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C(82) 7

CCPY NO

83

2 April 1982

CABINET

INTERNATIONAL CONFERENCE CENTRE

Memorandum by the Secretary of State for the Environment

1. Cabinet decided in July 1980 (CC(80) 29th Conclusions, Minute 4) that we should proceed with the proposed International Conference Centre (ICC) on the Broad Sanctuary site only if private finance could be obtained for its construction. In June last year I reported to Cabinet the terms of an offer by Pearl Assurance to finance the ICC (C(81) 34). The Chief Secretary, Treasury, opposed the proposal on the grounds that it would be "at least two to three times as expensive" as public funding - but he was not prepared to allocate public funds at that time (C(81) 35). Cabinet authorised me to conclude the deal with Pearl (CC(81) 25th Conclusions, Minute 5).
2. The terms of the Pearl offer were set out in the Annex to my paper. In the detailed negotiations that have taken place since then the original terms have been adhered to and the detailed arrangements for periodic rent review, including the notional market rent of a comparable office building on the site, which was one of the items for detailed negotiations, have been concluded. The rent review formula provides, as is now common on lease-leaseback schemes of this kind, for the first rent review due in 1991 to take account of growth in market rents since 1981 (the date to which the notional rent of the comparable building relates). Thus, the Chief Secretary, Treasury, has suggested that, if rents increased as a result of inflation from 1981, the rent payable after five years could represent a return to Pearl of about 8-10 per cent (which is what the market might expect in those inflationary conditions) rather than the initial 6.123 per cent payable in 1986 (although as the rent is reviewed every five years, the true rate of return is about 1 per cent less than 6 per cent or 8-10 per cent). There is no certainty, of course, that rents will move in line with inflation: the rent is fixed in relation to market rents prevailing at each review date. This is the only significant point that was not covered in the Annex to my earlier paper although it was made clear that there would be five-yearly rent reviews.
3. I have subsequently asked my new Accounting Officer to consider these terms and his advice to me is that "the deal with Pearl is as good as we are likely to get in the private sector".

4. I have also returned to the agents (Healey and Baker) who advised on the Pearl offer and they have informed me, having reviewed the process of negotiations and the terms of the offer, that "the terms negotiated are both reasonable in relation to property financing and the best that were available at the time". They add that they do not consider "that there are any material areas where you might have expected a better outcome, given the nature of the commodity and your requirements for the way in which it was to be financed" (ie as a property investment on lease-leaseback).

5. I should mention that when we set out to obtain competitive offers for financing the ICC, the Treasury were kept fully informed of all the processes - including the prior invitation to four leading agents which led to the selection of Healey and Baker.

6. Pearl Assurance have now signed the Agreement and the management contractors (Bovis) are ready to let the main contract for the structural steelwork (this was timed for Monday 5 April but has been deferred pending Cabinet's decision). The substructure contract (which is publicly funded at about £5 million) has been completed and the scheme is running to programme for completion in 1985-86.

7. The Chief Secretary, Treasury, adheres to his view that private financing is too expensive. He has suggested that we should inform Pearl that we do not wish to proceed with the Agreement and he has now offered to allocate funds for the project additional to the Property Services Agency Vote over the next four years (total cost at April 1982 prices about £36 million plus provision for variation on price and contingencies).

8. In his earlier advice to colleagues the Chief Secretary, Treasury, said that the Pearl offer would be "at least two or three times as expensive" as public funding. He has suggested that, taking account of the rent review formula, it could be three-and-a-half to four times as expensive. Even allowing for the rent review clause the cost is not widely different from that put to colleagues at the time the decision to proceed was taken. But, in any case, I cannot accept this basis of calculation. It assumes that the real cost of Government borrowing is 2 per cent per annum and that the rent of the ICC will rise in line with inflation throughout the 125 years of the lease. Both the method of comparison and the assumptions on which it is based are open to question. On equally plausible, I would say more realistic, assumptions (eg Government borrowing at $2\frac{1}{2}$ per cent per annum), the cost differential can be shown to be well within the range of two to three originally reported to Cabinet. All calculations of this kind, where market forces will determine the eventual cost, are highly artificial. In fact, it is unlikely that the ICC rent will keep pace with inflation in the longer run, since there is no provision in the lease for refurbishment of the building, whereas the market rents for office buildings will reflect modernisation.

9. The Treasury have also criticised the fact that there is no break-clause in the lease. It is quite unrealistic to suppose that there could be, since the building is designed expressly for Government purposes and there is no question but that the Government would wish to remain in occupation (at the end of the lease, both the building and the site will revert to the Crown). Nothing proves that more clearly than that the Chief Secretary, Treasury, is now prepared for it to be built at public expense.

CONCLUSION

10. I believe that to drop Pearl now would be a major breach of good faith. They have adhered strictly to the original agreement in principle, which we announced publicly last July, and we have no good grounds for going back on it. If we did so, the Government's credibility will be put at risk for future joint financing ventures. Having entered into such negotiations, and reached a satisfactory conclusion, we must show that we have the will to carry it through. I believe that the deal as formulated is the best that can be got in the private sector and, since Cabinet decided that the ICC was needed but there were no public funds available, it was right to negotiate it.

11. I therefore seek colleagues' approval to sign the Agreement forthwith.

M H

Department of the Environment

2 April 1982