

CONFIDENTIAL



MBAM

Jim (the last word to hope)
East
6/7
Buildings

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

6 July 1981

Dear Sir

INTERNATIONAL CONFERENCE CENTRE

While the Prime Minister has decided that the question of financing the International Conference Centre should not be reopened, I must comment on some of the points made in your minute to her of 30 June.

I know, though I do not share, your views of the wider implications of the decision to finance the Conference Centre in this way but I do not think it should be suggested that the agreement with Pearl Assurance is itself imprudent or the terms unreasonable. Certainly the total long-term cost will be greater than if the project were publicly funded: that is almost certain to be the case if one is renting rather than buying any commodity, although the extent of the difference in the case of property development depends on the assumptions made about inflation generally, increases in building costs and future rental movements in the area concerned, coupled with the financing costs, initial rent level and, most of all, the discount rate employed. Clearly, the lower the discount rate the greater the NPV of future rent payments and the less attractive the leasing alternative. But there is nothing unusual or disreputable about leasing: 60% of the Government office estate is leased and, of course, it is common practice in the private sector (where there may be tax advantages).

Having obtained the Cabinet's agreement to exploring the prospects for private financing, PSA prepared an assessment of the terms likely to be obtainable. This assessment was confirmed by 3 of the 4 leading firms of estate agents who were consulted initially (the 4th doubted whether the amount required could be raised for a project of this kind.) I also consulted David Young (Keith Joseph's Special Adviser) who suggested joint public/private funding but also commented that "Presented enthusiastically by the right Agent, I believe that it would enable us to obtain financing terms in the lower range of the 5½% - 7½% spectrum". Healey and Baker were then appointed to explore the market and, after approaching some 40 institutions etc, strongly recommended the offer by Pearl Assurance. That offer provides finance during construction at 10% and an initial rent of 6.123% of the total cost. This is well towards the lower end of the range that we were expecting to find. No rent becomes payable until completion of the building in 1986 and thereafter there is a conventional pattern of 5-yearly rent reviews. At the end of the lease the building becomes the property of the Government, since we retain the freehold of the site. Altogether, I do not think that these terms would be regarded as in any way unreasonable in the property world. Indeed, other potential investors were looking for a significantly higher rate of return.

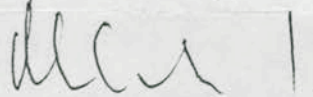
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Finally, you have commented more than once that the Pearl offer involves no significant commercial risk for them. Certainly they have the benefit of the Crown covenant and an assured tenant for the length of the lease. But they are looking to future rent reviews to maintain and enhance the value of their investment. Those reviews will be related to the future movement of office rents in the Victoria area. These have reached a high level and it is a matter of judgement whether they will continue to show a marked rate of increase. Some commentators believe that it may slow down, as new office space comes onto the market in locations closer to the City; and some of the institutions approached for the financing of the Conference Centre decided that they did not want to increase their property holdings in the Victoria area. The long-term demand for office space in London is distinctly speculative. This is the risk that the Pearl are accepting on this very large investment. The initial rate of return is probably slightly higher than for conventional office developments and this also reflects an element of risk in view of the size of the investment, the lack of future opportunities for refurbishment and reletting, and the fact that for these reasons (and not being a freehold interest) it is almost certainly a less readily marketable asset than a normal office development.

For all these reasons, I consider that the financing arrangements for the Conference Centre are a perfectly reasonable and defensible way of acquiring the facilities we need. It is a normal method of property development. The Public Accounts Committee have made it clear that they prefer Crown-ownership to leasing, but that is not to say that leasing is not a respectable form of tenure.

I will be writing to you separately about the general question of involving private finance in public sector capital projects. The purpose of this letter is simply to put on record that I believe that the arrangements made in this particular case have been well considered and are reasonable.

I am sending copies of this to the Prime Minister, the Home and Foreign Secretaries and Sir Robert Armstrong.

Yours ever


MICHAEL HESELTINE



Gov. Bldg.

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/16529/81

Your ref:

10 AUG 81

See copy

R

INTERNATIONAL CONFERENCE CENTRE ✓

11/4

Thank you for your letter of 22 July.

While gilt-edged borrowing might well be cheaper in the long term, I do not think that one should interpret this as meaning that we are not getting "good value for money" by the route we have taken. They are two different methods of financing the project and the terms we have got from Pearl are reasonable. Moreover, under these arrangements we do not start paying rent until 1986 and then at 6.123% on the amount "borrowed" until the first rent review in 1991. It is not possible to compare the real rate of return until we know the future rate of inflation and future rental movements in the Victoria area.

I accept that any similar projects must be considered on their merits, but if it is decided that a project to which the Government attaches importance should go ahead only if a leasing solution can be found, in view of the constraints on public borrowing, I do not think that this should be represented as "a device to get round normal accounting rules". The leasing alternative that we have adopted is perfectly reputable and normal commercially.

I am copying this letter to the Prime Minister, the Foreign Secretary, the Home Secretary and Sir Robert Armstrong.

yours
M

MICHAEL HESELTINE

11 AUG 1981





*Gov Bldg
Mr Lamberton
22/7*

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

22 July 1981

The Rt. Hon. Michael Heseltine MP
Secretary of State for the Environment

✓ Lamberton

Dear Michael

*R.
24/7*

INTERNATIONAL CONFERENCE CENTRE

Thank you for your letter of 6 July.

It is useful to have your views on record. I do not wish to say more on the substance of the decision. There are, however, two further comments I think I must make on your letter.

The first is on the cost of financing the Centre. My concern is that it will prove much more expensive than if the project had been funded in the conventional way.

We are essentially comparing two continuing streams of payment. One is the rent paid to Pearl Assurance. The other is the rate of interest paid on conventional Government debt. The assessment by my officials estimated the initial rent as equivalent to an annual real rate of return of about 5 per cent, which will be maintained if money rents keep pace with inflation. This can be compared with a real return on gilt-edged borrowing of say 2-2½ per cent per annum. That was why I believed that the financing of the Centre will be more expensive arranged through the Pearl, reasonable as the Pearl offer may be for a deal of its type. I do not think we are getting good value for money in this case.

Secondly, you consider that the decision on the Conference Centre could be a precedent for similar projects involving direct finance. This I must contest. In my view it must be an exceptional decision, not to be repeated.

If proposals are made for extending the public sector's de facto ownership of property, they must be considered on their merits as new proposals, on all fours with projects financed in the conventional way. Decisions on such expenditure should not be dependent on special and more expensive

/arrangements



arrangements for financing as a device to get round normal accounting rules.

I am sending copies of this letter to the Prime Minister, the Foreign Secretary, the Home Secretary and Sir Robert Armstrong.

A large, stylized handwritten mark, possibly a signature or initials, consisting of a vertical line on the left and a horizontal line extending to the right.

GEOFFREY HOWE

A handwritten signature in cursive script, appearing to read "John", with a horizontal line underneath it.



22 JUL 1981



The National Archives

LETTERCODE/SERIES <i>PREM 19</i>	Date and sign
PIECE/ITEM (one piece/item number) <i>771</i>	
Extract/Item details: <i>Minute to Whitmore/PM dated 21 July 1981 & attached side note</i>	
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Extract/Item details: <i>Letter Channing to Rickett dated 14 July 1981</i>	
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