DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBAP/88/197
Corrected: 8/29/88

CONFIDENTIAL

August 9, 1988

To: *Members of the Executive Board*

From: The Acting Secretary

Subject: Acquisition of Western Presbyterian Church Property and Enlargement of Fund Headquarters Building

Attached for consideration by the Executive Directors is a paper on the acquisition of the Western Presbyterian Church property and enlargement of Fund headquarters building which is proposed to be brought to the agenda for discussion on Wednesday, August 31, 1988. A draft decision appears on page 20.

Mr. Kaiser (ext. 7461), or for Section V Mr. Keuppens (ext. 7823), is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Acquisition of Western Presbyterian Church Property and Enlargement of Fund Headquarters Building

Prepared by the Administration and Treasurer's Departments

Approved by Graeme Rea and Gerhard Laske

August 8, 1988

I. Background

The stated policy objective of the Fund is to accommodate all its Washington-based staff in its headquarters building. This policy was endorsed by the Executive Board when it authorized the Fund to construct the present building on the block bounded by 19th and 20th Streets and G and H Streets ("Square 120"), and was reaffirmed when a further wing ("Phase IIa") was added to the building in the early 1980s. The enlarged building proved insufficient to meet this policy objective, and since 1983 the Fund has been leasing premises several blocks away, at International Square. At the present time, the Fund is leasing slightly over 130,000 sq. ft. at International Square, which is being used to accommodate the Bureau of Statistics and the Bureau of Language Services, and which by the end of the summer will also house the Joint Library. With the transfer of the Library, some 300 Fund personnel will be located in leased space.

Although the transfer of the Joint Library will relieve most of the current overcrowding in the headquarters building and provide a limited amount of space for expansion, this space will barely be sufficient to cope with the increase in personnel approved in the FY 1989 budget. There will be little flexibility to accommodate shifts in demand for space or to meet temporary needs which arise from time to time, and no material reserve for any growth that may occur in future years.

Since the completion of Phase IIa, the Fund has been obliged to lease all the space needed for the personnel and facilities which cannot be accommodated in the headquarters building. It has responded to the problem as it has arisen, generally after the need for further space has become acute. Unless action is taken to expand the headquarters building itself, the Fund will have no option but to continue to rely on the local leasehold market to accommodate all its needs for additional space, with the nature, location, and cost of the space being determined by what happens to be available in the market from time to time. This involves considerable direct costs in terms of rental payments and expenditures to equip and refurbish the leased premises to meet the Fund's needs. It also involves risks and uncertainty for the institution, and inconvenience both for the staff who are located some distance from headquarters, and for staff from headquarters who need to use the facilities located elsewhere.

Clearly, a much more satisfactory solution would be to expand the headquarters building, so that all the Fund's personnel and facilities can be housed in a single location which is owned and controlled by the Fund. Expanding the headquarters building is only feasible, however, if the Fund can acquire the remaining portion of Square 120, consisting of a public alley and the land occupied at present by the Western Presbyterian Church ("WPC"). As explained in more detail later in this paper, acquisition of this additional land would permit the Fund to construct an extension to headquarters which would meet all its existing needs and would also provide space for possible future growth. Any of this space which is in excess of the Fund's own needs from time to time could be leased out to suitable tenants. Although the land acquisition and construction would involve a substantial capital outlay, the Fund could expect to achieve significant cost savings over the longer time in comparison to leasing, and would enhance the valuable, and potentially saleable, asset represented by the headquarters building.

In a preliminary discussion of the Fund's space needs last month, some Executive Directors indicated that they would wish to have a clearer understanding of the likely size of the Fund's personnel complement in the years ahead, before reaching a decision to expand the headquarters building. This caution is appropriate, and full opportunity will be given to the Executive Board to examine and discuss the issue before it is asked to reach such a decision. In recent years, management, in its annual budget proposals, has shown a firm commitment to limiting as far as reasonably practicable the growth of the institution. This commitment will continue, as will the effort to increase productivity through the application of technology and automation. However, it should be recognized that the number and composition of the Fund's personnel during any given period must be determined primarily by the need of the membership for the Fund's services. On the basis of the need that exists at present, it does not seem likely that the Fund can expect a material reduction in the demand for its services, or the resources needed to meet that demand, in the immediately foreseeable future, nor can the Fund preclude the possibility--perhaps even the probability--that some further growth may be necessary.

These propositions, and their implications for the space needs of the Fund, should and will be discussed further with the Executive Board in due course. The purpose of the present paper, however, is to address a more limited issue, namely, the desirability of action by the Fund at this time to acquire the balance of the land in Square 120. If it acquires this land, and the zoning approvals necessary to develop it, the Fund will secure for itself the option to expand the headquarters building as necessary to meet its present and, to a substantial degree, its possible future needs for more space. If it does not acquire the land, it will have no option but to continue to rely on leasing arrangements to meet these needs, however costly and inconvenient such arrangements may be.

The Fund first explored the possibility of acquiring the WPC property in the mid-1960s, when it was buying all the other properties in Square 120. At that time, the leadership and the congregation of the WPC were willing to negotiate an arrangement with the Fund. Their position changed when they found that any proceeds from the sale of property or development rights of the church would accrue to the parent organization of Presbyterian churches in the Washington area, the Washington Area Presbytery, and that those proceeds could be allocated as the Presbytery saw fit and not necessarily to the benefit of the member church concerned. The negotiations were broken off, and the Fund proceeded to construct its headquarters on the balance of the block. The prospects for a successful acquisition are greater now than they were before, because the Washington Area Presbytery has relaxed some of the earlier restrictions on financial transactions of its member churches. It appears that, subject to some limitations, a member church is now allowed to sell its land and buildings for a replacement church within the same general area as its present location.

