

**STANDARISATION GUIDANCE
FOR LOCAL AUTHORITY HOUSING
PROJECTS**

CONTENTS

Clause	Page No
1. Introduction	1
1.1 Background	1
1.2 Scope of HRA PFI	1
1.3 Standardisation	2
1.4 Rationale	3
1.5 Approach	3
1.6 Structure	4
1.7 Terminology	5
2. Section 3.7: Existing Services	6
2.1 Introduction	6
2.2 Handover	6
2.3 Specification	8
2.4 Payment	8
2.5 Service Commencement	9
2.6 Guidance to Authorities for ITN	10
3. Section 4: Protections Against Late Service Commencement	11
3.1 Protections	11
3.2 Decant	13
3.3 Guidance to Authorities for ITN	13
4. Section 6: Information, Warranties and Latent Defects	14
4.1 Information	14
4.2 Latent Defects	14
4.3 Surveys	16
4.4 Guidance to Authorities for ITN	17
5. Sections 7-10: Service Requirements, Availability, performance and Payment	19
5.1 Introduction	19
5.2 Specifying Requirements	19

5.3	Payment Mechanism	20
5.4	Performance Monitoring	21
5.5	Damage	22
5.6	Guidance to Authorities for ITN	25
6.	Section 12: Authority Changes	26
7.	Section 13: Changes in Law	27
7.1	Application of General Guidance	27
7.2	Specific Changes in Law and Housing	27
7.3	Changes in Law Affecting Tenants	28
7.4	Changes to Welfare Benefits	29
8.	Section 16: Assignment	31
8.1	Application of General Guidance	31
8.2	Change of Circumstances	31
9.	Section 20.2: Termination on Contractor Default	32
9.1	Poor Performance in relation to Part	32
9.2	Termination Threshold for Part	33
10.	Leaseholders	35
10.1	Leaseholder Management	35
10.2	Recovery of Costs	36
10.3	Statutory Requirements	37
10.4	Application of Statutory Requirements	38
10.5	Financial Consequences	42
10.8	Sections 19 and 20 Landlord and Tenant Act	44
11.	Withdrawal of Dwellings from the Contract	50
11.1	Demand	50
11.2	Right to Buy Sales	53
11.3	Right to Manage	60
12.	Authority Functions	64

12.1	Introduction	64
12.2	Allocation of Tenants	64
12.3	Enforcement of Tenancy Terms	67
12.4	Introductory Tenancies	68
13.	Repair and Condition of the Accommodation	70
13.1	Tenant Actions	70
13.2	Right to Repair	72
14.	Development	74
15.	Capital Allowances	74

STANDARDISATION GUIDANCE
FOR LOCAL AUTHORITY HOUSING PROJECTS

1. INTRODUCTION

1.1 Background

1.1.1 Following a competitive process Government selected eight English housing authorities to participate in a 'Pathfinder' process in order to develop the use of the private finance initiative (PFI) in the local authority housing sector. The Regulatory framework contained in the Local Authorities (Capital Finance) Regulations 1997 (and amendments) permits PFI for local authority housing held within an Authority's Housing Revenue Account (HRA) and thus the generic term for this type of project has become 'HRA PFI'.

1.1.2 The Pathfinder Authorities developed their proposals in the form of Outline Business Cases (OBCs) which were considered and endorsed by the Project Review Group (PRG) in the normal way. The eight Pathfinder projects are now at various stages in the procurement process.

1.1.3 The Government's Spending Review 2000 (SR2000) announced further resources for housing PFI in July 2000. PFI credits of £300m have been allocated for 2002/03 with a further £300m in 2003/04.

1.2 Scope of HRA PFI

1.2.1 Whilst the housing stock included in HRA PFI projects is varied, all share some common characteristics:

- (a) The ownership of the stock remains with the local authority and tenants thus remain local authority tenants with secure tenancies;
- (b) The scope of the PFI contracts requires the private sector contractor to improve and then maintain stock at a level which enables the local authority's outputs to be met together with, for the most part, a tenancy management service.

1.3 **Standardisation**

- 1.3.1 Guidance on the ‘Standardisation of PFI Contracts’ (the "General Guidance") was published by the Treasury Taskforce in July 1999. That guidance covers all of the key issues that are likely to arise in public sector PFI projects generally, across a wide range of sectors and project types.
- 1.3.2 Draft guidance on the ‘Standardisation of Local Authority PFI Contracts’ (the “Local Authority Guidance”) was published by the Public Private Partnerships Programme (“4ps”) in May 2000. That guidance covers all the key issues that are likely to arise in local authority PFI projects generally. The Local Authority Guidance is due to be issued in its final form early in 2001 following an extensive consultation exercise.
- 1.3.3 The 4ps and the Department of the Environment, Transport and the Regions (DETR) together with the Treasury Taskforce (now incorporated into Partnerships UK) jointly commissioned lawyers Pinsent Curtis to produce guidance for local authorities on a standardised contractual approach to common issues likely to feature in HRA housing schemes.
- 1.3.4 The benefits of such an approach include:
- (a) reducing the time and costs involved in procurement for both public and private sector by minimising negotiation of common issues on different projects;
 - (b) encouraging the growth of the market and encouraging bidders to produce their best possible bids by minimising the costs they will incur in bidding.
- 1.3.5 This housing specific Guidance is intended to build on the General Guidance and the Local Authority Guidance by:
- (a) highlighting areas of the General Guidance and/or the Local Authority Guidance that have particular application, or require particular treatment, in local authority housing PFI projects; and

- (b) identifying issues that are likely to arise in local authority housing PFI projects that are not addressed in the General Guidance or Local Authority Guidance.

1.3.6 Like the General Guidance, this Guidance is intended to enable local authorities to strike a balanced contractual position that is commercially deliverable for the private sector and can provide value for money for the public sector. In providing a common understanding and approach to common issues, it is also hoped that it will help further reduce the time and cost of negotiations of local authority housing PFI contracts. This will enable the focus of negotiations to be on the deal specific issues rather than on issues that are generic to PFI or to local authority housing PFI projects generally.

1.4 **Rationale**

1.4.1 Separate guidance was considered necessary for local authority housing PFI projects, as opposed to accommodation projects generally, principally because of the distinct issues which arise as a consequence of the accommodation being continually occupied and the legislation conferring rights on the occupiers.

1.4.2 This Guidance concentrates on local authority housing PFI projects which primarily involve the refurbishment of existing housing accommodation. The construction of new housing accommodation within the Housing Revenue Account is currently not allowed by the concession for the PFI in the Local Authorities (Capital Finance) Regulations 1997.

1.5 **Status of this Guidance**

1.5.1 This Guidance has been produced in advance of the completion of any local authority housing PFI projects and therefore is based in part upon experience of PFI projects in other sectors which, at this stage, are considered to be applicable to this sector and in part upon suggested solutions based upon a reasonable assessment of appropriate allocation of risk.

1.5.2 As local authority and schools PFI projects may, in certain areas, raise similar issues, such as latent defects and third party damage, a uniform approach has been taken to

such issues with variations only in response to sector differences. Therefore certain sections in Part 1 of the Guidance have, where appropriate, as their base the Standardisation Guidance for Schools Projects produced in draft form by DfEE and the Treasury Task Force/Partnerships UK.

- 1.5.3 This Guidance has benefited from the input of the eight Pathfinder Authorities together with a representative sample of contractors, funders, registered social landlords (RSLs) and advisers who are actively involved in housing PFI. Consultees were asked for their views on an initial 'issues paper' which sought to establish the scope of the guidance and in many cases preliminary observations were followed up in discussions with Pinsent Curtis. Consultees were provided with a draft of this Guidance and further comments invited.
- 1.5.4 In the absence of the conclusion of negotiations on individual projects, it is accepted that this Guidance can offer only a view on what is likely to represent the optimum way forward on the relevant issues. It will be necessary to return to this Guidance in the light of closed deals and to amend it, where appropriate, to reflect experiences on individual projects.
- 1.5.5 At this stage, therefore, the Guidance has the status of 'working guidance'. It is intended that it is built on from the perspective of experience and developed into a 'model' project agreement which represents recommended best practice.

1.6 **Structure**

- 1.6.1 The rest of this Guidance is structured as follows:
- (a) Part 1 covers areas of the General Guidance where particular application is needed in the local authority housing sector, in the order in which they appear in the General Guidance;
 - (b) Part 2 covers areas relevant to local authority housing PFI projects that are not addressed in the General Guidance or the Local Authority Guidance.
- 1.6.2 Specimen drafting has been produced to accompany this Guidance as an aid to incorporating the various principles in legal documentation. It has been separated out

to discourage its treatment as a recommendation of best practice and, at this stage and for the reasons above, it should not be treated as definitive. This drafting can be obtained separately from the 4ps.

1.7 **Terminology**

1.7.1 The terminology used in this Guidance follows that used in the General Guidance and (where applicable) the Local Authority Guidance.

PART 1 – APPLICATION OF GENERAL GUIDANCE

2. SECTION 3.7: EXISTING SERVICES

2.1 Introduction

2.1.1 Section 3.7 of the General Guidance refers briefly to the issues that arise if a Contractor is taking over existing services, as well as contracting to provide new or additional services. This scenario, whilst not unique to local authority housing, is likely to be relevant for most local authority housing PFI contracts, as they will involve refurbishment of existing accommodation. They are likely to raise sensitive issues concerning the services that the Contractor will be required to provide in the period before full Service Commencement, (that is including a period while it is undertaking the works to refurbish the accommodation) and how they will be paid for. This issue is particularly complicated by the fact that, generally, the refurbishment of the accommodation will need to be undertaken in phases to enable the Authority to manage the refurbishment process across what may amount to several thousand units of accommodation. Authorities should also recognise that any TUPE transfers that may arise out of the Contract are likely to take effect from the time at which the Contractor takes over provision of the relevant Service.

2.2 Handover

2.2.1 The first question to address is, when does the Contractor take over full or partial responsibility for service delivery?

