

Briefing Note

From:	Assistant Chief Executive (Business Transformation)	To:	Overview & Scrutiny Task Group
Ext:	5480	Date:	9 July 2008

CHORLEY COMMUNITY HOUSING CONTRACT AND PROMISES TO TENANTS

PURPOSE OF NOTE

To inform members of the elements of the Council's contract with Chorley Community Housing and the promises the Council made to tenants which it should manage and monitor to ensure that these promises are kept and delivered.

BACKGROUND

The housing stock transfer took place at the end of March 2007 following a long period of consultation with tenants. The new company set up to deliver the improvements in both the fabric of the housing stock and additional services to tenants was Chorley Community Housing.

The stock transfer process requires that a contract is made between the Council and the new company that sets out the obligations of each of the parties.

The Council does not relinquish all responsibility to tenants once the transfer is made, as the Council is required to ensure the promises made to tenants during the transfer process are delivered. The promises in essence are the Council's promises to tenants delivered through Chorley Community Housing.

CONTENTS OF THE CONTRACT

Set out below is a summary of the main elements of the contract, with a brief description of each element which I think are relevant to the enquiry.

TEMPORARY ACCOMMODATION AGREEMENT

This agreement will govern the management of Cotswold House by the Company on the Council's behalf and will also govern the housing of homeless applicants to whom the Council owes a statutory duty to house by the Company. The agreement will also put the Company and the Parent under an obligation to procure (in consultation with the Council) suitable alternative temporary accommodation to replace Cotswold House by the latter two years of the Completion Date or 15 months after the grant of planning permission for the alternative site.

FIFTH SCHEDULE – WARRANTIES

The Fifth Schedule contains two forms of Warranty (one in favour of the Lenders and the other in favour of the Company)

PART I – DEED OF WARRANTY IN FAVOUR OF THE LENDERS

The Deed provides for a procedure for the Lenders to make a claim under the Deed. The damages are to be equal to the loss suffered by the Lenders as a result of the warranty being untrue, misleading or breached. The Lenders must demonstrate a loss before a claim can be

made. This is likely to occur only when the Company is in very serious financial difficulties and the Lenders have repossessed some or all of the Property.

The Deed of Warranty will provide that claims may only be brought by the Lenders within 30 years from the Completion Date. This period is the length of the loan. In common with other stock transfers, a financial limit on this exposure was not accepted by the Company's lenders as was thought likely at the time of our report to Council.

FIFTH SCHEDULE, PART II – DEED OF WARRANTY BY THE COUNCIL IN FAVOUR OF THE COMPANY

The form of this document is similar to the Council's warranty in favour of the Lenders and the statements (warranties) given are identical to the Lender's warranties.

As with the Lender's Warranty, the Company may in the event of any warranty being untrue, misleading or breached, serve notice on the Council and if the breach is not remedied within 28 days or if the Council has not given a satisfactory undertaking to remedy the breach (or the breach is otherwise not remediable) the Company is entitled claim damages for loss suffered.

The principal differences between the Company's Deed of Warranty and the Lender's Deed of Warranty are that the Company's rights to claim are limited in the following ways (the main limitations only are listed).

- Claims for breach of any of the warranties may only be brought within a specified period from the Completion Date; such period being agreed at 15 years (other than the environmental and vires warranties where a period of 18 years has been agreed); note that Abbey have still to agree to these limits.
- Claims for small sums cannot be brought unless a claim is greater value than £2,000 and no claim can be brought until they amount (in the aggregate) to a threshold of £25,000.
- Claims (other than in respect of vires and environmental claims) in respect of each dwelling forming part of the Property or other part of the Property affected by the breach if warranty are limited to the Rent Income foregone figure which is set out in the Right to Buy Sharing Agreement,
- The limit on environmental claims will be a separate fixed sum agreed at £18million.
- It has been agreed to provide a specific indemnity in relation to asbestos whereby the Council agreed to indemnify the Company in relation to costs incurred in dealing with asbestos in the properties if these costs exceed the provision (£2.2 million) allowed for in the Company's business plan. In relation to third party claims resulting from exposure to asbestos the Councils liability is unlimited save to the extent that the Company or its contactors have acted negligently or recklessly. It is considered by officers that this is an appropriate arrangement; firstly the Council have insurance policies to mitigate against claims arising from the Councils period of ownership of the Property (until around 3 years ago) and secondly the position is arguably analogous to potential claims by any former occupier of the Council's housing;
- There is no financial limit on vires claims.
- There are provisions which are designed to ensure that, if claims arising out of the same facts and circumstances are made both by the Company and its Lenders, the Council will only be required to meet the claim to the Lenders.
- There will be certain restrictions on the Company's ability to claim should the Company wish to redevelop any part of the Property. Broadly certain development is permitted and could result in a claim under the environmental warranties, and this includes work