In light of these considerations, management last year recommended that the Executive Board authorize a feasibility study on the acquisition of the WPC property (EBAP/87/61, Sup. 1, 5/15/87). At its meeting on June 5, 1987, the Board authorized management to proceed with the study. It was explained to the Board that the study would examine the feasibility of an approach under which the Fund, by agreement with the WPC, might acquire a suitable site for the church elsewhere in the vicinity and undertake to construct a new church for the WPC on that site, in exchange for the present church site. This package approach had been recommended by the Fund's real estate and zoning consultants as the one most likely to interest the WPC and to lead to a speedy decision on its part. Another element of the package, intended to make it more attractive to the WPC, would be the provision by the Fund of a capital endowment which could be used by the WPC to enhance its local mission activities. Following authorization by the Executive Board, the staff engaged the services of firms with expertise in the legal, real-estate development, and architectural and engineering fields to carry out the study, which has now been completed.

It should be emphasized that, up to this point, contacts with the church about a possible acquisition have been very limited and informal, and there has been no discussion of the findings of the feasibility study. Nor has there been any indication to potential sellers that the Fund is interested in acquiring their land. It is most important that information on these matters, and particularly on the cost estimates referred to in this paper, be kept confidential, lest disclosure prejudice the position of the Fund in any subsequent negotiations.

II. Findings of the Study

It has been difficult to locate suitable sites nearby for a new church. Much of the local area is covered by the George Washington University campus. The remainder is increasingly occupied by high-rise commercial office buildings, interspersed with older but fully-occupied residential structures. Nevertheless, two sites have been identified as potentially suitable and available for purchase. Both are appropriately zoned and could accommodate a church building of the requisite size. It is estimated that the present cost of acquiring either site, including amounts that might be necessary to obtain options to purchase, would be between $15 million and $17 million. The consultants have prepared a number of preliminary designs and site plans for a new church, which incorporate with different degrees of emphasis the components necessary for the church's urban mission. Considering the range represented by those designs, it is estimated that a suitable church building could be constructed and prepared for occupancy on either site for an amount between $6 million and $8 million. These figures include provision for a capital endowment referred to earlier.

In addition to acquiring the present church site, the Fund would wish to obtain all approvals from the zoning authorities necessary to permit it to build an extension to headquarters on the site. The Fund's zoning counsel, who participated in the study, believes that the Fund would be able to obtain such approvals. The likelihood of a favorable ruling would be enhanced if the Fund's zoning request were linked with the planned provision of a new church for the WPC in the vicinity, along with actions to ensure that its role in the local community would be continued and perhaps reinforced. In order to initiate the approvals process, assist in formalizing the necessary arrangements between the parties concerned, and prepare the many plans and other documents for presentation to the District of Columbia authorities, a certain amount of architectural, engineering, and legal work in connection with both a new church and potential future construction by the Fund would be needed, at an estimated cost of about $2 million.

The cost estimates of acquiring a new church site and building a new church on it, presented above, have been carefully assessed, but there are inevitably some uncertainties. The timing and method of the land purchase, combined with whether or not the Fund's identity as the purchaser remained undisclosed during the negotiating phase, could affect costs. Moreover, greater precision in the definition of the church's mission and its views on the desired design of the new church, as well as any unexpected conditions which inevitably occur in a construction project of this magnitude, also have potential cost implications and need to be taken into account in some fashion. Accordingly, a contingency amount of $2.5 million, or about 10 percent of the upper estimate of the cost of land plus construction, is proposed. Thus, the estimated cost of implementing the conclusions of the feasibility study amounts to between $25.5 million and $29.5 million, as summarized below. For purposes of this paper, the total cost will be assumed to be $30 million.

Estimated Cost Summary
(In millions of U.S. dollars)

Site acquisition	15.0 to 17.0
Construction and endowment	6.0 to 8.0
Documentation for zoning	2.0
Contingency	2.5
Total	25.5 to 29.5

III. Considerations Affecting a Decision to Purchase the WPC Property

1. The Fund's development potential

If the Fund were to become the sole property owner of Square 120 by acquiring the WPC site, it would be in a uniquely favorable position in terms of the amount of floor space it could erect on the site.

Any other owner of the WPC property would be permitted to build about 158,000 sq. ft. of floor space, or ten times the area of the property. However, because the zoning regulations in effect when the present headquarters building was built allowed a lesser extent of development than is currently permitted, the Fund has what is, in effect, a "development bonus" of some 228,000 sq. ft. which could be incorporated in a building that would complete the development of the whole block. Using land costs of the World Bank's new "J" building as a guide, land in the vicinity of a size sufficient to permit construction of the full 386,000 sq. ft. of floor space which the Fund, as the sole owner of Square 120, would be allowed to add to its present building would cost between $46 million and $66 million. In other words, by purchasing the church property at a cost of some $30 million, the Fund would acquire construction rights which, in the case of any other site in the area, would normally require a much larger capital expenditure.

2. Capacity of new extension

As part of the feasibility study, the Fund's architectural consultants have prepared a very preliminary design for a new extension which would take advantage of the full development potential available to the Fund. The configuration of the extension at this stage continues the design and standards of the existing building; it includes maintaining the existing proportions of office and common or "public" space, and it envisages the return of all 300 staff at International Square, including the Joint Library, and expanded food service facilities. The preliminary design does not contain additional parking, as the D.C. authorities continue to place severe restrictions on parking space in order to favor public mass transportation. On the basis of the preliminary design, it is estimated that the extension could accommodate between 600 and 700 persons. The consultants have also estimated that an extension of this size would take about four years to design and build, and at current prices would cost about $90 million to complete.

Given the uncertainties regarding the staffing levels of the Fund in the future, it is not possible at this point to determine conclusively whether the whole of such an extension will actually be needed by the Fund for its own use over the long term. However, if a decision were taken to develop the remainder of Square 120 to its full potential, it would be open to the Fund, with due regard to structural and security requirements, to offer surplus space in excess of a prudent reserve for lease to acceptable tenants, on terms which would not prejudice the Fund's use of the space when needed.