2.2.2 There are three options for an Authority:

- (a) responsibility for the whole of the housing accommodation in the Contract is taken over by the Contractor immediately following the start of the Contract (after financial close), or following a brief mobilisation period. This would provide a clean start and minimise ambiguity about responsibilities between the Authority and the Contractor, and is therefore the recommended approach. The Contractor would thereby take on the full individual housing management

services (on the assumption that housing management is part of the Service) and other aspects of the Contract output specification, from the start of the Contract. However, in relation to certain services, particularly those associated with repair and maintenance, this approach may require the Contractor to take on risks that are unacceptable to it at a realistic price, and so not provide value for money¹. A transitional specification with reduced performance standards or a less onerous performance regime in relation to these services may be necessary.

- (b) phasing the handover so that the Contractor takes over responsibility for the housing accommodation when it has planned to start work on them to bring them up to the full output specification standard. This would leave the Authority responsible for the accommodation between financial close and the programmed start date of the Contractor's works on site for each phase of accommodation. This may well create some greater complexity in the management arrangements throughout the transitional phase from financial close to the point at which all the accommodation has reached full Service Commencement. However, it is recommended where the first approach in (a) above does not provide value for money; and
- (c) hand the housing accommodation over to the Contractor only when it has been brought up to the full output specification standard. This would cause an additional complexity. The pre-contract arrangements, involving in-house provision or a separate contractor, would continue in relation to the housing management and maintenance services, while the Contractor was carrying out works to bring the accommodation up to the output specification standard. The scope for disputes over responsibility for any problems that may arise suggest that this would not be an attractive option, and it is therefore not recommended.

¹ The issue of tenant actions for disrepair is one such issue; see Section 13.1

2.3 Specification

2.3.1 In relation to the first of the three options (and possibly also the second), an interim output specification, will be needed for the service level that is expected for the period while the Contractor is responsible for the accommodation, which has not yet reached full Service Commencement. The interim output specification should include requirements in relation to individual housing management and maintenance services that the Contractor will be required to provide that at least keeps the housing accommodation to this pre-Contract standard (save for individual exceptional circumstances, for example, decoration in relation to housing accommodation due for demolition). It will also address other areas of concern to the Authority such as the issue of disrepair notices referred to in Section 13 below.

2.3.2 Using the full Contract output specification during the transitional period (albeit with a relaxed payment and performance regime) is likely to lead to regular performance failures due to the pre-existing condition of the accommodation. A specification more tailored to the transitional period is therefore recommended. In relation to the majority of the individual service requirements, the full Contract output specification may be relevant in this transitional period, particularly in relation to response and rectification periods, and individual housing management services. For others, particularly repairs and maintenance, it will be necessary to adapt existing arrangements or prepare a bespoke specification to cover this period. This may be achieved by defining two availability standards, a reduced standard (either the current standard or an improved standard sufficient to successfully defend any tenant disrepair notices)² for the transitional period and a full standard on and after full service commencement. The approach of having two standards may be equally applicable to both dwellings let on secure tenancies and leasehold properties.

2.4 Payment

2.4.1 As the Contractor will be providing services throughout this transitional period, there may also need to be payment arrangements to reflect the Service received. One

² See Section 13.1

approach would be to base payments before full Service Commencement on the appropriate level of service required, but taking into account any additional risks and costs assumed by the Contractor. This could be achieved by the Authority seeking bids on a unitised fee per day with a reduced rate applying during the transitional period until full service commencement (when compliance with the output specification would be to the reduced standard) with an increased rate after full service commencement reflecting compliance with the full standard. A performance regime can then be applied so that, in accordance with the principles of full payment mechanism, there would be no payment if accommodation was unavailable (other than due to the refurbishment works being carried out) and could not be used. There would also be deductions for poor performance, for example a failure to meet response or rectification periods that did not lead to non-availability.

2.4.2 An alternative to this approach would be for the Authority to make no payment in relation to the Service received during the transitional period. This would maximise the incentive on the Contractor to bring the housing accommodation up to the full Service Commencement level as quickly as possible. However, the Authority may lose some influence over the standard of service during the transitional period. Furthermore, this approach will lead to different funding requirements and cash flows for the Contractor and may not prove to be value for money, particularly where the refurbishment is undertaken over a lengthy period of time.

2.5 **Service Commencement**

2.5.1 A linked question in relation to local authority housing PFI contracts is, when does full Service Commencement occur? A similar issue arises in relation to “grouped” schools PFI contracts. Section 3.6 of the General Guidance deals with this issue in the context of single asset schemes, but the multi-asset local authority housing PFI schemes present two clear alternatives:

- (a) to stipulate that full Service Commencement will only be accepted when all the housing accommodation in the project reaches the required full Contract output specification level. This would incentivise the Contractor to bring it all up to the Contract output specification standard as quickly as possible. However, it

would also mean that the Authority was receiving the full Contract output specification level of service on some housing accommodation, but not paying for it. This will invariably impact on the price; or

- (b) to accept full Service Commencement as each phase of the housing accommodation reaches the Contract output specification standard, so that payments reflect the Service received. It will not be feasible to have full Service Commencement on a dwelling by dwelling basis. If the phased approach is adopted, some of the incentive effect of the first alternative above can still be achieved. Payment will not be increased pro rata as individual dwellings reach the Contract output specification. There is therefore an amount retained or abated until the last dwelling within the housing accommodation in the phase reaches Service Commencement.

2.5.2 The overall time period until the Planned Service Commencement Date (as defined in the General Guidance) of the whole of the accommodation will have a significant impact on the relative value for money of these two alternatives. The longer the period for refurbishment of the whole housing accommodation, the more reluctant the Contractor is likely to be to accept the delayed payment in the first alternative. Therefore, in instances involving a lengthy period for refurbishment, the second alternative in (b) above will be the most appropriate option.

2.5.3 The consideration of the two alternatives should also take into account practical objectives associated with the refurbishment, such as the effective operation of decanting and alternative accommodation arrangements. The first alternative, being focussed on completion of the refurbishment works to the whole of the housing accommodation, may be less effective in incentivising such objectives.

2.6 **Guidance to Authorities for ITN**

2.6.1 In relation to all of the issues explained in this Section affecting the Existing Services, i.e. the handover, the level of Service required, the payment arrangements and the Service Commencement, the Authority should identify in the ITN the structure that they believe will offer best value for money within the parameters of project

affordability, tenant needs and expectations, bankability and a reasonable and realistic approach to risk allocation. They should also invite bidders to offer alternative structures if improved value for money can be shown.

3. **SECTION 4: PROTECTIONS AGAINST LATE SERVICE COMMENCEMENT**

3.1 **Protections**

3.1.1 Section 4 of the General Guidance is equally relevant to local authority housing PFI contracts³. As is evident for the reasons explained in the introductory paragraph in section 3.7 above, the refurbishment works to the housing accommodation are likely to be completed in phases. Therefore, following Section 4.1.4 of the General Guidance the Authority may wish to protect itself against prolonged delay in achieving full Service Commencement. They can do this by having a long stop date after which the Contract may be terminated if the Contractor has not achieved full Service Commencement. The long stop date is likely to be more appropriately applied to the full Service Commencement of the whole of the housing accommodation rather than to each phase (however, where the refurbishment works period is particularly prolonged Authorities may give consideration to one or more strategic milestone dates which would have equal effect as a long stop date). However, as stated in the General Guidance, termination should be a last resort. The approach to be taken in relation to termination is set out in Section 20.2 of this Guidance.

3.1.2 Local Housing Authorities have statutory duties in relation to housing the homeless⁴, although the provision of housing accommodation in itself is a power rather than a duty⁵. However, this should not affect the principle that, in any project where existing housing accommodation is taken over, the Contract will need to deal with circumstances where the housing accommodation was habitable at the start of the Contract, but becomes uninhabitable during the transitional period – for example due to problems arising in the refurbishment works, or through failures in the

³ In particular Section 4.1.3

⁴ See Part VII Housing Act 1996

⁵ See Part II Housing Act 1985

maintenance provided. This would thereby address circumstances where the actions (or failures) of the Contractor threaten the Authority's ability to meet its statutory obligations. Where there is a shortage of accommodation to satisfy their statutory duties in relation to the homeless, Authorities will always be concerned not to allow accommodation to remain empty for prolonged periods of time due to failures of the Contractor.

- 3.1.3 In such cases, any payment deductions that the Authority can make are unlikely to compensate it for the costs of providing alternative housing accommodation in fulfilling its statutory obligations.
- 3.1.4 The recommended approach in such circumstances is to require the Contractor to provide suitable alternative housing accommodation and if the Contractor fails to do so, either to require:
- (a) liquidated damages to be paid, along the lines set out in Section 4.2 of the General Guidance. Liquidated damages must be a genuine pre-estimate of losses or damages the Authority will suffer and as such may be based on the cost of acquiring temporary housing accommodation to replace the accommodation that is not available; or
 - (b) that the Contractor cover this risk within the indemnities required as set out in Section 23.3 of the General Guidance. The indemnity should be structured to cover the cost of providing the housing accommodation and any of the associated Services which the Contractor has failed to provide.
- 3.1.5 If the nature of the works means that alternative housing accommodation is not required, then the option in paragraph 3.1.4(a) is the appropriate one provided the Authority is able to demonstrate losses or damages. The recommended approach should be applied to each phase. To avoid double counting, no deductions for unavailability during the transitional period, as a consequence of the carrying out of the refurbishment works, should be made in relation to housing accommodation to which the recommended approach is applied. However, Authorities should apply the

payment and performance mechanism, suitably adapted if necessary, to the alternative accommodation.

3.1.6 The recommended approach may not be appropriate in all circumstances. For example, the Contractor may already be bearing the cost of providing alternative accommodation where the Contractor is responsible for decanting and/or the size of the alternative accommodation requirement (for example a tower block) may be beyond the Contractor's means. In which case, the option in paragraph 3.1.4(a) to meet the Authority's losses and damages may be more appropriate.

3.2 **Decant**

An issue which may (where relevant) directly impact on the achievement of full Service Commencement by the Planned Service Commencement Date is the decanting of existing residents from each phase of the refurbishment by the specified date in the Contractor's works programme. The Contractor may incur additional cost if the specified date agreed in the Contractor's works programme is not achieved. The risk of not meeting the specified date due to a failure to decant tenants in sufficient time should lie with the party responsible for obtaining vacant possession of the relevant housing accommodation and/or providing alternative temporary housing accommodation for the existing residents to move into. In many instances, the Authority will accept this obligation being the party best placed to manage the risk associated with it. Where this is the case, then failure to achieve the specified date should amount to a Compensation Event⁶.