anticipated by the stock condition survey, consultation promises, works to protect public health, works to maintain sewers etc, works required to underpin properties and that permitted by the General Development Order. Commercial property development would not allow the Company to claim under the environmental warranties. In relation to Social Housing Development if the Company proceed to develop and after undertaking a site survey it is discovered that the land is contaminated, the Company shall be offered by the Council either (i) monies to allow the development to proceed notwithstanding any contamination (but only to the extent that such costs would be reasonably incurred by another RSL) (ii) (at the Company's choice) an alternative development site or the repurchase by the Council of contaminated land

The above limitations are still subject to the final agreement of the Company's lenders.

FIFTH SCHEDULE, PART LLL – DEED OF COVENANT BY THE COUNCIL IN FAVOUR OF THE COMPANY

In this Deed, the Council enters into various covenants with the Company. If the Council breaches any of the covenants set out in this Deed then the Company can serve a notice on the Council asking it to remedy the breach within 28 days. If the Council fails to remedy the breach (or it cannot be remedied) the Company can claim damages from the Council.

The covenants include the following two commitments:

- a) To consider waiving the right to clawback payment where the Company ringfence proceeds of sale to provide additional Social Housing in Chorley.
- b) To assist the Company in their application to Lancashire County Council to get roads adopted

PART LLL – PRICE ADJUSTMENT : VAT SHARING

Pursuant to the provisions of this Schedule the savings realised through the VAT shelter scheme arrangements detailed above are to be shared.

The precise drafting for this agreement is yet to be settled, but broadly speaking there will be six tranches of money available for distribution under the agreement, the first tranche being a sum of £650,000 due to the Council, the second and fifth tranches being a sums to deal with any underfunding in the Lancashire Pension Scheme attributable to transferring employees (the second tranche being limited to £1,750,000 with any greater amount in the fifth tranche); a third tranche being for the Council's account in respect of the costs of insuring against the environmental warranties (together with a further contingency sum in respect of warranty claims); fourthly a sum due to the Company to support its business plan with a sixth tranche to be shared equally between the Company and the Council.

CLAUSE 1 – DEFINITIONS

This clause sets out the principal defined words and phrases which are used subsequently in the Agreement.

CLAUSE 8 – NOMINATION ARRANGEMENTS, HOUSING AGENCY AGREEMENTS AND TEMPORARY ACCOMMODATION

This clause provides that the parties will enter into Nomination Arrangements on the Completion Date. The Nomination Rights Agreement allows the Council to nominate persons to vacancies occurring in the Company's housing stock. The Agreement provides that, in general, the Council may nominate into three out of four such vacancies in the Company's housing stock. Further detail about this is provided under Part 1 of the Second Schedule.

The parties will also enter into a Housing Agency Agreement on the Completion Date under which the Company will provide various housing services related to Homelessness and the maintenance of the Housing Register and a Temporary Accommodation Agreement which will govern the Company's management of Cotswold House and the procurement of replacement temporary accommodation by the Company.

CLAUSE 10 – PROVISION OF NEW TENANCY AGREEMENT

This clause requires the Company to issue a Tenancy Agreement in the form appearing in the formal consultation document (a copy of which will be set out in Part 2 of the Eighth Schedule to the Agreement) to all tenants who transfer from the Council on the Completion Date.

The Clause also states that the Company will give all of the additional rights contained in the Tenancy Agreement to transferring tenants even if they do not sign and return their Tenancy Agreement.

CLAUSE 13 – DESTRUCTION OF THE PROPERTY AND INSURANCE

The Council agrees to reimburse the Company's reasonable costs incurred in reinstating any building which is the subject of any damage as a result of a list of standard risks. Details of any such damage known to the Council will be set out in the Ninth Schedule.