3. Possible purchase of an alternative building or site

As an alternative way of meeting its space requirements to the extent these cannot be accommodated in the existing headquarters, the Fund could decide to buy another office building in the vicinity and either renovate it or raze it and construct another building on the site. While this would achieve the policy objective of housing all its staff in owned premises, it would clearly be very much a second-best alternative. The cost of acquiring land outside Square 120 and constructing a building of some 380,000 sq. ft. would almost certainly be substantially greater than the cost of expanding the present building. As indicated above, the site cost alone would be between $46 million and $66 million. Construction costs would also be higher because a building on a new site could not make use of the basic heating, cooling, electrical and water systems already in place in the headquarters building. 1/ In any event, the alternative of a building on a new site does not seem feasible in the foreseeable future; two local commercial real estate development firms have advised the Fund that they know of no suitably zoned property or building that is either available on the market now, or will be coming available in the next three to five years, in the area bounded by 15th Street on the east, 23rd Street on the west, K Street on the north, and Virginia Avenue on the south.

4. Continued leasing compared with extension of building

The only other alternative that is open to the Fund for its long-term space needs is to rely on leasehold accommodation. Attachment I compares costs of leasing over 37 years, on both a cumulative cash and a present value basis, with the cost of acquiring the church property and constructing a "Phase III" extension to headquarters. The present value analysis takes into consideration the time value of money, and it projects at what point in the future the cumulative cash payments for leasing would exceed the cumulative cash payments for purchase and construction. A "cost of money" rate that approximates the rate of remuneration is used for discounting purposes: in Attachment I that rate is 6 percent. Two possible scenarios are examined in Attachment I: "Static Manpower & Space," where manpower and leased space are assumed to remain at FY 1989 levels; and "Marginally Increasing Manpower & Space," where manpower is assumed to increase at 0.5 percent per annum. It will be understood that these assumptions are presented purely for illustrative purposes, and are not intended to be forecasts of how the Fund's manpower needs will actually develop.

1/ The existing systems were designed with a view to the need to supply a building that occupied the whole of Square 120.

Since it seems unlikely that there will be no increase at all in the Fund's manpower and its consequential need for space after FY 1989, the calculations presented in the "no growth" scenario must be regarded as extremely conservative. Under this scenario the Fund would pay a minimum of $4.1 million per annum in rent alone, and over the term of its current leases, (i.e., through FY 1994) would incur "sunk" costs of $28.2 million. On a cash basis, the cumulative cost of leasing would meet or exceed the combined cost of acquiring the church property and constructing "Phase III" in the 22nd year. On a present value basis this would occur in the 37th year. Those points are referred to as "breakeven points" in Attachment I.

The second scenario in Attachment I assumes an increase of some 379 employees over a 37-year period, or an average of about 10 persons per year. This too is a conservative assumption when compared with actual experience in the past. It is also assumed that the Fund could acquire additional leased space in exact correspondence with the increase in its personnel, whereas in practice the Fund would not be able to do this and would have to carry the cost of leasing some excess space. Even without taking this into account, however, over the term of current leases alone the Fund under this second scenario can expect to pay about $29 million in "sunk" costs, i.e., about the same amount needed to acquire the church property. As far as total costs are concerned, the "breakeven" points would occur in the 19th year on a cash basis, and in the 27th year on a present value basis. The results of the comparison are summarized in the table below.

Cumulative Lease Payments versus
Purchase and Construction Costs

	Static Manpower and Space		Marginally Increasing Manpower and Space	
	Cash Basis	Present Value Basis	Cash Basis	Present Value Basis
Breakeven point 1/	22nd year	37th year	19th year	27th year

1/ Based on purchase and construction estimates of $119,975,000 (cash) and $94,574,000 (net present value at six percent discount rate).

While rates higher or lower than 6 percent could be used for discounting, the leasing projections also incorporate assumptions of increases in leasing costs of from 4 percent to 6 percent each year. If interest rates were to rise significantly in the future, then the cost of money for the Fund would increase; but such costs would also rise for lessors, which would almost certainly result in higher rents for the Fund. Thus, the associated increases in projected lease payments would be likely to offset to an important extent the impact of a higher assumed discount rate. For example, if a 7 percent discount rate is assumed, and no adjustment is made to the projections of leasing costs, the breakeven point for the "marginally increasing" scenario would be about 30 years, instead of the 27 years shown above. On the other hand, should the lease inflation estimates also be adjusted upward, the breakeven point is estimated to be 26 years, or slightly earlier than if the 6 percent discount rate were used. This is because a higher rate of inflation is expected to have a greater impact on leasing costs and profits than upon the cost of money to the Fund.

5. Conclusion

This analysis indicates that the most cost-effective way for the Fund to meet its present level of space requirements, and any additional space requirements that may arise in the future, would be to acquire the WPC property and construct an extension to its present headquarters building. In addition to significant direct financial benefits in comparison with the other possible alternatives, this solution would avoid the inconvenience and loss of productivity associated with having staff distributed among two or more buildings in different locations. Continuing to rely on leased property is inherently unsatisfactory, and the other possible alternatives--buying or constructing another building to house personnel who cannot be accommodated in the present building--are not only much less attractive financially but would perpetuate the disadvantages of multiple locations.

The feasibility study has, moreover, identified two facts which argue for early action by the Fund. One is that, even on the most optimistic assumptions, it is likely to take about five years to acquire the WPC land, obtain the necessary zoning approvals and complete the construction of an addition to the headquarters building. In the meantime, the Fund will have to continue to lease a substantial and probably growing amount of space in other buildings. The other is that, as the area in the vicinity of the Fund becomes more fully developed, it is likely to become increasingly difficult to find alternative sites that might be acceptable to the WPC. The fact that there are currently two such sites provides an opportunity for the

Fund at this time to achieve an optimal long-term solution to its space requirements which may not be available in the future. Even if the Executive Board is not persuaded that an expansion of the headquarters building is necessary at present, it would be sensible and prudent to take action now to acquire the remainder of Square 120, in order to secure for the Fund the option to undertake such expansion at some future time.