3.3 **Guidance to Authorities for ITN**

The Authority's requirement in respect of the issues in this section 4 should be made clear in the ITN, so that the obligation that the Contractor will be expected to take on is clear and can be reflected in the pricing.

⁶ See Section 5.2 of the General Guidance

4. SECTION 6: INFORMATION, WARRANTIES AND LATENT DEFECTS

4.1 Information

4.1.1 Section 6 of the General Guidance relating to Contractor due diligence and Authority warranties is equally applicable to local authority housing PFI contracts. However, Authorities will be aware that this Section of the Guidance will be particularly applicable where Contractors may be expected to assume certain risks, for example in relation to the performance on rent collection, repairs, defects and vandalism. In these cases, Contractors will be heavily dependent in their assessment of the relevant risk upon the accuracy of the historical information and data provided by the Authority as part of the procurement process and in response to Contractors' due diligence enquiries. When the criteria listed in paragraph 6.3.1 of the General Guidance are satisfied in relation to the information or data supplied by the Authority, the Authority should consider giving warranties to help reduce the Contractor's costs. However, in which case, the Authority will be liable for damages/compensation arising from the inaccuracy of any information which is warranted and the Contract should contain an appropriate price variation mechanism.

4.2 Latent Defects

4.2.1 Whilst the General Guidance covers latent defects risk⁷, it is considered that this issue will be sufficiently contentious in local authority housing PFI contracts to warrant additional treatment in this Guidance. The latent defects risk is sufficiently broad to include any defect in any of the buildings or anything installed in the buildings attributable to defective design, workmanship, materials, plant or machinery, installation, preparation of the site or defects arising from adverse ground conditions.

4.2.2 Risks in relation to latent defects in buildings will arise in any project where the Contractor will be largely refurbishing or repairing existing accommodation, as opposed to designing and building new accommodation. However, this issue will be compounded generally in relation to local authority housing PFI contracts where the

⁷ See Section 6.5

Contractor proposes to meet the Contract output specification by refurbishing a significant amount of housing accommodation which may be of the same or similar design. The issue may be further compounded on a project specific basis depending upon the nature of the design of the accommodation, for example tower blocks and non-traditionally constructed dwellings may cause increased problems in relation to latent defects. The allocation of the risk in relation to latent defects is likely to be a contentious area in negotiating the Contract and there are a variety of approaches that may be appropriate:

- (a) retention of risk in relation to latent defects by the Authority;
- (b) full acceptance of latent defects risk by the Contractor; or
- (c) an arrangement to share the risk by, for example, agreeing that the Authority will retain the risk from Financial Close up until full Service Commencement, from when the Contractor will take on, or that the Contractor will take the risk up to a financial cap.

4.2.3 The approach that is appropriate in any particular Contract should be assessed in terms of the value for money for the Authority of the different options available which in turn may depend upon the nature of the design of the housing accommodation. Assessing value for money by the Authority will involve a technical assessment of the risk of a latent defect and, if relevant, the likely cost of remedy. The value of the risk if retained by the Authority, should be compared with the impact on the Contractor's price of acceptance of latent defects risk. Depending on how the Contractor would manage it, this latter risk may, for example, be determined by the costs (premiums and excesses) of insuring the risk, or of undertaking surveys and costing the estimated works that will arise. Contractors may see the risk as more manageable where there are different types of accommodation design, where the portfolio effect may be seen to effectively spread the risk in a way that is more acceptable than a single type.

4.2.4 Certain local authority housing PFI contracts may propose that the Contractor assumes the risk in relation to existing heating systems, such as district heating

systems as a consequence of assuming the responsibility for the supply of heat to the housing accommodation. The risk issues which arise in relation to such a proposal are the same as those relating to latent defects in buildings and this Section of the Guidance should be applied accordingly.

4.3 Surveys

- 4.3.1 The Authority should consider the extent to which the perceived value of latent defects risks can be minimised by comprehensive surveys of the existing condition of the accommodation. Such surveys are likely to be key to Contractor pricing. An Authority with such a project is likely to have undertaken stock condition surveys before procurement has commenced, if only to be able to develop a reference project and assess affordability. However, the information produced is unlikely to be sufficiently comprehensive to enable Contractors to make a priced assessment of the impact of latent defects risk.
- 4.3.2 There are a variety of options that may be adopted in relation to obtaining more detailed survey information:
- (a) the Authority commissioning more detailed "intrusive" surveys. If this option is followed, the Authority should agree the specification and appointment with the shortlisted bidders and either ensure that the appointment can be novated or transferred to the winning bidder or that appropriate warranties are available in its favour. The winning bidder should in turn reimburse the costs of the survey;
 - (b) shortlisted bidders jointly commissioning (by agreement with the Authority), and paying for, surveys to their specification, with the winning bidder reimbursing the others. This approach can work well, in leading to survey reports addressed to and warranted to the Contractor. It is dependant upon the shortlisted bidders being able to agree on the scope, terms of reference for the surveyor and for the survey work, such surveys should be available for issue to shortlisted bidders with the ITN;
 - (c) each bidder undertaking whatever further work they feel necessary.

The recommended approach is the second option in (b) above although the first option (a) is also an acceptable way forward should the second option not be practicable or deliverable, Authorities are reminded of the need to comply with the EU procurement rules if they are appointing the surveyor and the value of the appointment exceeds the relevant threshold.

4.4 **Guidance to Authorities for ITN**

4.4.1 The Authority must think through its approach to latent defects risk before commencing the procurement process, as this risk may significantly impact on the scheme costs, the value for money achieved and the procurement timetable. The factors that should be taken into account include:

- (a) the nature of the design of the buildings;
- (b) the existing condition of the buildings;
- (c) the quality of information available or obtainable;
- (d) the extent of the works to be carried out by the Contractor;
- (e) that the buildings will largely be occupied, affecting the nature and extent of the access gained and intrusive surveys undertaken;
- (f) the different nature of the design and condition of the buildings across the estate which may exacerbate or mitigate the risk.

4.4.2 The Authority should identify in the ITN the approach to latent defects that they believe will offer best value for money within the parameters of project affordability, bankability and a reasonable and realistic approach to risk allocation. They should also invite bidders to offer alternative structures if improved value for money can be shown.

4.4.3 However, in all cases where the Authority expects to transfer latent defects risk, it should recognise that detailed intrusive surveys will almost certainly be needed (with

the Contractor either as joint employer or warranted) – the issues are about when they are carried out and, by whom.

5. **SECTIONS 7-10: SERVICE REQUIREMENTS, AVAILABILITY, PERFORMANCE AND PAYMENT**

5.1 **Introduction**

5.1.1 Sections 7-10 of the General Guidance contain principles and approaches for dealing with service requirements, performance monitoring and structuring the payment mechanism. This Guidance is all applicable to local authority housing PFI Contracts.

5.2 **Specifying Requirements**

5.2.1 The recommended approach for PFI contracts generally is equally applicable to local authority housing PFI contracts. The Contract output specification should, in terms of defining the Service required, focus on outputs rather than inputs.

5.2.2 One important aspect of the output specification will be the performance standard fixed in relation to the collection of rent. One approach by an Authority may be to fix the performance standard by reference to the current level of collection either across the whole local authority area (or a particular part of it). However, this level may be artificially high or low, it may be high, for example due to the ongoing collection of outstanding arrears or low, for example, due to historic difficulties in collecting rent on the estate. A high collection rate applied throughout the Contract period may not sufficiently incentivise the Contractor and may also result in a high pricing of the risk, whilst a low collection rate may not achieve the required improvements to standards sought throughout the Contract period.

5.2.3 One solution to a low collection rate maybe to include a "step change" to the performance standard through a reasonable transition period. Subject to this, it is recommended that rent collection levels should be set in line with Best Value Performance Indicators⁸. Once the level of rent collection has been fixed, circumstances may occur over the Contract period which may result in a change in the level of collection. Whereas a Contractor may be prepared to commit itself to a

⁸ See Section 3 of the Local Authority Guidance

fixed collection rate in a short term management contract, such a commitment throughout a long term contract may come at a price. An Authority should therefore give consideration to including levels of rent collection in those parts of the Service which are to be quality benchmarked as part of its duty to achieve Best Value⁷.

5.2.4 Such benchmarking could be undertaken as part of the Authorities' Best Value Reviews against an appropriate comparator group such as the top quartile of local authorities in the region or the top quartile of housing management contract areas within the Authority. It would enable the performance standard to move with the equivalent for the comparator group at no automatic cost to the Authority. Such performance benchmarking should be developed by reference to the Local Authority Guidance⁷.

5.2.5 In addition, the fact that the Authority may be responsible for administering the system of income support should be reflected in the definition of "collectable rent". Allowances should be made in the performance standard for rent collection to take into account the timescales for the initial assessment and subsequent review of claims.

5.3 **Payment Mechanism**

5.3.1 The payment mechanism should flow directly from the Service requirements, as defined in the Contract output specification. Payment of the full Unitary Charge should only commence when the Authority accepts that the Service is fully available to the required standard – as set out in the General Guidance in Chapter 3. Nevertheless it will be important to consider the transitional arrangements as set out above⁹ in relation to Section 3.7 of the General Guidance.

5.3.2 A payment mechanism should then be established, using one of the models suggested in Chapter 10 of the General Guidance so that the Authority pays by reference to the unit of the housing accommodation available, with deductions for non-availability and/or for failures in performance not affecting Availability. This assumes that

⁹ See paragraph 2.3.2

demand/usage risk will stay with the Authority¹⁰. The 4Ps are currently preparing guidance on payment mechanisms for local authority PFI contracts generally, including housing.