Clause 13 also obliges the Company to insure the Property for its full reinstatement cost against fire and other usual risks from the Completion Date.

CLAUSE 14 - STAFF

The clause deals with the following matters:

It requires the Council to set out (in Part 1 of the Third Schedule) the names and other related employment details of the Council's staff who are to transfer to the Company upon completion.

The Company acknowledges and undertakes that it will become the employer of the transferring staff after transfer and that the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) apply to the transfer, as well as the Statement of Practice "Staff Transfers in the Public Sector."

It provides the Company with various warranties (against which the Council may disclose) in relation to the transferring staffs' employment with the Council. Accordingly, the staff are deemed to transfer on the same terms and conditions as they enjoyed with the Council and so the Company must be aware of all previous employment history.

The Council gives the Company an indemnity against losses which may be suffered by the Company as a result of breaches of the warranties, inaccuracies in the information provided by the Council in respect of transferring staff and other matters such as failure to pay the transferring staff up to the Completion Date.

The Council also agrees to indemnify the Company against any claims made by or in relation to staff retained by the Council. The Company could bring a claim under this indemnity if, for example, the Council fails to include an employee previously working in the Housing Service on the transfer list and that employee is later dismissed by the Council, and makes a claim against the Company.

The precise terms of the warranties and indemnities remain to be negotiated between the Council and the Company, as do the terms of an indemnity to be offered by the Council in respect of its current job evaluation process.

Before transfer, the Company will gain entry into the Lancashire Local Government Pensions Fund, for the benefit of the transferring employees. The Company will require an indemnity from the Council in respect of any underfunding attributable to transferring employees. The amount of the underfunding is awaited from the Scheme's actuary. We will attempt to endeavour to limit this indemnity to the calculation by the Scheme's actuary at the next triannual valuation. It is intended that this cost be met by proceeds from the VAT shelter (see below).

CLAUSE 15 – SUPPORT SERVICES EMPLOYEES

Following transfer, the Council will provide a limited number of services to the Company under agreements set out in Part 1 of the Tenth Schedule. The Council warrant that on termination of those service agreements no employee would then have a right under TUPE to transfer to employment of the Company.

Clause 22 – Dispute Resolution

Unless there is a provision elsewhere in the Agreement to the contrary, disputes under the Agreement shall be dealt with in accordance with the dispute resolution procedure set out in this clause.

SCHEDULE 1

Nomination Rights Deed

The purpose of the Nomination Rights Deed is to provide the Council with a means to discharge its statutory duty to secure accommodation for certain homeless and other persons. The Deed allows the Council to nominate persons for housing in 3 out of 4 Dwellings which in accordance with the provisions of the Deed are vacant and available for letting.

The procedures for nominations have been drafted to reflect current Council practice.

Temporary Accommodation Agreement

This agreement will govern the management of Cotswold House by the Company on the Council's behalf and will also govern the housing of homeless applicants to whom the Council owes a statutory duty to house by the Company. The agreement will also put the Company under an obligation to procure (in consultation with the Council) suitable alternative temporary accommodation to replace Cotswold House within two years of the Completion Date.

Fourth Schedule – Deed of Covenant by the Company

This Deed of Covenant will be entered into by the Company in favour of the Council on the Completion Date.

If the Company breaches any of the covenants then the Council can serve a notice on the Company asking it to remedy the breach within 28 days (or such other period as the parties may agree). If the Company fails to remedy the breach the Council can claim damages from the Company. The exception to this is, however that the Company shall not be so obliged to comply with particular covenants (covenants which have a direct financial effect on the Company) if the Company can demonstrate to the Council, acting reasonably, that circumstances out of the Company's control have caused a failure to meet a covenant or that to enforce such action would occasion an event of default, or potential event of default under the Company's Loan Agreement or any refinancing agreement it enters into pursuant to the Loan Agreement.

Wherever possible, the Council will consult with the Company before commencing any action to enforce its rights under the terms of this Deed. Where the covenants referred to below are for the benefit of tenants, the Company agrees that the Council holds those covenants on trust for the benefit of tenants, as required by CLG transfer policy.