IV. A Plan of Action

The staff and management, taking into account the advice received from the outside consultants who participated in the feasibility study, have devised a plan of action for the relocation of the church and the acquisition of the remainder of Square 120 by the Fund. Several points should be emphasized at the outset.

First, in order to induce the WPC to relocate it is important that management have authority to make a firm and unqualified proposal to the WPC covering all aspects of the plan, subject only to successful completion of each step in the process. Exploratory contacts indicate that the WPC would not be seriously interested in discussing possible relocation unless it could be assured, from the beginning, that the Fund was both (1) ready to commit itself to the terms agreed upon in those discussions and (2) willing to assume primary responsibility for implementing the various elements of the proposal, in particular the acquisition of a new site, construction of a new church building, and zoning negotiations. Even if the WPC were willing to entertain proposals which, from the Fund side, were expressed to be tentative and subject to Board approval, there would be little incentive for it to make concessions or compromises or to move to an early decision.

It must also be recognized that there is no pressure within the WPC at present either to relocate or to alter the physical plant of the church. Consequently, the Fund must formulate a proposal sufficiently attractive to the church leadership, the congregation, and the Washington Area Presbytery to persuade them that relocation would be beneficial and desirable. The proposal would have to emphasize the value of the new site, the advantages of an improved physical plant and the enhanced financial security that a capital endowment would provide.

Finally, once implementation of the action plan begins, the management must have the freedom to respond quickly and flexibly to circumstances as they arise. For example, since there is no assurance that the current owners of alternative sites for the church would be interested in an option to purchase or a conditional contract in lieu of an outright sale, it may be necessary for management to proceed at once to purchase a site, without further approval by the Executive Board. Similarly, having arranged an option or conditional contract, management may find it expedient to exercise the Fund's right to purchase even though final agreement has not been reached with the WPC, if the time for exercising this right is running out and there is a risk of losing both the Fund's deposit and its right to acquire the property.

For these reasons, the plan of action proposed for Board approval at this time includes all the steps deemed necessary to relocate the church, acquire ownership of the present church property, and secure the zoning approvals necessary to permit for the full development of Square 120. The plan could be accomplished through a sequence of steps, as follows: 1/

1. Contract to purchase alternative sites

The first step would be for the Fund to enter into a contract or contracts with the owners of suitable sites, which would ensure that the Fund could acquire the property at a firm price. This step is essential to provide the Fund with the basis for a firm offer to the WPC. Those contracts could take a number of forms, ranging from the immediate outright purchase of one site to options to purchase or negotiated conditional contracts on both sites, which could involve the payment of nonrefundable deposits. One objective of the contract negotiations would be to limit the financial liability of the Fund should the WPC reject the proposal to relocate or should negotiations with the WPC become protracted. However, as noted above, management would need to have the flexibility to purchase a suitable site even before final agreement is reached with the church, if it finds that this is necessary to avoid losing the site altogether.

2. Commitment from the WPC

The next step would be to secure from the WPC a binding commitment under which, in exchange for the conveyance of its property to the Fund, the WPC would receive a new church on a new site and a cash endowment. Two approaches have been considered: (1) a "turnkey" approach where the Fund takes the responsibility for, and bears the expense of, constructing the new church building and delivers it and the title to the property to the WPC upon completion, or (2) offering

1/ The sequence is summarized and linked to estimated costs in graphic form in Attachment II.

the WPC the necessary amount of capital with which to undertake construction itself. Although the latter approach would be advantageous for the Fund, provided there were enforceable assurances from the church on the timing of construction and the vacating of the site, informal contacts with the church suggest that the church would not wish to have the responsibility for managing the project and would find the "turnkey" approach much more attractive. Moreover, zoning approval to permit an extension to the Fund building is likely to be greatly facilitated if it is linked with the provision of the new church.

3. Zoning and other municipal approvals

The third step would be to obtain the necessary approvals from the local authorities for (1) rezoning either the present WPC property alone or all of Square 120 as a so-called "Planned Unit Development," (2) closing the public alley between the WPC property and that currently owned by the Fund, and (3) as a contingency, denying historic preservation status to the existing church edifice, if an attempt is made by third parties to secure such status. 1/ The Fund and the WPC would already by this point be contractually committed to cooperate and participate jointly in securing necessary local authority approvals.

4. Construction of a new church

The final step would be to construct the new church. Before beginning the construction, the Fund would complete the purchase of the new site for the church and transfer to the WPC the title to the new site. In exchange, the Fund would receive the WPC's entire right, title, and interest to its property in Square 120. As soon as this exchange has been made, construction of the new church would begin under one of the scenarios outlined in paragraph 2 above. Upon certification for occupancy, the WPC would take possession of the new church and the old church building would be demolished. Such matters as the design of the new church and the period of time after its completion for the WPC's relocation would have been agreed with the WPC before work got underway.

The WPC and the Fund would be contractually bound in a number of areas, such as in the seeking of zoning approval, the design aspects of a new church structure and conditions surrounding the exchange of property. Moreover, the Fund would not undertake to construct a new

---

1/ This question has been investigated by the zoning attorneys, and it is felt that such an effort would be unlikely to succeed, particularly since in the circumstances now being contemplated it would not have the support of the WPC itself.

church, or alternatively, release to the WPC the necessary capital for it to do so until zoning approval permitting the Fund to build an extension to its headquarters on the present church site had been received. Nevertheless, there are some risks. If the Fund obtains an option to purchase or enters into a negotiated conditional contract on one or both potential new sites for the church before reaching an agreement with the WPC--an action which may well be necessary in order to ensure the availability of the sites at a reasonable price--it may have to forfeit a deposit should the WPC reject proposals to relocate or should negotiations with the WPC become protracted. Another possibility is that having entered into a firm agreement with the WPC and acquired the land for the new church, the Fund may find that it cannot obtain the necessary approvals to construct an extension to headquarters, and would then have to dispose of the land at the prevailing market price. In those circumstances, in addition to the exposure it might face as a result of having to resell any property acquired in anticipation of the relocation and to forfeit any non-refundable deposits, the Fund would stand to lose most if not all the $2 million it would have invested in architectural, engineering, legal and other work incident to the process of zoning and other approvals. These risks exist, but they are normal commercial risks, and do not seem sufficiently serious to outweigh the considerable benefits which the Fund stands to gain from proceeding with the proposal.