- 5.3.3 A key principle of PFI is that the payment mechanism should result in a single unitary charge and therefore any individual aspects of the Service provided (for example, the collection of rental income) should, ideally, not be treated separately from any other. Performance standards for each aspect of the Service should be included as integral parts of the payment mechanism and given appropriate weightings to reflect the relative importance to the Authority.
- 5.3.4 The payment mechanism should also be structured to incentivise the Contractor to achieve the requisite performance standards in relation to the Service across the whole of the accommodation (this is also relevant to termination, see Section 20.2 of this Guidance).
- 5.3.5 As the number of dwellings forming part of the housing accommodation may reduce throughout the Contract period due primarily to the exercise of statutory rights, as contemplated by Section 11 of this Guidance, it is important that the payment and performance regime is drafted to prevent potential deductions for Unavailability proportionately increasing in relation to the remaining dwellings.
- 5.3.6 As explained in Section 13.1, an Authority will need to address the extent to which the issue of statutory nuisance or disrepair notices by tenants after final close, should give rise to the relevant dwelling becoming Unavailable and for what period. Any such definition should be by reference to the condition of the dwelling as assessed against an objective standard rather than the issue of such a notice per se.

5.4 Performance Monitoring

- 5.4.1 In relation to the Performance Monitoring, the General Guidance in Chapter 9 is again applicable to local authority housing PFI contracts. Authorities should also

¹⁰ See Section 11.1 of this Guidance

refer in particular to the Local Authority Guidance on the application of the Best Value regime to local authority PFI Contracts.

5.4.2 However, as with local authorities generally¹¹, further types of monitoring may be relevant to local authority housing PFI contracts, in addition to the usual ability for users or tenants to report failures. In particular the monitoring of tenant satisfaction as to the standard of services. However, the content of tenant satisfaction surveys should comply with the Local Authority Guidance in that they should be independent, be as objective as possible and not result in Contractors suffering double deductions in relation to the same performance failure¹²(DETR has issued guidance on carrying out satisfaction surveys as part of the Best Value performance indicator scheme). Authorities should also give careful consideration to the appropriate weighting to be given to tenant satisfaction surveys in the performance regime.

5.4.3 Furthermore, the new Best Value regime for local authority housing and the introduction of tenant participation compacts (by all local authority landlords from 1 April 2000) are key elements to making continuous improvements in local authority services. Tenants of local authorities have a statutory right to information concerning their tenancies and other aspects of the local authority's housing policy which affects them as well as a right to be consulted about changes in housing management. The aim of tenant compacts is to encourage further good practice in tenant participation in the Authority's provision of housing services. The compacts are not intended to be legally enforceable, but their existence and compliance will form an integral part of Best Value inspections. Authorities should consider ways in which tenant participation compacts could have a role in performance monitoring of local authority housing PFI contracts¹³.

5.5 **Damage**

5.5.1 One important difference in local authority housing PFI contracts from many other PFI contracts is that the housing accommodation is occupied by tenants 24 hours a

¹¹ See Section 3 of the Local Authority Guidance

¹² See Section 3 of that Guidance

¹³ Further information on tenant compacts is available on the DETR website

day (unless it is temporarily vacant) and that the environment of the housing accommodation, which is the subject of the Contract, is freely accessible by the general public (albeit that certain of the common parts, particularly in relation to blocks of flats may be subject to security access). This raises the risk of damage by tenants or third parties. Where the housing management service is to be retained by the Authority then the risk of tenant damage should be retained by them (allocation of the risk of third party damage should be addressed in accordance with the principles in paragraphs 5.5.4 and 5.5.5).

5.5.2 However, where the housing management service is to be provided by the Contractor, the apportionment of this risk is clearly related to the recommended objective application of housing policies by the Authority in Section 12 and to insurance¹⁴. To the extent that physical damage to the Assets is capable of being covered by the project insurances, the risk to be apportioned will be excesses and deductibles, increased insurance premia, shortfalls in insurances and risks which may become uninsurable (see Section 24 of the General Guidance). For the Contractor there may also be the responsibility for consequential Unavailability and Performance Deduction and the additional cost of vacant dwellings.

5.5.3 So far as material damage insurance is concerned as there will be an extremely low risk of total destruction of a significant part of the housing accommodation, an insurance project economic test (see Section 24.7 of the General Guidance) should not be necessary and the Contractor should be obliged to use the insurance proceeds to reinstate the relevant part of the accommodation and to make up any shortfall in insurances¹⁵. There will also be an issue where the risk of damage ceases to be insurable or is only insurable other than at reasonable commercial rates. In which case the approach contained in the General Guidance¹⁶ will generally be appropriate. However, where a previously insurable event occurs and the damage (for example it may only affect one or two units) is insignificant, an Authority should consider carefully whether it is appropriate and in its best interests to exercise its option to

¹⁴ See Section 24 of the General Guidance

¹⁵ See Section 27.7.3 of the General Guidance

¹⁶ Section 24.8

terminate the Contract (and pay force majeure compensation) rather than pay to the Contractor an amount equal to the insurance proceeds.

5.5.4 In view of this, how should both tenant and third party damage to the inside of the accommodation and the estate be addressed? There are three options for the Authority:

- (a) responsibility for tenant and third party damage is retained by the Authority on the basis that the Authority has the right to allocate tenants and there is little by way of security arrangements that the Contractor can put in place on the estate;
- (b) responsibility for tenant and third party damage is transferred to the Contractor as the Contractor is responsible for housing management (on the basis that housing management is part of the Service, otherwise the first option above should apply) and therefore part of the housing management function should be to prevent the occurrence of the tenant and third party damage. The disclosure of accurate historical information and data by the Authority will be central to the Contractor's assessment of the risks (see paragraph 4.1.1). Some Contractors may see this as involving them in risks that they are not best placed to manage. Nevertheless, they are best placed to address the consequences, and should be able to price the risk that they would be taking (on the basis of the availability of insurance, the claims history, the robustness of their design solutions etc);
- (c) an arrangement to share the risk by, for example, a division of responsibility for tenant and third party damage to more closely match risk with the ability to manage it (for example the Contractor may accept the risk of tenant damage but will only accept third party damage where it has responsibility for security, for example in relation to the common parts in blocks of flats) or by reference to a financial cap for either or both risks.

5.5.5 The second option in (b) above will often provide the clearest allocation of risk and responsibility and therefore should be the preferred option unless better value for

money and equivalent practical deliverability is clearly demonstrated by a sharing structure.

5.6 **Guidance to Authorities for ITN**

5.6.1 As with issues regarding existing services, the Authority should make clear in its ITN the structure it expects to represent best value for money and the risks it expects bidders to price into their bids, but invite bidders to propose and price alternative arrangements if better value for money can be demonstrated.

6. **SECTION 12: AUTHORITY CHANGES**

The General Guidance contained in Section 12.3 is fully applicable to a local authority housing PFI contract. However, some amendments to the drafting in the General Guidance will be needed to deal with variations associated with the withdrawal of dwellings from the Contract¹⁷ due in the large part to the exercise of statutory rights.

¹⁷ Section 11 of this Guidance

7. SECTION 13: CHANGES IN LAW

7.1 Application of General Guidance

7.1.1 Section 13.6 of the General Guidance deals with the definition and allocation of Changes in Law. The General Guidance recommends that Discriminatory and Specific Changes in Law (together Qualifying Changes in Law) should be an Authority risk and General Changes in Law a Contractor risk or shared risk depending upon which provides the best value for money for the Authority. The Local Authority Guidance also amplifies and allocates Changes in Law relevant to Best Value¹⁸. Subject to the qualifications set out below, the General Guidance¹⁶⁻¹⁹ and Local Authority Guidance are equally applicable to local authority housing PFI contracts.

7.2 Specific Changes in Law and Housing

7.2.1 The volume of legislation and case law relating to or impacting upon local authority housing is sufficiently great to consider whether the definition of a Specific Change in Law is currently applicable to local authority PFI contracts with sufficient clarity or whether additional wording needs to be added. Examples of Changes in Law which may be relevant include changes to the landlord and tenant legislation and/or public health legislation relating to the condition of the accommodation (or new case law on these subjects)²⁰, changes to welfare benefit arrangements,²¹ changes to the right to repair thresholds²² and changes applicable to social housing more generally.

7.2.2 The current definition of Specific Change in Law covers Changes in Law specifically referring to those services within the Contract such as housing management, building management and maintenance, building cleaning, security etc. The extent to which the definition applies on a project specific basis will depend upon the definition of the Service in the Contract and the value for money considerations associated with the

¹⁸ See Section 3

¹⁹ See Section 13.3 of the General Guidance

²⁰ See Section D1 of this Guidance

²¹ See Section D2 of this Guidance

²² See Section D2 of this Guidance

breadth of that definition and the extent of the risk transfer. Is the Service defined by reference to the services per se, or as applied to accommodation, housing accommodation or local authority housing accommodation? So far as the Authority is concerned, for the maximum risk transfer and subject to demonstrating value for money, the definition of Service ought to be by reference to the provision to local authority housing accommodation (as opposed to housing accommodation or accommodation more generally or to the specific services per se). However, bearing in mind that legislation is increasingly being applied to the social housing sector generally, therefore encompassing both local authorities and registered social landlords, it may be equitable to define Specific Change in Law by reference to Changes in Law applicable to local authorities or both local authorities and registered social landlords. This is the recommended approach.

7.2.3 Where this approach is adopted, a Change in Law which impacts upon tenant management or building maintenance generally would comprise a General Change in Law. A Change in Law which impacts upon tenant management or building management specifically relating to local authority housing (or relating to both local authority and registered social landlord housing) would amount to a Specific Change in Law. An example would be, legislation which placed a requirement on all landlords of dwellings to have a minimum amount of sound proofing would be a General (and at the Contractor's risk and cost or a shared cost) rather than a Specific Change in Law (unless it only applied to local authority housing or both local authority and registered social landlord housing when it would be an Authority risk and cost).

7.3 Changes in Law Affecting Tenants

7.3.1 The other area of Change in Law which is relevant to local authority housing is that which specifically applies to tenants or tenancies of local authorities. In particular changes to or increases in tenant rights or other changes to the circumstances of local authority tenants (as distinct from the rights of tenants generally). These may not specifically refer or apply to the Service but nonetheless may impact upon Contractor's costs. For example, changes in the thresholds or amounts of

compensation relating to the right to repair are unlikely to refer or apply to the Service in the same way as changes to the statutory duty of repair confined only to local authority landlords. However, both may have the same effect on the Contractor's costs; the latter directly in relation to an increase in the standard of repair and the former indirectly in relation to the increased obligation which the Contractor may have automatically assumed to the tenant in the Contract. On the other hand, if the Contractor has not automatically assumed the increased obligation under the Contract, then the increased obligation could only be passed through by way of an Authority Change.

