

WEDNESDAY 18 June 2008

Olympic Preparedness

You asked me to carry out a high level review of the progress that has been made in preparing London for the 2012 Olympic Games. I am writing to set out my initial conclusions.

The review has been carried out over a three week period and therefore inevitably it has been a high level exercise. It seeks to identify risks and issues requiring further attention and areas where additional work should be carried out and/or alternative policy approaches considered.

There is no doubt that the recent changes to the economic environment and illiquidity in the banking system will add significant pressure to aspects of the project. This will impact on sale values, availability of private finance, appetite for sponsorship opportunities and tenant demand for space in legacy developments. There will also be continuing pressures on costs from the broader global economic environment (rising oil and raw material prices) and the continuing high level of terrorist threat). Collectively we must face up to this new economic reality as we plan to deliver a successful but cost effective Games.

In carrying out this review I am grateful for the assistance of KPMG LLP and the time and energy of Neale Coleman, your Senior Adviser on the Olympics, and of Richard Sharp. The work has been based upon a review of relevant documentation and a series of meetings with directors and senior officers of:

- Olympic Delivery Authority (“ODA”);
- London Olympic Games Organising Committee (“LOCOG”);
- London Development Agency (“LDA”);
- The Home Office;
- Government Olympic Executive (“GOE”);
- Grant Thornton, in their capacity as business planning consultants for the Legacy master plan.

We are very grateful for the access we have had to the various organisations and the open way they have shared knowledge and information.

I set out my initial observations below.

ODA

Games and ODA budgets and cost forecasts

The Games budget was set in March 2007 at £9.325 billion. The largest element of this budget relates to the ODA. In its announcement last December the ODA’s baseline budget was presented by government as totalling £6.090 billion including £500 million of allocated contingency with additional unallocated contingency of £2.009 billion remaining. However, some £1 billion of this additional contingency is an integral part of ODA’s real baseline budget/forecast of final costs. This now stands at £7.111 billion and the programme contingency included in this forecast is likely to be spent in full. A

further £1 billion contingency is held by the government's Funders Group to cover wider risks, including economic risk.

General progress

The ODA has made good progress, on what is a complex and challenging site, in taking forward the physical preparation of the Olympic Park, and remains on track to start its main construction activities in 2008.

By the end of March 2009, the ODA expects to have entered into contractual arrangements on individual projects valuing £5.1 billion against its current anticipated final cost of £7.111 billion. At the end of March 2008 the ODA had awarded contracts to the value of £2.7 billion. This includes the relative larger and more complex contracts for the Olympic Stadium, the Aquatics Centre and 70% (by value) of the contracts to be awarded under the structures, bridges and highways project. More recently the ODA has also awarded the contract for the Velopark.

Given the advanced state of procurement and design on the main venues and the tight programmes to complete the major venues in time for test events and the Games, there is no real scope for fundamental changes to what is now planned and is in the process of procurement. Attempting to do so would run the risk of adding to the eventual cost through delay.

Site preparation and infrastructure

Site preparation and infrastructure is progressing well. The ODA has been hitting its milestones and is well on course to deliver a high quality platform for building the Olympic venues. This has been done while making significant savings from the original budget and is a major achievement, as recognised by the IOC in the recent report by its Co-ordination Commission.

Contributing factors would appear to be:

- The original budget was based on a well developed master plan and included a lot of detailed work in respect of the key areas (bridges, highways, site works, etc)
- The key risk in the budget was in respect of ground conditions. Generally ground conditions have been in line with, or slightly better than, the assumptions included in the original budgets
- Good levels of market interest and competition between contractors have been achieved.

Venues

The original venue budgets were not based on detailed designs and assumed that there would be some competitive tension in the market place. This has not been the case with either the Stadium or the Aquatics Centre where the ODA has found itself in a single bidder position.

The ODA has reached a contractual position with McAlpine on the Stadium and Balfour Beatty on the Aquatics Centre. Both contracts are target cost rather than fixed price as it would not have been economically viable to seek to secure this. The ODA are realistic about the significant level of risk that remains within these contracts.