5. Timing of action

It is estimated that the plan of action, from Executive Board approval through razing the current WPC building, would take slightly over three years to complete. At the conclusion of step 3, estimated to be in two to two-and-one-half years time, it would be appropriate for the Executive Board to make a firm decision on whether to undertake the construction of an extension to the headquarters. By that time, the precise implications of any restrictions and allowances resulting from the earlier hearings by the District of Columbia authorities would be known and final definition to the conformation and capacity of such an extension could be determined. It would also be possible at that point to assess more clearly its probable cost. Assuming that the Executive Board decides to proceed with the construction of a new addition, work could begin as soon as the present church is vacated and razed. While an immediate construction start would obviously be financially advantageous, it is expected that the zoning approvals would give the Fund the flexibility to start construction at any time within five years. If construction is not begun within the prescribed period, the Fund would have to apply for a renewed or amended approval.

V. Financing of the Proposed Acquisition

The costs of land acquisition and construction of an extension would represent comparatively large expenditures in the context of the Fund's administrative and capital budgets, and thus raise questions about the financial impact, and in particular about the effect on the Fund's income position and on the rate of charge. This Section summarizes the effect on the Fund's income position and related variables under the present method of determining the net income target and setting the rate of charge on the use of ordinary resources; it also outlines various alternatives that might be considered to mitigate these effects.

Under the Fund's present budget and accounting policies, all administrative outlays, including those for items included in the capital budget (fixed property), are included as an item of current cost in the Fund's total administrative expense in the year the expense is incurred. 1/ The total of these budgeted outlays, including those of a capital nature, are also included in the projection of the Fund's administrative expenses. These are one element in projecting the net income position, which underlies the Executive Board's determination, at the beginning of the financial year, of the rate of charge on the use of ordinary resources. It follows that any increase in fixed property expenditures will--unless the Executive Board decides otherwise--require a higher rate of charge than would otherwise have been necessary to achieve a given target amount of net income.

In years when the level of administrative expenditures is not subject to wide variations, the impact of changes in these expenditures on the rate of charge is small compared to the effect of fluctuations in operational variables such as remuneration payments or the changes in the use of Fund credit. When there is a "lumpiness" in administrative expenditures resulting from nonrecurring outlays like a major construction project, the effect on the rate of charge becomes more pronounced. The estimated effect of the expenditures needed to acquire the present church site and construct an extension to headquarters on the rate of charge, under the present method of setting charges and assuming the current target amount of net income and use of Fund resources to continue unchanged, is summarized in the following table. The table assumes that construction of the extension would begin in FY 1992, as soon as the land acquisition process is completed.

1/ The Fund's policy on accounting for fixed assets were last reviewed in 1985. See "Accounting for Capital Assets" (SM/85/246, 8/27/85, and Executive Board Meeting No. 86/186, 11/21/86).

Proposed Expenditure and Effect on the Rate of Charge

(In millions of SDR and percent)

	Total 1/ Additional Cost in US$	Total 2/ Additional Cost in SDR	Reduction Lease Payments	Effect on the Rate of Charge
FY 1989	18.15	13.85	--	+0.09
FY 1990	2.00	1.53	--	+0.01
FY 1991	9.00	6.87	--	+0.04
FY 1992	32.83	25.05	--	+0.16
FY 1993	29.00	22.13	--	+0.14
FY 1994	29.00	22.13	--	+0.14
FY 1995 3/	--	--	-4.2	-0.03

1/ From Attachment I.
2/ Converted at the June 30, 1988 SDR/US$ rate.
3/ The reduction in the rate of charge shown for 1995 would continue annually thereafter as a result of the expected future reduction of lease payments.

In order fully to cover these expenditures, the rate of charge in FY 1989 would have to be about 9 basis points higher than otherwise; 1/ in FY 1990 and FY 1991--that is, before the construction of the extension starts--the impact would be smaller and amount to 1 and 4 basis points, respectively. During the main construction (FY 1992-1994), coverage of these expenses by charges would raise the rate by about 15 basis points.

The Executive Board will recall that for FY 1989 the basic rate of charge was set at the beginning of the year at 5.5 percent. This rate would remain unchanged for the current year, unless it appears at mid-year that, based on the actual results of the first six months of the year, there will be a substantial shortfall of net income for the year. 2/ As most of the expenditures projected for FY 1989 are

1/ For example, 5.59 percent rather than the agreed 5.50 percent.
2/ The projected income position will be reviewed after completion of the first half of the financial year. If at that time net income, on an annualized basis, falls short of the target amount by SDR 25.1 million, the Executive Board will have to consider how to deal with the situation. If the trigger point were reached, the additional expenditures, if any, in the first half of FY 1989 would be an element that the Board would take into account in this consideration.

expected to occur in the second half of the financial year, the rate of charge for FY 1989 would not be automatically affected by the expenses of the project. However, the expenditures would reduce net income for the year, and thus affect net income in excess of the target amount, if any. It may be recalled that net income at the end of the year in excess of the target amount shall be used retroactively to reduce the rate of charge on the use of ordinary resources for the year. 1/ To the extent that the outlays in FY 1989 for the proposed project reduce net income for the year, they might also reduce any refund to members subject to charges unless the Executive Board decided to offset such an effect.

