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COUR DES COMPTES EUROPÉENNE



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**Negotiation by the European Parliament of the rent paid for the buildings
IPE-0, IPE-1 and IPE-2 (also known as WIC and SDM buildings)
situated in Strasbourg**

INTRODUCTION

1. In a letter to the President of the Court of Auditors dated 17 May 2006 the President of the Parliament's Committee on Budgetary Control, Mr Fazakas, wrote that it would be helpful if the Court would extend the scope of its ongoing audit on building expenditure to include certain aspects concerning the Parliament's lease of the WIC and SDM buildings from the City of Strasbourg.

2. The Court of Auditors has decided to carry out work concerning the WIC and SDM buildings. Taking into account that various aspects of this subject have been examined by a working group within the Committee on Budgetary Control, by a task force within the European Parliament (EP) administration and by the EP internal auditor, the scope of the Court's work has been limited to the examination of how the EP negotiated the rental contracts. The Court's work was based on the documents made available to the auditors by the EP administration.

IPE-0

Background

3. In a letter dated 25.5.1979 the President of the EP informed the Mayor of the City of Strasbourg (CS) that at its meeting of 4 and 5.4.1979 the Bureau had decided to rent for 18 years from the date of its completion, expected for the spring of 1980, a building CS was having constructed for the EP (IPE-0). After the initial period of 18 years, the contract would be renewable every year. The building was expected to have a total surface of about 41 000 m². The Bureau considered a total annual rent of 14 611 000 FF acceptable. In the same decision the Bureau had rejected an automatic indexation of the rent, but in his letter the President of the EP mentioned the possibility of price revisions requested by one of the contracting parties and justified by new events¹. With a letter of 5.6.1979

¹ Original French wording of the letter: "Le Bureau élargi du Parlement n'estime pas possible d'appliquer à ce loyer une clause de révision automatique une fois par an en fonction de l'indice du coût de la construction publié par l'Institut National de la

the Mayor of Strasbourg accepted the conditions set out in the letter from the President of the EP.

4. On 4.8.1979 CS informed the EP that about 80 % of the cost of the building was financed by the Société Civile Immobilière "Erasme" (SCI), a company set up by a Dutch pension fund and the Société d'Aménagement et d'Equipement de la Région de Strasbourg (SERS). CS granted to SCI an annual return on investment of 6,5 % over 18 years indexed to building costs ("*Dans le cadre de ce bail, la Ville garantit à l'investisseur pour 18 ans un rendement annuel de 6,5 % de l'investissement indexé sur le coût de la construction*")². The cost of the work financed by CS amounted to 51,6 million FF³.

5. On 4.11.1980 CS⁴ proposed to let to the EP the completed office building, which had an area of about 39 183 m² including meeting rooms, lounges, bars, car parking places, etc. The rent demanded was 465 FF/m², i.e. a total annual rent of 18 220 095 FF. CS stated that this amount resulted from the financial investment and equipment costs borne by the City.

6. A note of 27.11.1980 of the EP Directorate General for Administration, Personnel and Finances set out that:

- in 1979 a rent of 14 600 000 FF for an area of 41 000 m² had been "indicated", the final area being 39 183 m² and certain areas having been "rectified", the amount was reduced to 14 079 000 FF;

Statistique et des Etudes Economiques (INSEE). Toutefois, l'on pourrait prévoir une possibilité de révision des prix à la demande de l'une ou l'autre des parties, et ceci dans le cas où des éléments nouveaux pourraient comporter une modification sensible des loyers fixés".

² Letter of 4.8.1979 from the Secretary General of the CS to the President of the EP.

³ Letter of 17.10.1980 from SERS to the Secretary General of the CS, on file.

⁴ Letter from the mayor of the CS to the President of the EP.

- CS requested that to this amount the return on the investment made directly by the City (51 600 000 FF) be added; a return of 6,5 % resulted in "further rent" for 3 354 000 FF⁵;
- a further amount of 787 095 FF was added because of the increase of the INSEE construction price index;
- the sum of the above amounts (14 079 000 + 3 354 000 + 787 095) gave 18 220 095 FF.

7. In December 1980 the Quaestors⁶ considered the revised rent demanded by CS as reasonable and the Bureau⁷ agreed that a rent contract be signed by the President of the EP.

8. The rent contract was signed on 12.1.1981 and applied from 1.11.1980. The contract stipulated that the area of the building was 39 183 m² and the annual rent 18 220 095 FF. Article 4 of the contract stipulated that the rent might be revised, on request from one of the parties and by mutual agreement, in order to take account of the evolution of the INSEE index of construction costs⁸.