The extent of cost pressures affecting the venues can be seen in the £106 million increase in the anticipated final cost of the venues since November 2007. As an example, the ODA's current estimate of final cost for the Stadium contract has risen from £496 million in November to £525 million. The rise in the venues budget has been offset by savings achieved or forecast elsewhere in the programme which mean there has only been a very small increase in the overall anticipated final cost of the total programme of £16 million.

Containing cost pressures and avoiding further calls on the contingency will be difficult and require sustained effort to manage contractors effectively and to identify and realise cost opportunities across the programme. This process must be overseen from the top by the Olympic Board on the basis of the best possible information and I am aware that you have already written to the Olympics Minister to make this point.

Olympic Village

The illiquidity of the banking system and falling house prices have had serious implications for the original arrangements between the ODA and Lend Lease, the developer of the Olympic Village Project. Lend Lease is currently having difficulty in both securing the private finance necessary to finalise the transaction and in determining what additional funding is required to make the project viable.

The imperative for the ODA is to protect the existing programme to enable both Stratford City Retail Centre and the Olympic Village to be delivered to meet various requirements for the Games. The ODA Board has agreed to fund Lend Lease to commence the vertical build of the Olympic Village from May 2008 even though no Development Agreement has been agreed. In the meantime, the ODA is working with Lend Lease and its banks to secure private equity and debt funding and also exploring other options for financing the project, including extending the involvement of Registered Social Landlords. In all scenarios some significant additional public sector funding is likely to be required to deliver the project.

The current Olympic budget assumes that the ODA makes a contribution of £550 million to Lend Lease to cover infrastructure and other costs associated with the Village development. The budget also includes a receipt of £250 million in respect of overage payments receivable from the developer. The £250 million valuation is based on previous work carried out by Ernst and Young.

There now must be a major risk to the recoverability of the existing assumed £250 million receipt. Assuming further public sector investment needs to be made there must also be a serious risk surrounding its recoverability

The Village is an absolutely critical part of the legacy from the Games and fundamental to the regeneration ambitions for Stratford and the wide Lower Lea Valley. While recent economic changes have had a major impact on the proposed delivery arrangements it should ultimately produce an asset with substantial value and opportunities to re-finance

after its completion. Restructuring the deal following any additional public sector investment must include the prospect of additional returns to the public sector later. The regeneration legacy from the Games should not be put at risk by reducing the quality of the proposed Village development, in particular in its design and sustainability standards.

Transport

It appears that good progress has been made in respect of transport and significant savings from the original budget have been made.

Most of the key transport initiatives that need to be delivered for the Games are outside the responsibility of the ODA – they principally lie with TfL and Network Rail. At present the major schemes are on programme for delivery in time for the Games. The ODA needs to ensure that it continues to monitor the progress of these organisations in delivering the key facilities required for the Games.

The great majority of the capital investment in transport schemes will produce improvements and benefits that last well beyond the Games. This is true both of the schemes being supported directly out of the Olympic budget, such as the expansion of Stratford Regional Station and improvements to the North London Line, and to other schemes which contribute to the Olympic transport plan. These involve an additional £5 billion in investment and bring major benefits across London through schemes such as the East London Line extensions and the extensions to the Docklands Light Railway.

One area where additional work is required is in considering what further local transport schemes may be required in the area of the Olympic Park after the Games. This should be considered in the LDA's work on the proposed Legacy Masterplan Framework (see below).

The investment in the transport legacy together with delivery of the Crossrail project on time is the key foundation for the delivery of the future regeneration of this area. It is essential that the opportunities provided by this first class transport infrastructure are seized.

Security

The security plans are at a very early stage and significantly behind the rest of the planning. It is absolutely vital that significant progress is made quickly on security planning so that necessary facilities are identified early enough to be provided cost effectively. As was seen with Wembley, there will be significant cost implications if security considerations have to be built in to the Olympic facilities/logistics at a late stage. It is also difficult to have confidence in current cost estimates in the absence of a full, costed security plan. Failure to catch up and complete this work satisfactorily will have serious implications for Londoners as they will be the people most exposed to disruption and security risks. I recommend you should ensure you have regular direct reporting on progress from those responsible for delivery in this critical area of the project.