7.3.2 Following the same reasoning as that contained in paragraph 7.2.2., if such a Change in Law as referred to in paragraph 7.3.1 is applicable, then the relevant limb of the definition should refer to Specific Changes in Law applicable to the tenants or tenancies of local authorities or both local authorities and registered social landlords

7.3.3 It is recommended that the definition of Specific Change in Law should be amended to include Changes in Law which specifically refer to tenants or tenancies of local authorities (or both local authorities and registered social landlords), although Authorities should examine such a risk transfer on a project specific basis, and following a value for money assessment.

7.4 **Changes to Welfare Benefits**

7.4.1 Changes in Law relating to welfare benefit (unless confined to local authority tenants or both local authority and registered social landlord tenants) would not, in accordance with the foregoing, amount to a Specific Change in Law. However, changes which affect rent collection may be more difficult to categorise depending upon the nature of the Change in Law. Although Contractors will not necessarily be expected to take the full credit risk on rent collection, changes in income support may impinge upon their performance in relation to rent collection levels. The recommended approach in addressing this issue is through the Best Value performance benchmarking arrangements referred to in Sections 7-10 of this

Guidance²³. In doing so the Contractor's performance would be compared with another comparator group in the light of changed circumstances. Indeed, a Change in Law relating to income support may be an agreed Best Value review trigger.

²³ See Section 3 of the Local Authority Guidance

8. SECTION 16: ASSIGNMENT

8.1 Application of General Guidance

The General Guidance relating to restrictions on the Authority²⁴ assigning or transferring its rights or obligations under the Contract equally applies to local authority housing PFI contracts.

8.2 Change of Circumstances

It is appreciated that PFI contracts are long term contracts and as such circumstances may change. If, for example, a whole stock transfer were to be undertaken during the Contract period, then three alternatives are available to the Authority:

8.2.1 to retain the accommodation which is the subject of the Contract;

8.2.2 to transfer the accommodation which is the subject of the Contract to the person to whom the whole of the Authority's stock is transferred, subject to that person assuming the obligations of the Contract;

8.2.3 to exercise its option to terminate the Contract voluntarily.

An Authority is unlikely to find the first option appropriate in the light of a whole stock transfer. So far as the second option is concerned, the issue for the Contractor and the Contractor's financiers will be the credit worthiness of the transferee and its ability to fulfil the obligations of the Authority under the Contract. In this respect, Authorities are recommended to follow the Local Authority Guidance²⁵. The third option will involve the Authority paying Authority default compensation²⁶.

²⁴ See Section 16.3 of the General Guidance

²⁵ Section 5

²⁶ See Section 20.5 of the General Guidance

9. SECTION 20.2: TERMINATION ON CONTRACTOR DEFAULT

9.1 Poor Performance in relation to Part

9.1.1 The approach set out in Section 20.2 of the General Guidance as supplemented by Section 5 of the Local Authority Guidance, in terms of both events of default and consequences, is fully applicable to local authority housing projects. However, in the context of local authority housing PFI contracts, Authorities will also need to consider carefully how the Contract is structured to deal with the possibility of a persistent, unacceptable level of performance in relation to a series of dwellings forming part of the housing accommodation, whilst performance across the remainder of the housing accommodation is acceptable. A similar issue which arises in relation to “grouped schools” PFI contracts. There is a need to ensure that all the housing accommodation receives an acceptable standard of performance. No part or parts of the housing accommodation should have to suffer unacceptable standards over a substantial period. Practical disadvantages would arise as a result of any partial termination, i.e. termination in relation to just an individual or distinct part of the housing accommodation with the remainder of the housing accommodation continuing under the Contractor. Partial termination is likely to be extremely disruptive to the management of the housing accommodation, unattractive to bidders and funders (and tenants), and contentious, for example, in terms of the compensation that would be payable.

9.1.2 Authorities often start from an assumption that partial termination is a necessary requirement to protect their interest, but in doing so they may actually achieve the opposite effect to that intended. The right of partial termination on the part of the Authority will leave open the possibility of the Contractor taking a view that part of the housing accommodation is too difficult (and costly) to bring up to the required standard. They may therefore accept suffering the payment deductions, and the risk of partial termination, rather than bring the part of the housing accommodation up to the required standard. In such circumstances, a partial termination may actually improve the balance of risk and reward for the Contractor.

9.2 Termination Threshold for Part

- 9.2.1 There is a much greater incentive on the Contractor to address the needs of every part of the housing accommodation in the project if there is a risk of termination of the whole Contract for their performance in relation to part or parts of the accommodation. The proposed solution to this issue is to structure the events of termination for Contractor default in relation to poor performance at two levels:
- (a) poor performance across the whole contract, e.g. events of non-availability or levels of performance deductions aggregated across all parts of the housing accommodation (as in the General Guidance, Section 20.2.2 (Events Leading to Termination)); and
 - (b) subject to the comments in paragraph 9.2.4 a persistent level of unacceptable performance in relation to individual or distinct parts of the housing accommodation, for example continuing non-availability which is not rectified despite appropriate notices and warnings.
- 9.2.2 In this way, the interests of the Authority, the Contractor and financiers, are actually consistent, as the incentive on the Contractor to prevent persistent poor performance on individual or distinct parts of the housing accommodation is maximised, and the complexities of partial termination are avoided.
- 9.2.3 In defining the extent of the individual or distinct parts of the accommodation and on setting thresholds for termination, it is important to balance the Authority's need to incentivise the Contractor to address problems in the Service, with the need to reach a solution which is bankable at a reasonable price.
- 9.2.4 Financiers may have concerns about the exposure of the whole project funding to termination due to the Contractor's performance in relation to individual or distinct parts of the accommodation, but it is important to bear in mind that:
- (a) the level of poor performance at which termination can occur (for example, the number of days of Unavailability and the period over which it is judged) will be negotiable in the circumstances of each Contract;

- (b) the extent of the individual or distinct parts of the accommodation, where poor performance may lead to termination, will be negotiable in the circumstances of the Contract;
- (c) rectification periods as set out in the General Guidance (Section 20.2.4) provide a further period of time for remedial action – such as replacement of a subcontractor – before termination can occur;
- (d) the Financiers will have step-in rights under the Direct Agreement (Section 30 of the General Guidance) before termination can occur.

9.2.5 However, where the Authority does consider termination of the whole Contract in relation to the standards of service for an individual or a small number of dwellings within the housing accommodation, to be disproportionate to the default, they should consider alternative remedies such as:

- (a) a similar provision which focuses on Unavailability across a more significant number of dwellings within the housing accommodation, rather than just one or a small number; or
- (b) an increase in the deduction under the payment mechanism to reflect the increased severity of loss and to maximise the incentive on the Contractor to address the cause of the problem.

PART 2 - ISSUES NOT COVERED BY THE GENERAL GUIDANCE

10. LEASEHOLDERS

10.1 Leaseholder Management

10.1.1 Only accommodation where the freehold is owned by the Authority should be included within the Contract. The Authority should not be concerned with private freehold owners (whether existing at the time of financial close or becoming so following the exercise of the right to buy during the Contract period) other than in relation to the recovery of costs for certain minimal services (such as the maintenance of common grassed areas). Whether the recovery of these relatively small sums should be part of the Service (particularly part of the performance and payment mechanism) will depend upon whether housing management is included in the Contract and value for money considerations. Whilst the position is therefore relatively straightforward in relation to traditional houses²⁷ it is more complex in relation to flats and maisonettes which will be sold on a leasehold basis.

10.1.2 Where leasehold properties are part of the buildings that are the subject of the Contract, and where housing management is part of the Service, then it is likely that the optimum value for money will be achieved by including leaseholder management services in the Contract. However, where the converse is the case, then leaseholder management services should be excluded.

10.1.3 Leaseholder management in itself should not have a material impact on the Contractor's risk analysis unless the number of leaseholders is significant. The management of the leasehold accommodation will necessarily involve a reduced level of service comprising largely repairs, maintenance and cleaning to the exterior structure and common parts (if any). Performance criteria are capable of being formulated for these services. However, the Contractor will quite reasonably seek relief from performance deductions where the provision of the services has been

²⁷ As the right to buy requires the transfer of freehold of houses

prevented or interfered with by the leaseholder, although there is little likelihood in practice of such interference occurring.

10.2 Recovery of Costs

10.2.1 An Authority should, at an early stage, verify provisions of leases under which the leasehold accommodation has been sold. This is to ascertain the extent to which the costs of carrying out the works (including the initial refurbishment works and any subsequent planned maintenance) and providing the Service are able to be recovered from the leaseholder under the terms of the lease. Particularly, for example, where a significant part of the works relate to remedying design problems, such works may be more correctly categorised as "improvements" as opposed to "repairs". Furthermore, the nature of the Contract means that the works are effectively being paid for over time. Therefore, an Authority will also need to verify whether the cost of carrying out works and providing services are recoverable "up front" or only after the Authority has actually defrayed the expenditure.

10.2.2 The risk of recovery of service charges from leaseholders should be apportioned in the way that provides the best value for money to the Authority. Service charge recovery, as mentioned previously, is in part linked to the adequacy of the drafting of the leases, the statutory provisions protecting leaseholders (as will be explained below) and ultimately leaseholder credit risk. The limit on the amount of the cost of works which leaseholders are expected to contribute (currently £10,000 in any five year period under the Mandatory Reduction of Service Charges (England) Directions 1999) will assist in enabling the collection of a greater proportion. A leaseholder is also entitled to a loan from the Authority²⁸. The transfer of the whole of the credit risk of recovery of service charges to the Contractor will provide poor value for money and is not recommended.

10.2.3 However, the **process** of service charge collection (including levels of recovery) is capable of being subject to performance criteria. An Authority should have regard to value for money considerations when fixing the performance criteria for the

²⁸ Sections 450A, 450B and 450C Housing Act 1985 and Housing (Service Charge Loans) Regulations 1992 SI No 1708

Contractor. The Contractor will wish to have a degree of certainty that the Authority will not be in a position to influence the Contractor's provision to the extent that there may be a reduction in performance with consequent deductions from the Unitary Charge. For example, legal action may be required to be taken under a lease for non payment of the service charge or other breach of leaseholders covenants which may impact on the Contractor's performance. The decision by the Authority as landlord on whether or when to proceed with such an action may impact upon performance. As a consequence therefore, it is recommended that the Authority and Contractor agree a policy for enforcement of the terms of the lease (in much the same way as the enforcement of tenancy terms²⁹). Such a policy should be output rather than input driven to fit within the output specification for the Services. It should not be a method statement but series of statements setting the parameters for action by the Contractor.