Assuming that construction of the extension occurs in FY 1992-1994, the rate of charge on ordinary resources would, other things (in particular, the target amount of income) being equal, be about 0.14-0.16 percent higher than in the absence of the additional outlays. After completion of the construction and consequential saving of lease payments, the rate of charge would be lower in the subsequent years by about 0.03-0.04 percent. In the longer term, the result would be a substantial cumulative net saving and a consequential reduction of the rate of charge.

There are at least two possible alternatives the Executive Board could consider to avoid or mitigate the impact of the acquisition and construction on the Fund's income position and on the rate of charge. 2/ The first of these alternatives would involve a temporary modification of the present determination of the net income target and of setting the rate of charge; and the second would call for a change in the Fund's policy of accounting for capital expenditures. These will be discussed in the following paragraphs.

One method to avoid an undesired impact on the rate of charge of the proposed project that would require comparatively little change in present procedures would be a reduction each year in the Fund's target amount of net income by an amount equal to the projected outlays during the year for the proposed project. 3/ The result would

---

1/ See Executive Board Decision No. 8861-(88/67), as amended, Section 11, paragraph 4.

2/ Other possibilities are conceivable but would be more likely to raise legal and possibly also taxation issues, or would conflict with generally accepted accounting principles.

3/ If it were considered desirable not to avoid but to even out over the length of the construction project the impact on the rate of charge, the target amount of income could be raised during periods of low expenses and reduced when expenses are comparatively high. In its results, this method would be similar to prefunding these expenditures, albeit over a limited period.

be that recorded net income and reported reserve accretion would be lower than would otherwise be the case by the amount of these expenses. However, the Fund would acquire an asset (more exactly, increase the value of the existing building) even if it is not reflected in its financial statements, and over time would experience actual saving of administrative expenditures. In economic terms, therefore, the temporary reduction in the target amount of net income and of reported reserve accretion could not be considered imprudent.

Alternatively, the Fund could change its method of accounting for capital expenditures and reflect the acquisition of a fixed asset in its balance sheet. In this context, it may be recalled that when the Fund's policy of accounting for capital expenditures was last considered by the Executive Board, there was general agreement that the expensing of capital outlays in the year of acquisition could be revisited when the Fund again incurred large expenditures of a capital nature. The Fund could adopt the alternative method of depreciation accounting. Under that method, capital outlays for fixed capital with a limited useful life, such as an addition to the headquarters building, would be capitalized and depreciated (i.e., expensed against income) over the estimated life of the asset, thus spreading the absorption of the cost over a longer period. Under this method and assuming that the existing premises of the Fund together with any new addition would be capitalized at net historical cost and written down over a period of, say, 30 years, the increase in the rate of charge would be about 0.03 percent, which would be virtually offset by a similar reduction in the rate of charge as a result of the saving of lease payments. It should be noted that the adoption of depreciation accounting would require consideration by the Executive Board of a number of ancillary issues, such as valuation of existing property, items to be capitalized in the future, depreciation method and period, etc.

VI. Summary and Conclusions

By the end of this year, three major units of the Fund and about 300 of its personnel will be located outside the headquarters building, in leased premises. If the Fund maintains its present size and takes no action either to enlarge the headquarters building or to acquire a second building, it will have no choice but to maintain its present leasing arrangements indefinitely. If any further growth in its manpower and facilities occurs, it will have no choice but to lease all additional space that may be needed in the future to accommodate this further growth.

Reliance on the local leasehold market to meet a significant, and potentially increasing, proportion of its space needs entails material costs, inconvenience, and uncertainties for the institution and its staff. As the area around the Fund continues to develop, it is becoming more difficult to find suitable leasehold space at a reasonable cost. A more desirable and cost-effective solution would be to expand the present headquarters building, so that all the Fund's personnel and facilities can be housed in a single location.

An expansion of the headquarters building is possible only if the Fund can acquire the property presently owned and occupied by the Western Presbyterian Church. A study commissioned by the Executive Board last year has concluded that it is feasible to do this, on terms which are likely to receive favorable consideration by the church, and which would be cost-effective for the Fund. However, in order to induce the church to sell its present site, the Fund must be able to provide it with a suitable alternative site in the neighborhood. At present, it is possible to identify one or two such sites which the Fund might be able to acquire at a reasonable cost; but the number is very limited, and is likely to become more so as development of the area continues. Accordingly, if the Fund wishes to retain the option of expanding the headquarters building, it should be ready to act in the matter as soon as possible.

Acquisition of the church property, and a suitable rezoning of the site, would allow the Fund to build an addition to the headquarters building sufficient to accommodate all of the personnel and facilities currently housed in leased premises, and would provide space for up to 300 or 400 additional staff. An addition of this size would take full advantage of the "development bonus" available to the Fund as the sole owner of the block on which the headquarters is situated. Given the difficulties of predicting what demands will be placed on the Fund in the future, or the implication of these demands for the size of the institution, there can be no absolute assurance either that the Fund would actually need all of this additional space, or that the space would be sufficient for all its future needs. However, to the extent that at the time of occupancy or later the available space exceeded the Fund's own needs, it could arrange to let the surplus space to suitable tenants.

The estimated cost of relocating the church, acquiring the present church site, and obtaining the necessary zoning approvals should not exceed $30 million. The estimated cost of expanding the headquarters building to take full advantage of this site would be about $90 million. For the reasons outlined in Part III above, it is considered that these costs would be more than offset by the direct financial benefits to the Fund, quite apart from the indirect productivity gains that would arise from having all the Fund's staff and facilities consolidated in one building, and the value of the reserve asset represented by an enlarged headquarters building and land.

Given the existing need for more space than can be accommodated in the present headquarters, and the desirability of making some appropriate provision for the possibility of future growth, the Fund would seem justified in commencing the construction of an addition to headquarters as soon as it has acquired the church site. This is an issue which will need to be examined further by the Executive Board before any decision is taken on the matter. Even if the Board were to decide to continue to rely on leasehold arrangements for the present in the expectation that the Fund's space needs might diminish, however, it would seem advisable and prudent for the Fund to acquire the remainder of Square 120, thereby securing for itself the option to enlarge the building at some future time, if this expectation is not realized.