9. On 25.6.1982 CS requested a revision of the rent for 1982 (i.e. the second full year of the renting period) corresponding to the evolution of the INSEE index of construction costs⁹. The EP accepted¹⁰. The same indexation was applied also in

⁵ Original French wording of this place in the note: "A ce chiffre, la Ville de Strasbourg demande d'ajouter la rémunération des investissements complémentaires qu'elle a effectués pour un montant de 51 600 000 FF. A un taux de 6,5 %, cela signifie un loyer supplémentaire de 3 354 000 FF".

⁶ Minutes of the College of the Quaestors meeting of 2.12.1980.

⁷ Minutes of the Bureau meeting of 3.12.1980

⁸ This was the index generally applied to the revision of rents at the time when the contract was signed.

⁹ Letter of 25.6.1982 from CS to the EP Director-General for Administration, Personnel and Finances.

¹⁰ Internal administrative note of 8.10.1982.

1983 and 1984¹¹. From 1.1.1985 the rent was converted into ECU and revised every two years with reference to weighted indices of consumer prices in the European Community¹².

10. According to Article II of the rental contract, its duration was for a period of 18 years. During this period the Parliament reserved the right to terminate the contract at one year's notice without having to pay a compensation, if obliged to leave the place because of changes in the location of the Institutions of the European Community¹³. From 1.11.1998 onwards the contract was tacitly renewed every year.

Observations

11. In December 1980 the Bureau accepted to pay rent calculated on the basis of 465 FF/m² for the whole area of the building. This is higher than any price considered "acceptable" by the Bureau in April 1979 and actually accepted by the Mayor of CS on 5.6.1979. At this date CS was already financing a part of the construction cost, but the Mayor accepted the Bureau's conditions without requesting an increase of the rent. The EP financial controller remarked that the rent calculated on the conditions set by the Bureau in April 1979 would have amounted to 14 000 000 FF, not 18 220 095 FF. The financial controller stated in writing that it was the Bureau's responsibility to decide whether to accept such an increase of the rent (*"...le montant du loyer ne correspond pas à ce que le Bureau, en sa réunion des 4/5 avril 1979 considérait comme acceptable...L'appréciation*

¹¹ Note of 10.2.1984 of the EP Directorate for General Administration.

¹² Codicil of 27.8.1985 to the contract.

¹³ "...dans le cas où il serait obligé de quitter les lieux loués pour faire face aux modifications qui interviendraient à l'équilibre existant en matière d'implantation des institutions de la Communauté Européenne".

de cette augmentation et son acceptation ne peuvent relever que de la compétence du Bureau")¹⁴.

12. The EP was aware that SCI had been granted a 6,5 % return on investment and, as mentioned in paragraphs 6 and 7 above, considered that the same rate could be earned by CS for its part of the investment. However, it does not appear from the available documents that the EP ever ascertained the total construction cost and the part of it supported by each investor.

13. The Bureau rejected an automatic rent indexation and the contract required the agreement of both parties for the revision of the rent. However, the EP accepted the first possible request of an index-linked rent increase without any prior negotiation.

14. At the expiry of the initial period of 18 years the EP should have opened negotiations for a possible reduction of the rent taking into account the capital recovered by the investors, the return obtained on the investment and the written-down value of the depreciated building¹⁵.

¹⁴ Note of 5.11.1980 from the financial controller (Mr Etien) to Mr Paludan-Muller, Director for Administration.

¹⁵ In a special report of 21.6.1979 on accommodation policies of the institutions of the European Communities (OJ C 221, 3.9.79) the Court of Auditors recommended that all institutions examine the possibility of negotiating a reduction of rents after an initial period in which capital and financing costs might have been fully recovered by the investors. The effects of such recommendation were followed-up in paragraph 10.51 of the annual report concerning the financial year 1987 (OJ C 316, 12.12.1988). In its reply to this paragraph the EP stated that it had set in motion interinstitutional cooperation with a view to the renegotiation of leases in Luxembourg.

THE EXTENSIONS TO THE IPE-0 BUILDING: IPE1-2

Background

15. On 6.7.1983 the Bureau decided to invite CS to extend the IPE building¹⁶. On 13.1.1986 the first extension to the IPE building (IPE-1) was delivered to the EP. On 10.6.1986 CS sent to the EP an invoice for the first provisional rent¹⁷. The rent, calculated on the basis of 730 FF/m² applying to a total area of 3 320,80 m², amounted to 2 424 184 FF. This amount, converted into ECU at a rate of 6,70899 FF/ECU, resulted in an amount of 361 333,67 ECU.

16. On 29.12.1986 a codicil to the contract of 12.1.1981 was signed. The codicil stated that the annual rent for the first extension to the building would amount to 361 333,67 ECU and would be added to the rent of the main building. The same codicil stipulated that a second extension to the main building would be delivered at the latest on 31.12.1987. The estimated surface of this second extension was 21 505 m² and a provisional rent was indicated (630 FF/m²).