Programme contingency

As identified above there are a number of significant cost impacts which could affect the overall programme arising from several different areas. Given the difficult economic reality we now face it is not possible to be certain the level of programme contingency remaining will be adequate.

LOCOG

LOCOG has been subject to various reviews by the IOC as regards progress to date. These reviews have been very positive and, as the IOC has reported, LOCOG is significantly further advanced with its detailed operational planning than any previous host city.

On the LOCOG budget the key challenge in respect of income will be to meet the local sponsorship target of £700 million. However, progress to date has been good and by the time of the Beijing Olympics LOCOG expects to have secured over half its target for local sponsorship.

The large number of temporary or adapted venues means that LOCOG has a substantial venues budget. LOCOG is continuing to negotiate with the ODA as to what is provided by whom particularly on the venues at the Olympic Park.

LDA/Legacy

The LDA's investment in land assembly and remediation and the ODA's investment in new infrastructure and other enabling works (which accounts for a major proportion of overall cost of the project) are fundamental to achieving the long term legacy aspirations. Together with the transport investment this has created unique potential for the regeneration of highly disadvantaged areas.

The successful exploitation of these opportunities through the development of the Park for legacy is probably the most important aspect of this project. I am concerned about how far there is a clear vision for legacy and whether it has the right profile and sufficient resources devoted to it. The complexity of achieving successful post Olympic regeneration and legacy (maybe only achieved by Barcelona in the last 25 years) is a warning of how urgent a priority this should be for the project. I am disappointed that we find ourselves at an advanced stage of the procurement process without clear and agreed plans for legacy for a number of important venues. I comment further below on how I think we should now accelerate progress and bring real impetus to the work in this area.

LDA budgets

The LDA's committed funding to the Olympics totals £1.969 billion. This is principally to cover land assembly and remediation (£1.086 billion) and direct contributions to the Olympic budget (£550 million). It also includes £333 million in interest payments. The funding of these Olympic costs is assumed to be through grant of £1.3 billion and land receipts of £672 million.

Land and remediation costs

The LDA's budget for acquiring and remediating the land on the Olympic Park is £1.086 billion. Most of these costs have now been spent or contracted. The LDA has agreed with the ODA that the ODA should procure the remediation work as part of its overall enabling works package and the LDA has agreed a capped contribution to the costs of this work. Accordingly the LDA believe that there is little further exposure to overruns.

Contributions to the Olympic budget

As part of the original public sector funding package agreed between the previous Mayor and government prior to the award of the Games to London the LDA was to contribute £250 million to the Olympic budget. When the new budget of £9.325 billion was set in March 2007 the previous Mayor agreed to contribute a further £300 million to the budget which it was stated would not be found from increases in Council Tax or fares.

The previous Mayor proposed that this additional £300 million should be contributed by the LDA and the LDA Board agreed a funding and borrowing strategy to enable this contribution to be financed. The assumed contribution of £300 million is included in the £1.969 billion total referred to above.

The memorandum of understanding with government relating to this contribution states that the timing of this payment is a matter to be agreed between the Mayor and government. I understand that no such agreement has yet been reached and comment further on this issue below after looking at other issues relating to the funding of the legacy of the Games.

It should be made clear to government that any additional LDA contribution towards the Olympic budget should, like that from the other funders, go towards supporting programme contingency as well as other costs. If some of the contingency is not required the LDA's contribution should be reduced accordingly.

Legacy responsibilities

Following the successful land assembly process the LDA is now significantly the largest land owner in the Olympic Park with a smaller amount remaining in the ownership of the Lee Valley Regional Park Authority. There is approximately 230 hectares of land in the LDA's direct control of which 102 hectares must be returned to Parklands/Metropolitan Open Land in legacy as a condition of the planning consent. The remaining 120 hectares includes legacy stadia facilities, roads, rivers, utilities and other infrastructure, and development platforms. On current analysis there is approximately 70 hectares of net development land available for physical residential and commercial development.

