

ONE BIRDCAGE WALK LEASE AND FINANCE FAQ

Institution of
**MECHANICAL
ENGINEERS**

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This document is updated regularly.

FAQs

During our consultation, we received many questions about the proposed long-term lease and about the financial issues raised by the project. Below is a collation of the questions we have been asked most frequently.

Lease

Why would the lease be so long?

We need to grant a lease of this length so that we maximise the funds we raise from 3 Birdcage Walk. We have been advised that if the lease is 100 years or below, we will receive a considerably lower sum than we would receive for a longer lease.

What is the difference between an outright sale of 3 Birdcage Walk and the sale of a 250-year lease?

We have been advised that we can expect a similar sum for the sale of the freehold of 3 Birdcage Walk and for selling a long lease. The advantage of selling a lease is that we will have some control, albeit limited, over the activities in 3 Birdcage Walk. Our decision on which option we take will depend on the offer we receive from a would-be purchaser – our priority is to maximise the sale price for the Institution.

What rent would the Institution receive for a long lease?

We will receive a capital sum for the sale of the lease, but we will not receive any rental income, apart from possibly a peppercorn rent.

Does the Institution own the freeholds of 1 and 3 Birdcage Walk?

Yes, we own the freeholds to both buildings.

Who do you think would buy 3 Birdcage Walk given so many businesses are reducing their office space?

We have been advised that due to its location the building is likely to attract the biggest value for residential use.

What is the risk of an organisation we do not want to be associated with taking the lease of 3BCW?

We will draft the lease agreement to include certain restrictions on the use of 3BCW. We want to minimise the restrictions to maximise value but ensure there are sufficient to protect our interests. These details will be developed with legal support in the event we progress to that stage.

Finance

Does this make financial sense?

The venue space in the refurbished building will be the same size as now but more flexible and of higher quality so the potential for venue hire income should be improved in the medium term. Recent high levels of enquiries have shown that demand for these types of events remains post-COVID-19.

Income from tenants will be eliminated (except for a very small space occupied by the Support Network, the independent benevolent fund for the IMechE) but operating costs will be reduced both by less space, a much less leaky building, and by more modern services so that the net position is expected to be flat.

Since the whole of 1BCW is being refurbished, capital expenditure requirements should be very low for a number of years. The plan is to establish a designated fund for refurbishment so that there are sufficient reserves for the next cycle of modernisation.

What if the property market means a poor value leasehold?

The proposal is that we only accept an offer on the sale of the leasehold of 3BCW above an agreed minimum value (we can't share this due to market sensitivity). If this value cannot be obtained, we will pause the project and review our plans. At present the Westminster property market is very buoyant and the agents are confident we will achieve the valuation we need.

What happens during construction?

A logistics plan has been developed to ensure that there is staff space and event space available during the construction phase by renting a location somewhere else in London. The building itself is not expected to be accessible. The cost of this is included within the project cost plan.

Where will member events be held during refurbishment?

We intend to rent space somewhere in London to support staff and member needs during the period of construction.

What about the loss of rental income?

The loss of income from the current tenants in 3BCW would be almost entirely offset by the reduction in maintenance and operational cost across 3BCW.

What about next time we need a major refurbishment?

The next time a major investment like this is likely to be required in the building is in over 10-20 years' time. It is difficult to predict what will be happening by then. The finance board are currently scrutinising the likely P&L and level of free reserves on a 10+ year horizon, including consideration of maturing investments, freedom from our pension liability, as well as an ongoing maintenance and operation and periodic refurbishment plan.

What about all our building tenants and the income they bring?

Our tenants pay well below the market rate for the space they lease due to the poor quality of the building finishes and services. Over the period of the refurbishment, the lost tenant revenue will be fully offset by the reduction in building operational costs. Following refurbishment, we will be able to charge full market rates for rental.

What is the revenue we receive from tenants and room hire at BCW?

The most reliable figures are from 2019, the last normal year before the pandemic. These show the building was self-sufficient funding-wise. In 2019, the gross BCW costs totalled £1,283k which included facilities department costs and building depreciation. We received income of £592k from venue hire from Birdcage Walk and £690k rental income.