Accordingly, it is recommended that the Board authorize management to enter into and, if possible, conclude arrangements for a relocation of the church and acquisition of the site, and to obtain all necessary zoning approvals, at a total cost not exceeding $30 million. This will involve negotiations with the church authorities and (through intermediaries) with the owners of the possible alternative sites. It is important to the success of these negotiations that management be authorized from the outset to enter into firm and binding commitments covering all aspects of the proposal. As noted in Part V of this paper, the expenditures needed to acquire the church property will have some effects on the Fund's income position, and potentially, on the rate of charge. There will be a more substantial impact if and when action is taken to enlarge the headquarters building. However, a number of possibilities exist for mitigating these effects. To the extent expenditures occur in the current financial year, these would arise only in the second half of the year, and it is proposed that their effect on the Fund's income be discussed in connection with the mid-year review of the income position.

VII. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

Management is authorized to proceed with the acquisition of the Western Presbyterian Church property and to take action to secure appropriate zoning and other municipal approvals on the basis of the plan outlined in Part IV of EBAP/88/197, at a cost not to exceed $30 million, with the understanding that the Executive Board will be informed from time to time of the progress of major elements of the plan, and that management will request further consideration by the Executive Board in the event it appears that any particular element will deviate substantially from the plan in time or cost.

Attachments

LEASING COMPARED TO PURCHASING & CONSTRUCTING

(In thousands of U.S. Dollars)
(As of 7/5/88)

LEASING

	Static Manpower & Space						Marginally Increasing Manpower & Space					
	Years	Manpower[1]	Lease Payments[2]	Cumulative Payments	Present Value[3]	Cumulative Present Value	Years	Manpower[4]	Lease Payments[5]	Cumulative Payments	Present Value[3]	Cumulative Present Value
FY 1989		2,142	4,178	—	—	—		2,142	4,178	—	—	—
FY 1990		2,142	4,328	—	—	—		2,151	4,434	—	—	—
FY 1991		2,142	4,475	—	—	—		2,161	4,695	—	—	—
FY 1992		2,142	4,629	—	—	—		2,170	4,971	—	—	—
FY 1993	5	2,142	5,196	—	—	—	5	2,180	5,710	—	—	—
FY 1994		2,142	5,370	—	—	—		2,190	6,035	—	—	—
FY 1995		2,142	5,550	5,550	3,691	3,691		2,200	6,376	6,376	4,240	4,240
FY 1996		2,142	5,737	11,287	3,600	7,290		2,209	6,736	13,112	4,226	8,467
FY 1997		2,142	5,933	17,220	3,512	10,802		2,219	7,117	20,229	4,212	12,679
FY 1998	10	2,142	6,262	23,482	3,497	14,299	10	2,229	7,670	27,899	4,283	16,962
FY 1999		2,142	6,609	30,091	3,481	17,780		2,239	8,264	36,163	4,354	21,316
FY 2000		2,142	6,975	37,065	3,466	21,247		2,249	8,901	45,065	4,424	25,739
FY 2001		2,142	7,361	44,427	3,451	24,698		2,259	9,585	54,649	4,494	30,233
FY 2002		2,142	7,769	52,196	3,436	28,134		2,270	10,317	64,967	4,563	34,796
FY 2003	15	2,142	8,200	60,395	3,421	31,555	15	2,280	11,103	76,069	4,633	39,429
FY 2004		2,142	8,654	69,049	3,407	34,962		2,290	11,944	88,014	4,702	44,131
FY 2005		2,142	9,133	78,182	3,392	38,354		2,300	12,846	100,860	4,771	48,902
FY 2006		2,142	9,639	87,822	3,377	41,731		2,310	13,813	114,673*	4,839	53,741
FY 2007		2,142	10,173	97,995	3,362	45,093		2,321	14,848	129,521	4,908	58,648
FY 2008	20	2,142	10,737	108,732	3,348	48,441	20	2,331	15,958	145,479	4,976	63,624
FY 2009		2,142	11,166	119,898*	3,285	51,726		2,342	16,895	162,374	4,970	68,594
FY 2010		2,142	11,613	131,511	3,223	54,948		2,352	17,884	180,258	4,963	73,557
FY 2011		2,142	12,077	143,588	3,162	58,110		2,363	18,926	199,184	4,955	78,512
FY 2012		2,142	12,561	156,149	3,102	61,212		2,373	20,025	219,209	4,946	83,457
FY 2013	25	2,142	13,063	169,212	3,044	64,256	25	2,384	21,183	240,392	4,936	88,393*
FY 2014		2,142	13,585	182,797	2,986	67,242		2,395	22,403	262,795	4,924	93,317
FY 2015		2,142	14,129	196,926	2,930	70,172		2,406	23,689	286,484	4,912	98,230
FY 2016		2,142	14,694	211,620	2,875	73,047		2,416	25,044	311,528	4,899	103,129
FY 2017		2,142	15,282	226,902	2,820	75,867		2,427	26,471	337,999	4,885	108,014
FY 2018	30	2,142	15,893	242,795	2,767	78,634	30	2,438	27,974	365,973	4,871	112,885
FY 2019		2,142	16,529	259,324	2,715	81,349		2,449	29,093	395,066	4,779	117,664
FY 2020		2,142	17,190	276,513	2,664	84,013		2,460	30,257	425,323	4,689	122,352
FY 2021		2,142	17,878	294,391	2,613	86,626		2,472	31,467	456,791	4,600	126,952
FY 2022		2,142	18,593	312,984	2,564	89,190		2,484	32,726	489,517	4,513	131,466
FY 2023	35	2,142	19,336	332,320	2,516	91,706*	35	2,496	34,035	523,552	4,428	135,894