The LDA has agreed with the ODA to provide it with access to its land to enable it to construct the infrastructure and venues in the Park on the basis that these and the land will be returned to the LDA following the Games in the condition required by the planning consents granted for the immediate legacy transformation after the Games.

The Olympic Board has agreed that the LDA should act as the legacy client for the Olympic Park. This is a common sense decision given its land ownership position. This

brings with it a range of responsibilities and opportunities for the LDA to deliver including:

- acting as the ODA's client in respect of the requirements for the venues and park after the Games
- examining and agreeing proposals for use and management of the venues and park after the Games and negotiating arrangements with future operators, tenants and end users
- preparing a master-plan (generally known as the Legacy Masterplan Framework or LMF) to guide future development in and around the Park after the Games and making planning applications to implement the master-plan
- devising a development strategy to procure future development and secure capital receipts required to pay off the borrowing incurred to meet Olympic costs

All of these tasks require co-operation with and involvement of a significant number of partners and stakeholders, in particular Government and its agencies (including the ODA, London Thames Gateway Development Corporation, and the proposed Homes and Communities Agency), the Boroughs and the local community. The LDA needs to ensure that these tasks are carried out in such a way as to prioritise the overall regeneration benefits for the area and to secure new opportunities and improvements in quality of life for existing communities in the area.

The LDA has agreed a programme of work to meet these responsibilities under the direction of Tom Russell who has been recruited as its Director of Olympic Legacy. Consultants and advisers have been appointed to assist on master-planning, preparation of a development strategy and of a business plan for the Park and venues in legacy. The programme seeks to deliver a comprehensive strategic plan including an agreed LMF by early 2009. Given what I have already said about the importance of an agreed legacy vision every effort should be made to accelerate delivery of the elements of this work programme.

When the ODA is wound up, it will have residual contractual rights and obligations and there will be a substantial reconstruction programme to manage. If the LDA is to assume these rights and obligations and carry out these it will need to be satisfied that there is sufficient resources and funding in place to do so.

Risks and issues

In carrying out these responsibilities the LDA is exposed to risks in respect of:

- Capital receipts in respect of land on the Olympic Park;
- Legacy capital costs;
- Legacy revenue costs.

Capital receipts

The LDA's funding profile for the next 20 years assumes a total receipt from sale of the land on the Olympic Park of £672 million. The valuation of this receipt is based upon

total land value of £838 million. This is reduced by agreement in the latest memorandum of understanding that the National Lottery receives 75% of any receipts above £650 million and some of the receipts falling outside the 20 year period. The £838 million valuation is based upon advice commissioned from Knight Frank in 2007.

One key assumption behind the Knight Frank valuation was that house prices would increase by 6% per annum. Clearly, house prices have not increased by 6% in the last year nor are they likely to in the immediate future. However, the LDA currently believe that the other key assumptions behind the Knight Frank advice (housing densities, the level of social housing, house prices, etc) are very prudent. And in effect, the LDA can accommodate a reduction in land values of up to 20% and still receive the first £650 million of its carrying value.

The LDA have not commissioned another valuation of the land at this stage. The LDA is working with its advisors and partners, including the local boroughs, to develop further the master plan process for the Olympic Park legacy after the Games. This will seek to prioritise the regeneration benefits and is also likely to identify opportunities to increase value.

Whilst the assumptions supporting the £838 million land value appeared prudent in 2007, it is inevitable that the current market environment conditions will make the recovery of the LDA's £672 million more difficult. However, land sales are not assumed to commence before 2014 and there is significant opportunity for market movement (upwards or down) between now and then. The land valuation and its consequences for the LDA's financial strategy should be reviewed once a clear preferred option for the legacy master-plan has been identified.