10.3 Statutory Requirements

10.3.1 As mentioned previously, there are certain statutory provisions which either restrict the recovery of, or specify procedures for the recovery of, service charges from local authority leaseholders. Sections 19 and 20 of the Landlord and Tenant Act 1985, as will be explained below, contain such provisions for works and services. The position is further complicated by an Authority's inability to recover the cost of works undertaken in the first 5 years after a leaseholder sale, if the works have not been notified to the leaseholder as part of the Authority's offer notice issue as part of the right to buy procedure³⁰.

10.3.2 Section 19 of the Landlord and Tenant Act 1985 states that costs incurred and which are recoverable through a service charge can only be included in that service charge to the extent that they are reasonably incurred and that the services or works are of a reasonable standard. Authorities should refer to the full text of Section 19 at the end of this Section for its full effect. It is open to leaseholders to apply to a Leasehold

²⁹ See Section 12.3

³⁰ Section 125 Housing Act 1985

Valuation Tribunal for determination of the reasonableness of the charges or the reasonableness of the works.

10.3.3 Section 20 of the Landlord and Tenant Act 1985 contains the procedures which Authorities must follow when carrying out works as landlord, to a property which is the subject of a long leasehold interest. This section provides the opportunity for leaseholders to make observations (which the Authority must have regard to) on the need for the works, the identity of the Contractor and the reasonableness of the expenditure. In particular, two estimates for the cost of the works to be recharged to the leaseholders must be obtained, one of which must be from a person wholly unconnected with the Authority. Furthermore, where the leaseholders are represented by a recognised tenants association, the association may propose persons from whom it believes the Authority should obtain estimates. Authorities should refer to the full text of Section 20 at the end of this Section for its full effect³¹. The Secretary of State will not be providing exemptions for Authorities to be able to dispense with the requirements of Section 20 (although a court may do so if it is satisfied that the landlord acted reasonably, however it may be difficult to persuade a court that exemptions should be given for every lease in the Contract).

10.4 **Application of Statutory Requirements**

10.4.1 The principal issue for Authorities is the compatibility of compliance with the requirements of Sections 19 and 20 Landlord and Tenant Act 1985 with the Contract. The Contract will contain an element in the Unitary Charge to cover the cost of undertaking works to the accommodation occupied by leaseholders (both the initial refurbishment works and subsequent major maintenance works). The cost of the works will therefore be met by the Authority over time through the Unitary Charge. However, unlike other more usual scenarios in a PFI contract, this element of the costs may be recovered from individual leaseholders under the lease provided it is identifiable, subject to the terms of the lease and the statutory procedures having been complied with. Section 19 is relative in its operation in that it limits recovery to such

³¹ The draft Bill and Consultation Paper Commonhold and Leasehold Reform: August 2000 contains proposals to substitute new provisions for the existing Section 20.

sums as are judged to be reasonable. The procedural requirements in Section 20 of the Landlord and Tenant Act 1985 on the other hand are absolute in that the procedural requirements must be undertaken, prior to the time the Authority incurs the costs, for them to be recoverable from the leaseholders.

- 10.4.2 The consequences for the Authority of the non-compliance with Sections 19 and 20 are quite different. It is for the Authority to demonstrate compliance with Section 19; that the amount of the proposed service charge is reasonable. There is no statutory obligation to select the lowest tender (having obtained at least two estimates, one independent, to comply with the requirements of Section 20) and conversely the selection of the lowest tender does not guarantee a finding of reasonableness. Reasonableness can be demonstrated through other means, such as from the collation of other industry benchmarking costs. Furthermore, an Authority may apply to the Leasehold Valuation Tribunal for an advance determination of reasonableness. However, failure to obtain an estimate from a person "wholly unconnected with the [Authority as] landlord" would prevent the Authority from complying with Section 20 (unless a court order is obtained under Section 20(9)).
- 10.4.3 The procedural requirements of Section 20, particularly in the context of the Contract, to secure two estimates (one independent) must be satisfied prior to the time the Authority incurs the costs. It is a matter for the Authority to take legal advice on the individual circumstances on the point at which the costs are incurred by the Authority. Although such has not been the subject of judicial interpretation it is suggested, in general terms, to incur the costs, it is likely that the extent of the works must be known and priced, together with a contractual commitment by or on behalf of the Authority to pay for the works at that price. The signing of the Contract will not amount to the incurring of the cost unless the Contract itself or through a sub-contract contains the details of works for each of the leasehold properties separately identified and costed (Authorities may need a separate arrangement in the Contract for paying for the works to leasehold properties outside the Unitary Charge and for the recovery of such costs if the Authority's lease only permits the recovery of costs actually disbursed).

- 10.4.4 The requirement of Section 20 is that at least one estimate for the cost of the works must be obtained from a person wholly unconnected with the Authority, as landlord, prior to the costs being incurred. As a party to the Contract, the Contractor should be regarded as connected to the Authority.
- 10.4.5 If the requirements of Section 20 could be complied with during the procurement or bidding process for the Contract, then the works would have to be capable of being specified and priced and two estimates for the works obtained at a point prior to the costs being incurred. This point would be at contract signature or, if later, at financial close. In order that the bidders could satisfy the independent estimate requirement detailed proposals should have been prepared to identify all works necessary for each leasehold property and the Contractor's proposals worked up to enable the bidders to define and price the works with sufficient certainty. One difficulty of this approach is that in a typical PFI procurement the Authority's works requirement is defined by reference to an output specification. Therefore, to comply with Section 20 at this stage, Authorities would have to ensure that a full solution which meets the output specification is in place and that the solution must be sufficiently detailed to identify and price the works to such leasehold property. Any subsequent change to the price during negotiations with the preferred bidder would require comparison against a second estimate.
- 10.4.6 If an Authority were to seek to comply with Section 20 by using the bidding process, the Authority would also have to have due regard to Section 19 and be satisfied that the costs in the bids are reasonable and that they are capable of being defended in any proceedings before the Leasehold Valuation Tribunal. In particular, Authorities would have to give consideration to those elements in the costs which reflect costs associated with long term funding and risk profile.
- 10.4.7 Furthermore, there are other problems with endeavouring to comply with Section 20 during the procurement or bidding process which include, the solutions may not be designed to a level whereby a quote could be provided, the bidders may not be offering comparable solutions, any attempt at achieving commonality may detract from competition and there may be an adverse effect on risk transfer and balance

sheet treatment due to the Authority defining the nature of the asset. Therefore, as a consequence of all of these issues, this approach is not recommended.

- 10.4.8 If the requirements of Sections 19 and 20 cannot be met during the procurement or bidding process, then arrangements will need to be put in place to ensure that they are otherwise met whether before or after Contract signature. This will be required, in any event, for major maintenance during the Contract period. The Authority may then be faced with the practical difficulty of obtaining a second estimate for the works where the supplier will clearly not be employed to carry out the works (unless, of course, it is intended that the supplier will be employed by the Construction sub-contractor). However, the statutory requirement in this regard is to obtain an independent estimate which, if challenged, will have to stand up to scrutiny and prove to be genuine.
- 10.4.9 The arrangements put in place by the Contractor or sub-contractor will have to allow for a second estimate to be obtained for the cost of works to each leasehold property and the recharging of the lowest cost to the leaseholder, unless it is reasonable to disregard inadequate bids following a process of evaluation of the estimates, including any from tenant association-nominated bidders, and also having had regard to observations from leaseholders. This may be achieved either by comparing the independent estimate with the works cost for the individual leasehold property in the Contract or with an estimate separately issued by the Contractor (or sub-contractor). The principal issues for the Authority in relation to the former option will be to ensure that the works cost is capable of being broken down by reference to each leasehold property and that the cost is reasonable (having regard to long term funding and risk profile issues as mentioned previously). The contract change mechanism will need to be sufficiently robust to allow for any changes arising out of the Authority's duty to have regard to observations on the works from leaseholders.
- 10.4.10 In conclusion, the options available for the recovery of costs from leaseholders can be summarised as follows:-
- (a) compliance with Sections 19 and 20 during the bidding process; Sections 19 and 20 can be satisfied at the date of contract signature or financial close, in

relation to leasehold properties, if the PFI procurement process has been undertaken such that sufficiently detailed proposals have been prepared to identify all the works necessary for each leasehold property to meet the output specification. This will mean that Contractor's proposals have been worked up at bid stage, the works have been priced by more than one bidder, the cost of the works is reasonable (following a process of evaluation of the estimates and having regard to the observations of leaseholders) and the eventual contractual commitment by the preferred bidder for the procurement of the works to the leasehold property reflects that cost; and

- (b) compliance with Sections 19 and 20 other than during the bidding process; this will apply to the initial refurbishment works which do not fall within paragraph 10.4.10(a) above and to major maintenance works during the Contract period. Sections 19 and 20 are likely to be satisfied when the works are actually undertaken if, prior to the works being contractually committed, the extent of the works to each leasehold property has been fully identified, the Contractor has obtained at least one independent estimate in relation to the cost of the works, the cost of the works is reasonable (following a process of evaluation of the estimates and having regard to the observations from the leaseholders) and the contractual commitment by the Contractor for the procurement of the works reflects that cost. The Contractor will be obliged to market test the works to leasehold properties on each occasion that they are required to be undertaken.

All the procedural requirements contained in Section 20 should also have been complied with in both circumstances in (a) and (b) above.

However, for the reasons explained in paragraphs 10.4.5-10.4.7 above option (b) is the recommended approach.

10.5 **Financial Consequences**

- 10.5.1 Authorities should be aware of the financial consequences of not complying with Sections 19 or 20. Unless the court exercises its discretion, the Authority's recovery will be limited to be either £1,000 or £50 times the number of service charge payers,

whichever is the highest (or indeed less or none of it were determined that the works were unnecessary). In which case, the Authority will incur a significant loss.