17. On 5.1.1988 CS informed the EP administration¹⁸ that, the second extension (IPE-2) having been completed, a rent of 2 089 339,70 ECU was requested, calculated on the basis of 680 FF/m² (97,156 ECU/m²) for an area of 21 505 m².

18. Replying to a request from the EP, CS explained that the amount of 630 FF/m² appearing in the codicil of 29.12.86 to the contract of 12.1.1981 was provisional, while the amount of 680 FF/m² resulted from a calculation based on the actual costs¹⁹.

¹⁶ Minute of the meeting of 6.7.1983.

¹⁷ Letter of 10.6.1986 from the Secretary-General of CS to the EP Director for Infrastructure and Internal Service.

¹⁸ Letter from the Secretary-General of CS to the EP Director-General for Administration, Conferences and Interpretation.

¹⁹ Letter of 22.1.1988 from the Secretary-General of CS to the EP Director-General for Administration, Conferences and Interpretation.

19. On 28.1.1988 the EP requested from CS the exact figures concerning the construction costs of the buildings rented in Strasbourg. No reply to this request was obtained and the EP did not insist for obtaining it.

20. On 6.9.1988 CS wrote to the EP that, following remarks made by the EP, the surface of IPE-2 was recalculated at 20 880 m², instead of 21 505 m². This had no substantial effect on the annual rent, which was recalculated at 700,35 FF/m², instead of 680 FF/m², and thus amounted to 2 088 292 ECU, instead of 2 089 339,70 ECU. It was agreed that IPE-2 had been completed on 9.12.1987 and the renting period started on 10.12.1987²⁰.

21. On 22.12.1989 a codicil to the contract of 12.1.1981 was signed. This codicil established the rent for IPE-2 as indicated in the above-mentioned CS letter of 6.9.1988. The rent was added to the rent of the main building.

Observations

22. While aware that, as stated by CS, the requested rents had been calculated with reference to the capital and financial costs of the investments, the EP did not require CS to state the amount of such costs and provide evidence of the charges actually supported by CS. EP accepted the amounts of rent per m² requested by CS and the resulting total amounts.

²⁰ Letter of 6.9.1988 from the Secretary-General of CS to the EP Director-General for Administration, Conferences and Interpretation.

CONCLUSIONS

23. The construction of the IPE buildings is atypical in so far as it took place at a time where major changes occurred in Parliament and where the cost of money was particularly high. Keeping these particular circumstances in mind, it can be concluded that, when negotiating the initial contract, the EP does not appear to have exploited the following facts and arguments:

- on 5.6.1979 the Mayor of Strasbourg accepted to let the IPE O building to the EP for 14 611 000 FF. The contract signed on 12.1.1981 stipulated a rent of 18 220 095 FF. This increase was mainly due to the request by CS for return on its investment. However, when accepting, on 5.6.1979, the price offered by the EP, CS was already making a direct investment, additional to the capital invested by SCI Erasme. At that time this was not considered a reason to request a higher rent;
- while aware that the investors intended to obtain, through the rent, a return on investment of 6,5 %, the EP did not ascertain the total construction cost and the part of it supported by each investor. Consequently, it was not in a position to determine whether the rental amount requested was reasonable.

24. Although in its decision of 4/5.4.1979 the Bureau had rejected an automatic indexation of the rent and, accordingly, the wording of the initial contract did not provide for automatic indexation, the EP accepted in 1982, without any negotiation, to pay, in fact, an automatically indexed rent.

25. When discussing the codicils referring to the rental of the extensions, the EP accepted the amount of the rent requested by CS, without insisting on disclosure of the actual costs supported by CS and the methods applied to calculate the rent.

26. According to the EP administration²¹, the rents of the IPE buildings were negotiated on the basis of the price per square metre and considered reasonable in comparison with the price paid by the EP for other buildings in Strasbourg and

²¹ Note of 8.6.2006 to the Secretary-General from the Director-General for Infrastructure and Interpretation.

in other cities. However, the comparison referred to prices paid for an average square metre (offices, meeting rooms, lounges, bars, car parks, etc. added up) of buildings having different areas and structures and, sometimes, different functions.

27. At the end of the first 18 years period, the EP did not follow the recommendation made by the Court in its special report of 1979 (see paragraph 14). The possibility of negotiating a reduction of the rent after the initial period, in which capital and financing costs might have been fully recovered by the investors, was thus not examined. Nor did the EP establish any specific procedure for reviewing the reasonableness of the rent paid for the WIC and SDM buildings.

This document was adopted by the Court of Auditors in Luxembourg at its meeting of 7 September 2006.

For the Court of Auditors

Hubert Weber
President