Legacy capital costs

The ODA currently has a ring fenced transformation budget of £350 million to cover the cost of converting the Park and the various sports facilities to legacy mode. ODA value engineering exercises to contain costs and achieve savings in the Olympic budget have inevitably reduced planned spend in areas that are vital for legacy such as landscaping. Early business planning work for the LDA by Grant Thornton has already identified the need for additional investment in the park to achieve the standard and quality of legacy park which local partners and stakeholders aspire to - an environment of the highest quality that is capable of being a destination in its own right.

The LDA is also concerned about potential shortfalls in the transformation budget for venues. It is not clear that the existing budgets will provide turnkey legacy facilities at either the Stadium or Aquatic Centre. The LDA have appointed Capita Symonds to review this issue and identify any shortfalls.

Given the overall cost pressures affecting the Olympic budget there is a real danger that legacy budgets will be seen as the soft option for achieving reductions and savings. Much has been made of the fundamental importance of the lasting regeneration legacy of the Games as the reason for staging them, most recently in the government's Legacy Action Plan just published. It is essential that the ODA identifies adequate budgets (including appropriate contingency) to plan, fund and deliver the necessary work to transform the venues and park so they are fit for their subsequent uses and that achieving this is not put at risk by cost over-runs elsewhere in the budget.

When the Capita Symonds work is complete this issue will require urgent discussion with the ODA and government to ensure this objective is achieved. It may be sensible to link these discussions to reaching agreement on the timing of the further LDA contribution to the Olympic budget to ensure that this helps to underpin delivery of the legacy commitments.

Legacy revenue funding

Legacy budgets and business plans are being prepared for the key venues and the park. This is very difficult as end users have not yet been identified for the key facilities, nor particularly in the case of the Stadium is the exact shape of the legacy agreed. The previous Mayor agreed as part of the bid commitments that the GLA should contribute £10 million a year to the revenue costs of maintaining the Park and any revenue deficits for the venues. Initial business planning work by Grant Thornton suggests that this may not be sufficient to meet the likely costs. Common sense would indicate that given the lack of progress in settling the legacy plans any current estimates of future legacy revenue funding requirements are unlikely to be robust.

This risk, as well as the very high capital costs of the venues, emphasises the need to look for the most financially sustainable legacy uses for the venues. This needs to be settled as a top priority. Negotiations with prospective tenants and end users must be accelerated, as a central part of the ongoing work on the legacy vision. Speedy progress is also important to ensure that as far as possible final designs and specifications for the key venues meet the requirements of their legacy uses, though the scope for this is now inevitably limited.

Additional specialist resources, including input from experienced venue and leisure operators, should be deployed and there should be a full and open examination of all options to provide the most sustainable legacy uses for the main venues.

Delivery and implementation

The LDA has increased its capacity to deliver the range of important responsibilities that it has in relation to legacy with the recruitment of additional experienced senior staff and the appointment of consultants and advisers. A detailed programme is in place to deliver the outputs of an agreed LMF and overall strategic plan by early next year. It is vital this programme and timetable is kept to and, as recommended above, accelerated as far as is possible.

Some consideration has already been given to the best vehicles for delivering the legacy and whether one or more new special purpose vehicles might be desirable to provide focus and drive as well as an opportunity to bring in more expertise from the private sector. I agree with this approach particularly to ensure there is a focused and commercially oriented vehicle to implement the development strategy to maximise the benefits from legacy. It is important also to ensure that the local boroughs have an adequate say in planning the regeneration legacy. Decisions on this should again be taken as soon as possible.

Legacy delivery is vital to the future judgements that will be made as to the success or otherwise of the Olympic project. Whether the billions of public money now being

invested in the Olympic project are seen as value for money stands or falls on the legacy that London as a city inherits. Given the fundamental importance of this issue I believe you should establish a Legacy Board of Advisors to work and advise you exclusively on the Olympic Park legacy after 2012 and move as quickly as possible to establish a separate vehicle with responsibility for legacy delivery.

David Ross
17 June 2008