The Covenants

The Company have agreed covenants (ie legally binding commitments) in relation to the following issues:

- a) The treatment of any surpluses generated by the Company
- b) Rent and service charge increases undertaken by the Company (in particular, restricting the Company to the rent policy as described in the Consultation Document)
- c) To partake in formal consultation liaison meetings with the Council
- d) The requirement on the Company to carry out consultation promises
- e) Not to seek possession of transferring tenants' dwellings otherwise done in accordance with the provisions of the enhanced tenancy agreement to be issued by the Company
- f) To continue to allow tenants to exercise the Right to Buy
- g) Not to change the constitution of the Company insofar as it relates to the Company's objects or powers or the representation of the Council without the Council's consent
- h) to allow the Council to nominate Board Members to the Board of the Company
- i) To assist in the provision of records/files etc
- j) To maintain a budget for disabled adaptations
- k) To maintain an office presence within Chorley Town Centre

Fifth Schedule – Warranties and Covenants

The Fifth Schedule contains two forms of Warranty (one in favour of the Lenders and the other in favour of the Company) and a Deed of Covenant by the Council in favour of the Company.

v Statutory Obligations

That no action could be taken against the Council in respect of its compliance with all appropriate statutory and bye-law requirements relating to the Property.

xii Environmental Matters

This paragraph deals with a number of environmental issues which could affect the Property. In particular, the Council warrants that the Property complies with all current environmental laws and that there is no environmental contamination or dangerous substance affecting at, on, or under any of the Property.

The Council is looking to put in place insurance in respect of claims which the Company or the Lenders make against the terms of the environmental warranties and have appointed Marsh as brokers in this regard. Note that such insurance would not necessarily cover the full amount of any claim made, or extend to the same length of time as the warranty period. This is discussed at paragraph 3.14.3 below.

SCHEDULE 2 – DISCLOSURES

The Council's disclosures against the warranties will be set out in this Schedule. A disclosure will be made where a matter is not as stated in one of the warranties.

Fifth Schedule, Part 2 – Deed of Warranty by the Council in Favour of the Company

The form of this document is similar to the Council's warranty in favour of the Lenders and the statements (warranties) given are identical to the Lender's warranties.

As with the Leader's Warranty, the Company may in the event of any warranty being untrue, misleading or breached, serve notice on the Council and if the breach is not remedied within 28 days or if the Council has not given a satisfactory undertaking to remedy the breach (or the breach is otherwise not remediable) the Company is entitled to claim damages for loss suffered.

The principal differences between the Company's Deed of Warranty and the Lender's Deed of Warranty are that the Company's rights to claim are limited in the following ways (the main limitations only are listed):

- claims for breach of any of the warranties may only be brought within a specified period from the Completion Date; such period being agreed at 15 years (other than the environmental and vires warranties where a period of 18 years has been agreed); market experience is that the length of warranties provided by Councils in the last two years or so range from 15 to 20 years in respect of title warranties, although clearly each LSVT must be viewed according to its own circumstances.
- claims for small sums cannot be brought unless a claim is greater value than £2,000 and no claim can be brought until they amount (in the aggregate) to a threshold of £25,000
- claims (other than in respect of vires and environmental claims) in respect of each dwelling forming part of the Property or other part of the Property affected by the breach of warranty are limited to the Rent Income foregone figure which is set out in the Right to Buy Sharing Agreement.
- the limit on environmental claims will be a separate fixed sum agreed at £18 million
- there is no financial limit on vires claims
- there are provisions which are designed to ensure that, if claims arising out of the same facts and circumstances are made both by the Company and its Lenders, the Council will only be required to meet the claim to the Lenders
- there will be certain restrictions on the Company's ability to claim following redevelopment of the Property

The above limitations are still subject to the agreement of the Company's lenders.

Fifth Schedule, Part 3 – Deed of Covenant by the Council in Favour of the Company

In this Deed, the Council enters into various covenants with the Company. If the Council breaches any of the covenants set out in this Deed then the Company can serve a notice on the Council asking it to remedy the breach within 28 days. If the Council fails to remedy the breach (or it cannot be remedied) the Company can claim damages from the Council.

The covenants include the following:

- a) To co-operate with the Company by considering joint objectives for housing in Chorley and by giving formal and reasonable consideration to the use of its statutory powers to assist the Company in the fulfilment of its objectives
- b) To maintain all amenity and play areas which will remain in the ownership of the Council and which adjoin or are adjacent to the Property until such areas are sold or their use changes.
- c) To answer (and at its own cost) all requisitions raised by the Land Registry in respect of the Council's title to the Property to enable the Company to be registered at the Land Registry with absolute title
- d) To use reasonable endeavours to process all claims for Housing Benefit within the statutory periods

Fourteenth Schedule

Part 1 – Right to Buy Sharing Agreement

This Agreement provides that any capital receipts arising on preserved right to buy sales are to be apportioned between the Council and the Company.