How would maintenance and refurbishment of the building be funded without the option of selling a long lease for 3 BCW?

We do not have the level of free reserves required to do the work, so should the members wish to retain the whole site we would have to seek a mortgage, for which we would require 2/3 majority support in a subsequent vote.

What happened to the funds from the sale of the publishing business a few years back and why can't they fund the work?

Funds released from the sale of the publishing business have been mainly invested in the Stephenson fund, the PEP companies, and in reducing the pension fund deficit. The Stephenson fund investment will not mature until 2024 at the earliest, and it may be more financially prudent to keep investments through that fund which is performing well. The PEP companies had a difficult time a few years ago but were performing well before the Covid pandemic (as shown in the 2019 accounts). Although they are recovering from COVID-19, the PEP companies will not be able to provide significant profits in the required timescale. This means that we do not have the level of free reserves to fund the repair and refurbishment work hence the proposal today. For more information on the performance of our PEP companies, please see our latest annual review.

What contingency has been allowed for cost growth in the 1 BCW refurb project?

The project plan includes different scenarios with different levels of contingency applied, one of the biggest factors which dictates the level of contingency is the sale price for the leasehold of 3BCW which is subject to a large margin of variance due to market interest.

Common to all scenarios we have

10% design development

10% construction risk

1% employers changes

14% Inflation

Scenario specific modelling also include up to an additional 20-40% contingency of build cost.

What would the economics of a mortgage look like? i.e. how many years until the reduced future operating cost paid off the mortgage

A mortgage for essential repairs only to 1 and 3 BCW would increase operating costs because of the additional depreciation on the capital costs of the work, with only a marginal saving in heating (probably not even enough to pay the interest on the mortgage) so all mortgage capital repayments and additional depreciation would have to be funded by reducing operating costs in some other way i.e. by reducing services. While some (but not all) of the mortgage repayment could be funded by selling other assets e.g. our investments or the Sheffield building, these assets also generate income so we would still have to cut services to cover the loss of that income.

Leasing 3 BCW is a one-off. How will the Institution ensure that future maintenance of 1 BCW and all other assets is sustainably funded?

The plan is that each year the trustees would designate (i.e. set aside into a protected fund) some of our free reserves into a renewal and refurbishment fund so that by the time significant work needed doing in the future we would have sufficient reserves in hand. Ideally, the amount each year would be equal to the depreciation on the refurbishment capital costs. This will require reductions in operating expenses to enable generation of sufficient free reserves each year for this purpose because of the additional depreciation costs of the refurbishment.

Charitable fund raising

We have investigated this option. The advice of the fundraising professionals we spoke with indicated that there are two main problems here:

1: We don't need the space within 3BCW therefore it is hard to find a material upside for those who offer funds, and we are increasing both the project cost and future operational cost if we keep it.

2: It takes many years of preparatory work to build up to a major fundraising exercise like this. We don't have those years to wait to get certainty as to whether we can proceed.

Increase subscriptions to pay for the work

We do not intend to increase subscriptions to pay for the work.

Refurbishment costs: What is the cost breakdown of the £16 million?

We can't provide this breakdown as it is commercially sensitive in the event the project proceeds, approximate breakdown:

Superstructure – 5%

Internal finishes – 11%

Furniture, Fixtures and Equipment – 4%

Services – 45%

External works – 35%

Why is there such lack of detail in the risk assessment pack?

The document is a high-level overview and we cannot publish the full risk register for reasons of commercial sensitivity.

Regarding the recent key risks document from the Real State Strategy Group, can you please elaborate on the following quotation under section B4 (Costs):

"Mitigation at this stage is: i) a series of base cost increase assumptions that add up to approximately 50% on top of the assessed build costs: ii) in addition, contingencies constitute a further 75% on the build costs"

No, there is some contingency within the £16m figure which has been shared but not the full amount included within the scenario planning.

Why are so few finance details being made public to members?

The financial details are commercially sensitive. If we were to share the project finances with membership we would essentially be making them public, this would put us at a significant commercial disadvantage.

If I have further questions, how can I get answers?

Please email us at birdcagewalk@imeche.org