PURCHASING & CONSTRUCTING

	Church Buyout	Phase III[6]	Total	Present Value[3]
FY 1989	3,729	650	4,379	4,131
FY 1990	317	1,000	1,317	1,172
FY 1991	18,979	2,000	20,979	17,614
FY 1992	6,300	29,000	35,300	27,961
FY 1993	—	29,000	29,000	21,670
FY 1994	—	29,000	29,000	20,444
FY 1995 onwards	—	—	—	—
Total Cash Payments	29,325	90,650	119,975	92,993

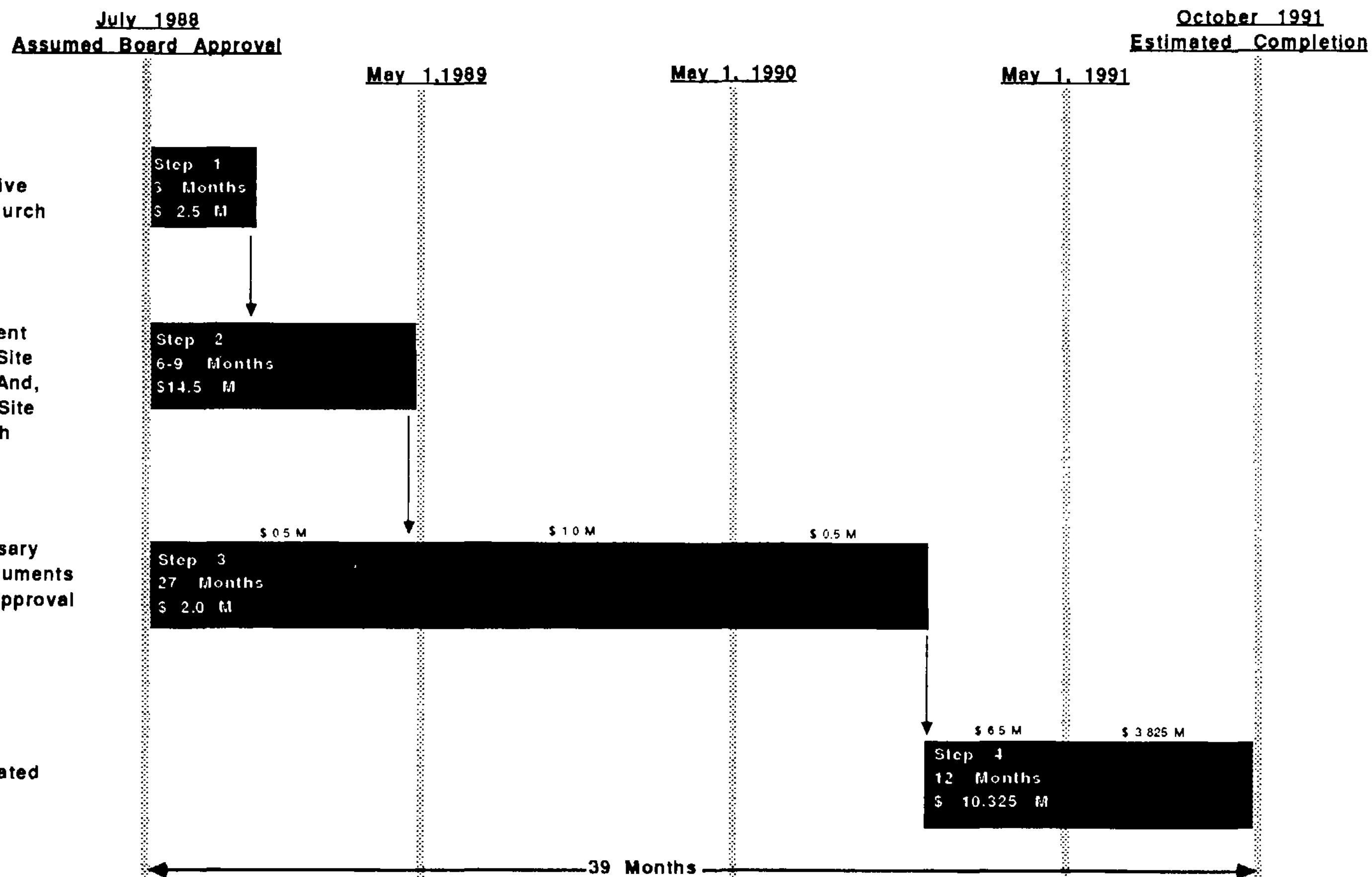
NOTES:

1 Constant at FY 1989 total equivalent manpower level; excludes staff not at HQ or International Square
2. Costs for FY 1989 through FY 1994 are "sunk" costs; costs for FY 1995–1997 are based on O.T. Carr forecasts and annual increases; increases for FY 1998–2008 are at 5.54 percent per annum and for FY 2009 and beyond, at 4.0 percent per annum.
3 At 6 percent per annum
4. Annual increases at 0.5 percent.
5. Based on space increasing at 350 sq. ft. per person; lease payments are computed on the same basis as in Note 2 above.
6. Costs for FY 1989–91 are principally for zoning and preliminary design; for presentational purposes, annual costs thereafter are assumed constant.

*Breakeven Points

ATTACHMENT I

A Plan For Action
Sequence Of Major Events And Associated Estimated Costs



STEP 1
Fund Seeks Option(s) to Purchase Alternative Site(s) to Relocate Church

STEP 2
Fund Obtains Agreement From Church On New Site And Church Building; And, Fund Purchases New Site to Relocate the Church

STEP 3
Fund Prepares Necessary Design And Legal Documents And Obtains Zoning Approval To Construct Phase III On Square120

STEP 4
Church is Built/Relocated on New Site

Estimated Expenditure By Financial Year	FY 1989 $17.5 M	FY1990 $ 1.0 M	FY1991 $ 7.0 M	FY1992 $ 3.825 M	Total $29.325 M

ATTACHMENT II