The Lands Division of the Ministry of Defence has 42 staff.

II. LOCATION OF WORKS SERVICES

5. The arguments for moving works services from PSA to MOD are that it would:

i. eliminate undue double handling and lead to quicker decision taking;

ii. provide a direct line of approach to policy branches and undivided Ministerial responsibility;

iii. enable the organisation and its systems to be tailored more precisely to those of the Services, to identify overall costs more readily and improve understanding and control; and

iv. permit a new approach involving almost total reliance on contractors for property management, planning, design, construction and maintenance, accepting any risks associated with reduced supervision.

6. The arguments for leaving them with PSA are:

i. The exercise of the critical function by PSA in spending MOD money.

ii. MOD is already a large Department and additions could be expected to bring diseconomies of scale, not the reverse.

iii. Entirely separate civil and defence works in PSA and MOD would lack the common professional and other services, career structures and the opportunities of staff to interchange and learn from each other which PSA can offer as an entity. Complete division would therefore be less effective overall, bringing further diseconomy.

iv. "One should stick to one's last". PSA is more likely effectively to deploy the expertise and resources needed in this area than a Department where it would form a small and relatively minor part of the activities.

v. Overall, a common approach across the public sector for important initiatives in maintenance, standardisation, value for money and other fields.

III. LOCATION OF ESTATE MANAGEMENT

7. The arguments for moving Estate Management back to MOD are:

i. as above for Works (paragraph 5i.); plus

ii. that it would reunite policy, accountancy, and agency into a common Lands Directorate which would at once be responsible for all MOD estate holdings and transactions.

MANAGEMENT IN CONFIDENCE

8. The arguments for leaving Estates Management with PSA are:
 - a. the general arguments set out in paragraph 6 (although these need to be modified to an extent by the more limited nature of the estate management function and the more substantial role which MOD plays in it); plus
 - b. the opportunity, under PSA's restructuring proposals, to integrate estate management and works services more effectively if that is seen as a desirable objective.

1) Mr Butler ^{RRB} to see



2) Prime Minister: Mr Jenkin has asked for a word with you tomorrow about this (with RIA). He will want to concentrate on Mr Alfred's position, but if you have time you may like to look at the policy background set

Ref. A084/695

MR BUTLER

Property Services Agency: Restructuring out in the attached minute especially page 10. DMB 8/3

--- I attach a submission to the Prime Minister and a report prepared in pursuance of the remit laid upon me by the Prime Minister's meeting on 22 December 1983.

2. In considering this the Prime Minister should be aware that the Public Accounts Committee (PAC) has been investigating the Property Services Agency, particularly in relation to the deficiencies of management revealed by the Wardale-Touche Ross report. The publication of that report went fairly quietly, partly because other events at the time overshadowed it. But the PAC investigation will reopen the matter; and the investigation has not (from the Government's point of view) been going well: the PAC has elicited from Sir Geoffrey Wardale particulars of further deficiencies not dealt with in the Wardale-Touche Ross report, and I am told that Mr Alfred's two appearances before the Committee were disastrous. The Secretary of State for the Environment says that he "lost his cool" and "has blown it", saying all the defensive things that he was advised not to say. The result is likely to be a report which will be extremely critical of the management of the PSA.

3. Mr Alfred has clearly forfeited the confidence of the Secretary of State, who believes that he may be obliged to ask Mr Alfred to resign (or even to dismiss him), if Mr Alfred does not decide for himself that he ought to resign, even before his appointment expires at the end of 1984.

4. I am considering as a matter of some urgency how we should replace Mr Alfred, if that is what happens. The other point to have in mind is that, if there is indeed a risk that Mr Alfred will have to resign shortly, it would probably be better that Ministers should not take decisions on proposals for restructuring which are very much of his devising and which his successor might wish to change.

RIA

ROBERT ARMSTRONG

6 March 1984