10.5.2 Authorities should also have regard to Section 20B Landlord and Tenant Act 1985 which generally precludes Authorities from recovering costs through a service charge where they were incurred more than 18 months previously. However, such costs are recoverable if, within eighteen months of incurring them, the Authority notifies the leaseholder in writing that the leaseholder will be required to contribute towards them.

10.6 **Leaseholder Works and Services within Unitary Charge**

10.6.1 As indicated previously, it is recommended that Authorities include the process of management and maintenance of leasehold properties and the recovery of service charges in the payment and performance mechanism. The Unitary Charge, set at Contract signature, will (subject to adjustments for Availability and Performance Deductions indexation, benchmarking and market testing etc) be fixed for the whole of the Contract Period. As a consequence, the actual amounts recharged to individual leaseholders to cover the costs of works and services following compliance with Sections 19 and 20 will not be reflected in periodic adjustments to the Unitary Charge. It is a matter for the Authority to assure itself at the time of Contract signature that the preferred bid will provide sound value for money over the Contract Period.

10.6.2 However, it is also recommended that Authorities include compliance by the Contractor and its sub-contractors with the legal requirements in Sections 19 and 20 as a performance requirement or standard in the payment and performance mechanism. Such a provision may be supplemented by a performance standard relating to the level of service charge recovery generally. This will be set by reference to agreed timescales, but should exclude from such performance standard sums which are unrecoverable due to the mandatory recovery limits being exceeded³²

³² see paragraph 10.2.2 above

or due to the works not being included in the Authority's offer notice as part of the right to buy procedure³³.

10.7 **Guidance to Authority for ITN**

Where a local authority housing PFI project includes leasehold dwellings it is suggested that the Invitation to Negotiate issued to shortlisted bidders identifies the leasehold dwellings and invites bidders to submit proposals to deal with the requirements of Section 20 (both in relation to the initial refurbishment works and subsequent major maintenance) taking into account the recommendation in paragraph 10.4.10.

10.8 **Sections 19 and 20 Landlord and Tenant Act**

19 Limitation of service charges: reasonableness

(1) Relevant costs shall be taken into account in determining the amount of a service charge payable for a period:

(a) only to the extent that they are reasonably incurred; and

(b) where they are incurred on the provision of services or the carrying out of works, only if the services or works are of a reasonable standard

and the amount payable shall be limited accordingly.

(2) Where the service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made by repayment, reduction or subsequent charges or otherwise.

[(2A) A tenant by whom, or a landlord to whom, a service charge is alleged to be payable may apply to a leasehold valuation tribunal for a determination:

³³ see paragraph 10.3.1 above

- (a) *where costs incurred for services, repairs, maintenance, insurance or management were reasonably incurred;*
 - (b) *whether services or works for which costs were incurred are of a reasonable standard; or*
 - (c) *whether an amount payable before costs are incurred is reasonable.*
- (2B) *An application may also be made to a leasehold valuation tribunal by a tenant by whom, or landlord to whom, a service charge may be payable for a determination:*
 - (a) *whether if costs were incurred for services, repairs, maintenance, insurance or management of any specified description they would be reasonable;*
 - (b) *whether services provided or works carried out to a particular specification would be of a reasonable standard; or*
 - (c) *what amount payable before costs are incurred would be reasonable.*
- (2C) *No application under subsection (2A) or (2B) may be made in respect of a matter which:*
 - (a) *has been agreed or admitted by the tenant;*
 - (b) *under an arbitration agreement to which the tenant is a party is to be referred to arbitration; or*
 - (c) *has been the subject of determination by a court or arbitral tribunal.]*
- (3) *An agreement by the tenant of a [dwelling] (other than an arbitration agreement [...]) is void insofar as it purports to provide for a determination in a particular manner, or on particular evidence, of any question:*

- (a) *whether costs incurred for services, maintenance, insurance or management were reasonably incurred;*
- (b) *whether services or works for which costs were incurred are of a reasonable standard; or*
- (c) *whether an amount payable before costs are incurred is reasonable.*

(4) *[...]*

[(5) If a person takes any proceedings in the High Court in pursuance of any of the provisions of this Act relating to service charge and he could have taken those proceedings in the county court, he shall not be entitled to recover any costs.]

20 *Limitation of service charges: estimates and consultation*

[(1) Where relevant costs incurred on the carrying out of any qualifying works exceed the limit specified in subsection (3), the excess shall not be taken into account in determining the amount of a service charge unless the relevant requirements have been either:

- (a) complied with; or*
- (b) dispensed with by the court in accordance with subsection (9);*

and the amount payable shall be limited accordingly.

(2) In subsection (1) "qualifying works", in relation to a service charge, means works (whether on a building or on any other premises) to the costs of which the tenant by whom the service charge is payable may be required under the terms of his lease to contribute by the payment of such a charge.

- (3) *The limit is whichever is the greater of:*
- (a) *[£50] or such other amount as may be prescribed by order of the Secretary of State, multiplied by the number of dwellings let to the tenants concerned; or*
 - (b) *[£1,000], or such other amount as may be so prescribed.*
- (4) *The relevant requirements in relation to such of the tenants concerned as are not represented by a recognised tenants' association are:*
- (a) *at least two estimates for the works shall be obtained, one of them from a person wholly unconnected with the landlord;*
 - (b) *a notice accompanied by a copy of the estimates shall be given to each of those tenants or shall be displayed in one or more places where it is likely to come to the notice of all those tenants;*
 - (c) *the notice shall describe the works to be carried out and invite observations on them and on the estimates and shall state the name and the address in the United Kingdom of the person to whom the observations may be sent and the date by which they are to be received;*
 - (d) *the date stated in the notice shall not be earlier than one month after the date on which the notice is given or displayed as required by paragraph (b);*
 - (e) *the landlord shall have regard to any observations received in pursuance of the notice; and unless the works are urgently required they shall not be begun earlier than the date specified in the notice.*
- (5) *The relevant requirements in relation to such of the tenants concerned as are represented by a recognised tenants' association are:*

- (a) *the landlord shall give to the secretary of the association a notice containing a detailed specification of the works in question and specifying a reasonable period within which the association may propose to the landlord the names of one or more persons from whom estimates for the works should in its view be obtained by the landlord;*
- (b) *at least two estimates for the works shall be obtained, one of them from a person wholly unconnected with the landlord;*
- (c) *a copy of each of the estimates shall be given to the secretary of the association;*
- (d) *a notice shall be given to each of the tenants concerned represented by the association, which shall:*
 - (i) *describe briefly the works to be carried out;*
 - (ii) *summarise the estimates;*
 - (iii) *inform the tenant that he has a right to inspect and take copies of a detailed specification of the works to be carried out and of the estimates;*
 - (iv) *invite observations on those works and on the estimates; and*
 - (v) *specify the name and address in the United Kingdom of the person to whom the observations may be sent and the date by which they are to be received;*
- (e) *the date stated in the notice shall not be earlier than one month after the date on which the notice is given as required by paragraph (d);*

- (f) *if any tenant to whom the notice is given so requests, the landlord shall afford him reasonable facilities for inspecting a detailed specification of the works to be carried out and the estimates, free of charge, and for taking copies of them on payment of such reasonable charge as the landlord may determine;*
- (g) *the landlord shall have regard to any observations received in pursuance of the notice and, unless the works are urgently required, they shall not be begun earlier than the date specified in the notice.*
- (6) *Paragraphs (d)(ii) and (iii) and (f) of subsection (5) shall not apply to any estimate of which a copy is enclosed with the notice given in pursuance of paragraph (d).*
- (7) *The requirement imposed on the landlord by subsection (5)(f) to make any facilities available to a person free of charge shall not be construed as precluding the landlord from treating as part of his costs of management any costs incurred by him in connection with making those facilities so available.*
- (8) *In this section "the tenants concerned" means all the landlord's tenants who may be required under the terms of their leases to contribute to the costs of the works in question by the payment of service charges.*
- (9) *In proceedings relating to a service charge the court may, if satisfied that the landlord acted reasonably, dispense with all or any of the relevant requirements.*
- (10) *An order under this section:*
 - (a) *may make different provision with respect to different cases or descriptions of case, including different provisions for different areas; and*
 - (b) *shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.*

11. WITHDRAWAL OF DWELLINGS FROM THE CONTRACT

11.1 Demand

11.1.1 Generally

- (a) Consideration has been given to the extent to which the risk arising from changes in general market demand for social housing can be transferred to the Contractor. It is suggested that such demand risk is generally best managed by the Authority. As a consequence, any reduction in market demand for social housing will generally remain a risk borne by the Authority. Clearly demand will be more of an issue in some parts of the country than in others.
- (b) It is likely that the payment mechanism will be based upon a traditional performance regime conforming to one of the models in the General Guidance.³⁴ This will be based on performance standards denoting the availability of the accommodation to the Authority and the provision of core maintenance and management services to be provided to the tenants occupying the housing accommodation.
- (c) Sub standard performance by the Contractor may have an effect on the level of demand for accommodation. Nevertheless it is recommended that failure to meet the standards applicable to the housing accommodation required by the output specification should generally not result in a transfer of the demand risk but should be more properly addressed as a performance issue through the performance and payment mechanism.
- (d) Market demand for the housing accommodation may change over the Contract period. In these circumstances the Authority would continue to pay the Unitary Charge subject to deductions for Unavailability of the housing accommodation and sub-standard performance of the core services and subject to the Authority taking steps itself to mitigate the effects of changing levels of demand. However, the Authority will continue to be in receipt of PFI Credits.

³⁴ See paragraph 10.4.2

- (e) In preparing their business case each Authority should have had regard to projected changes in demand for social housing throughout the Contract period. Additionally, it is always within the Authority's control to manage the demographic demand for the housing accommodation which is the subject of the Contract.

11.1.2 **Withdrawal of Dwellings**

- (a) Only in exceptional circumstances should an Authority consider instigating a proposed Authority Change and/or inserting provisions in the Contract enabling withdrawal of dwellings from the Contract. For example, where it is mutually agreed that certain identified dwellings are to be demolished after a specified period. Any such withdrawal of dwellings should not be on an individual basis, but in "manageable tranches". This advice is reinforced by the cumulative effect on the sustainability of the Contract of the withdrawal of dwellings, through the right to buy³⁵ (and indeed right to manage³⁶) and voluntary withdrawal.
- (b) The withdrawal of units of accommodation should not be treated as a partial termination - i.e. a voluntary termination by the Authority in relation to the withdrawn units of accommodation requiring the payment of compensation (Authority default) on a pro rata basis³⁷.