Broadly, proceeds of sale will be apportioned as follows (i) the Company with a sum in respect of the Company's administration costs for administering the right to buy scheme (ii) a further sum to the Company reflecting the loss of rental income to the Company from that property (iii) the Council will receive a sum equal to 25% of the sale proceeds with (iv) the remainder of sale proceeds being to shared between the Council and Company.

The rental income formula will be calculated according to formula which will be agreed by the financial consultants Tribal and Enterprise BWNL acting for the Company and the Council respectively.

Part 2 – Disposal Clawback Agreement

The purpose of this agreement is to ensure that if the Company disposes of property in a certain way then the Council shall share in the value received by the Company. The Council will receive 50% of any such consideration after the subtraction of any reasonable items of cost and expenditure properly incurred by the Company in relation to the disposal.

The length of this clawback agreement together with the nature of any disposals by the Company which will be exempt from the clawback provisions are currently being negotiated between the parties.

The provisions of this clawback arrangement are not binding on any mortgagee (ie the Lenders) or any successor.

Part 3 – Price Adjustment: VAT Sharing

Pursuant to the provisions of this Schedule the savings realised through the VAT shelter scheme arrangements detailed above are to be shared.

The precise drafting for this agreement is yet to be settled, but broadly speaking there will be five tranches of money available for distribution under the arrangement, the first tranche being a sum of £650,000 due to the Council, the second tranche being a sum to deal with any underfunding in the Lancashire Pension Scheme attributable to transferring

employees; a third tranche being for the Council's account in respect of the costs of insuring against the environmental warranties (together with a further contingency sum in respect of warranty claims); fourthly a sum due to the Company to support its business plan with a fifth tranche to be shared equally between the Company and the Council.

SIXTEENTH SCHEDULE – DEVELOPMENT AGREEMENT

Development Agreement

Under the terms of this Agreement, the Company agrees to undertake certain works listed in a Schedule to the Development Agreement. The aim of the development works is to enhance the value of the transferred properties and broadly corresponds to the programme of works detailed in the Consultation Document. This Agreement is intended to enable the Company to recover VAT incurred on sub-contractor's invoices when carrying out the various enhancement works set out in the Schedule.

The Council is able to share in VAT recovered by the Company under the VAT shelter scheme through the VAT Sharing schedule (see Schedule 14 above).

Due to recent Inland Revenue decisions, it is possible that the VAT shelter scheme arrangements may lead to adverse consequences for the Company in respect of its liability to pay Corporation Tax. As a consequence of this, the Council and the Company have agreed a mechanism whereby the VAT shelter scheme arrangements may be unwound (but preserving the obligation of the Company to complete the works programme as specified in the promises in the Consultation Document). The mechanism for doing this involves the parties entering into one of the two alternative deeds contained in the Seventeenth Schedule.

Seventeenth Schedule – Deeds of Variation

As mentioned above in connection with the Development Agreement, this Schedule contains two Deeds which can be used to vary the VAT shelter scheme arrangements. The arrangements can either be unwound in part (pursuant to the Deed appearing in Part 1) or in full (pursuant to the Deed appearing in Part 2). In each case, the obligation of the Company to complete the works programme in accordance with the Consultation Document is preserved through the Deed.

SUMMARY

The contract represents the legal agreement to deliver the proposals made to tenants during the transfer process. The promises to tenants were set out in a consultation document circulated to all tenants and which is a plain english guide to the transfer process. The contract is the legal enactment of that consultation, which also sets out the obligations of both the Council and Chorley Community Housing. Attached at Appendix A are the relevant extracts from the consultation document. In terms of the promises made to tenants included in this briefing note is a lot of information regarding the Council's contract with CCH, but the overriding issue is that the promises made to tenants should be kept and it is the Council's responsibility to try and ensure this happens. I am happy for members to digest the document and contact me if they require clarification on any points. I shall also be attending subsequent meetings of the task group to support the scrutiny process.

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