11.1.3 **Change Mechanism**

- (a) The General Guidance³⁸ relating to Authority Changes is equally applicable to the voluntary withdrawal of dwellings from the Contract. In particular, an Authority should where possible avoid withdrawing dwellings during the construction or development phase. A value for money assessment should be undertaken of the withdrawal and future use of the dwellings when compared with their retention in the Contract. The Contract should contain a procedure

³⁵ See Section 11.2 of this Guidance

³⁶ See Section 11.3 of this Guidance

³⁷ See Section 20.5 of the General Guidance

³⁸ See Section 12.3 of the General Guidance

for calculating the cost adjustments to the Contractor arising as a consequence of the withdrawal of the dwellings. The approach of the Authority to the cost adjustment should be similar to that for the right to buy³⁹. In particular, the Authority should remain free to decide how it wishes to use any capital receipt which may arise from any disposal of the withdrawn dwellings, i.e. the Authority should not be obliged to pay any part of a receipt to the Contractor⁴⁰.

- (b) When the withdrawal of dwellings from the Contract has been agreed by the Contractor, neither the Contractor nor the Contractor's financiers should have any veto over the future use of the withdrawn units. The position is no different to the use by the Authority of its other property within the vicinity of the accommodation which is the subject of the Contract. It is in the mutual interest of both the Authority and the Contractor to keep the accommodation within the Contract sustainable.
- (c) If the ability to withdraw dwellings is on an exceptional basis within the Contract and where the dwellings are clearly identified and/or the circumstances of withdrawal are clearly identified, both the Authority and the Contractor should be confident of the contract's sustainability in those events. Consequently, termination of the Contract should not normally be contemplated. However, as mentioned previously, the cumulative effect of the voluntary withdrawal of accommodation with other areas of "compulsory" withdrawal (such as the right to buy and right to manage) may result in the Contract becoming unsustainable in financial and/or management terms. Consequently, a threshold will need to be agreed which when exceeded will give either party the right to terminate the Contract. This threshold will be agreed on a project specific basis, probably by reference to the technical assumptions in the financial model. The technical assumptions taken into account may include the impact on the Contractor's fixed costs, the effect on the projected Internal Rate of Return and the Senior Debt cover ratios.

³⁹ See Section 11.2 of this Guidance

⁴⁰ Although the Authority may of course decide to do so after having complied with the rules in the Local Government and Housing Act 1989 and Local Authority (Capital Finance) Regulations 1997 (as amended) relating to the setting aside of a prescribed proportion of the receipt to redeem existing debt on the units of accommodation.

11.1.4 Termination thresholds

- (a) If accommodation is withdrawn to take the numbers of dwellings below the agreed threshold, then such termination should be a voluntary termination by the Authority (whether invoked by the Authority or the Contractor) and compensation paid by the Authority in accordance with the General Guidance⁴¹.
- (b) Ultimately, of course, it is always open to the Authority to decide at any time that the scope of the project has changed too much, or that further changes will be so costly that it wishes to use its right of voluntary termination⁴² to meet the financial consequences of such.

11.2 Right to Buy Sales

11.2.1 Background legislation

- (a) Pursuant to the Housing Act 1985⁴³ a secure tenant⁴⁴ has the right to buy⁴⁵ the freehold of a house of which the Authority has a freehold interest or the lease of a flat, or a house where the landlord has only a leasehold interest⁴⁶. There is a qualifying period of at least two years as a public sector tenant (wider than merely being a tenant of the Authority).
- (b) A person exercising the right to buy may be entitled to a discount on the purchase price⁴⁷ (the purchase price in turn is calculated by reference to the open market value of the unit of accommodation taking into account certain assumptions⁴⁸). The discount is calculated by reference to the secure tenant's period of occupation as a public sector tenant. The discount entitlement, in the case of a house, is 32 percent plus 1 percent for each complete year by which

⁴¹ See Section 20.5 of the General Guidance

⁴² See Section 20.5 of the General Guidance

⁴³ Part V

⁴⁴ See Section 79 Housing Act 1985 for the definition of a secure tenant, although broadly it covers all local authority tenants

⁴⁵ Subject to certain exemptions and limitations, see Sections 120, 121, Schedule 1 and Schedule 5 Housing Act 1985

⁴⁶ Section 18 Housing Act 1985

⁴⁷ Section 129 Housing Act 1985

⁴⁸ Sections 126 and 127 Housing Act 1985

the qualifying period for discount exceeds two years up to a maximum of 60 percent. In the case of a flat, the discount entitlement is 44 percent plus 2 percent for each complete year by which the qualifying period exceeds two years, up to a maximum of 70 percent⁴⁹. However, there is a limit on the maximum discount which may be claimed by (a) an order of the Secretary of State and (b) by means of a minimum sale price⁵⁰. The maximum discount fixed by (a)⁵¹ varies depending on where in England the property is (from £38,000 in London to £22,000 in the North East). The minimum sale price is fixed by reference to what is commonly called the cost floor⁵².

- (c) The cost floor is the aggregate of the relevant costs attributable to the unit of accommodation for the period of 10-11 years⁵³ prior to the date upon which the notice exercising the right to buy is served. The relevant costs comprise construction costs, acquisition costs, cost of repairing and remedying defects, costs in excess of £5,500 of repair or maintenance or works to deal with any defect and costs of other works.
- (d) The right to buy discount cannot reduce the purchase price below the total of the aggregate of the relevant costs except where the relevant costs exceed the market value, which will then be the purchase price. The cost floor rule should deliver the same result under a PFI contract as would be delivered in other circumstances if the application to purchase is lodged within 10-11 years of the costs being incurred, provided the costs are incurred by the Authority or the Contractor as agent for the Authority. The Contract should provide for a proper examination of the costs appertaining to each individual unit of accommodation to enable an Authority to satisfy the statutory requirements in respect of the cost floor.
- (e) Furthermore, the Authority should ensure that works are notified to all leasehold purchasers as part of the offer notice to ensure that the Authority may

⁴⁹ See Section 129 Housing Act 1985

⁵⁰ Section 131 Housing Act 1985

⁵¹ The Housing (Right to Buy) (Limits on Discount) Order 1998 SI 1998 No 2997

⁵² See The Housing (Right to Buy) (Cost Floor) (England) Determination 1999

⁵³ The period is calculated by reference to the local authority accounting year

recover the cost of works undertaken within the first five years of the leasehold sale (see Section 125 Housing Act 1985).

- (f) An Authority should only enter into the Contract where the Contract proves to be value for money. In the view of the DETR⁵⁴ "the existence of a PFI Contract should not in itself encourage or discourage sales under the right to buy scheme. Local authorities should therefore seek to avoid contract terms which are designed either to encourage or discourage right to buy sales".
- (g) Right to buy sales are likely to occur throughout the Contract period. The consequent improvement in the environment as a result of the works which are the subject of the contract may encourage right to buy applications. Indeed, an Authority may see the Contract as a means of diversifying tenures within the area of the Contract.

11.2.2 Change Mechanism

- (a) The Contract should contain a Change Mechanism to deal with the adjustments to the Unitary Charge following the exercise of the right to buy and (where the unit of accommodation is a house resulting in the sale of the freehold) the consequent withdrawal of the unit of accommodation from the Contract. The same issue arises where a group of leaseholders acquire the freehold reversion. It is likely to be administratively cumbersome and costly to adjust the Unitary Charge on each occasion that a right to buy sale occurs. It is therefore recommended that the Authority and Contractor agree a regular review period in the Contract (either by reference to time periods, quarterly or six monthly or by numbers of sales or both) following the expiry of which the Unitary Charge is adjusted by reference to the aggregate of the sales in the review period. The recommended approach to right to buy sales is to treat the withdrawal of the dwellings as an Authority Change⁵⁵ as opposed to a partial termination.⁵⁶ The

⁵⁴ See paragraph 3.1.1 the DETR advice note on pathfinder authorities: Council Leaseholders and right to Buy Sales in Housing PFI Contracts, February 2000

⁵⁵ See Sections 5.2 and 12.3 of the General Guidance

⁵⁶ In the same way as the voluntary withdrawal of units, see Section 11.1

Change Mechanism should be able to deal with such circumstances as the effects of the changes will be reflected in the Contractor's pricing of the change.

11.2.3 Construction Phase Compensation

- (a) The General Guidance⁵⁷ relating to Authority Change is equally applicable to right to buy sales. The sales may occur at any time during the Contract Period and therefore either before, during or after the construction or refurbishment phase. The application of Authority Change in housing PFI contracts may be more complicated due to the Service commencing from financial close albeit with the full Service not commencing until the full Service Commencement Date. Furthermore the introduction of the full Service is likely to be phased. An Authority Change before or during the construction or refurbishment phase is treated as a Compensation Event in the General Guidance⁵⁸. It is recommended that this approach is equally applicable to a change arising from a right to buy sale. This approach would enable the Contractor to apply for relief from its obligations (primarily if the Contractor considers that it may not be able to achieve Service Commencement on or before the Planned [full] Service Commencement Date or otherwise comply with its obligations under the Contract) and/or claim compensation under the Contract (where the Contractor incurs costs or loses revenue)⁵⁹. However, any application for relief and/or claim for compensation should arise as a direct result of the Compensation Event. Consequently, it will only be in exceptional circumstances that the Contractor will be able to demonstrate to the reasonable satisfaction of the Authority that the Authority Change, as a consequence of the right to buy sale, is the direct cause in the delay in the achievement of the Planned [full] Service Commencement Date. In the majority of cases the unit of accommodation can merely be excluded from the Contract without any impact on the Planned [full] Service Commencement Date.

⁵⁷ See Sections 5.2 and 12.3 of the General Guidance

⁵⁸ See Section 5.2 of the General Guidance

⁵⁹ See, for example, draft of Section 5.2 of the General Guidance

- (b) Compensation is calculated by reference to the Estimated Revised Project Costs, defined in the General Guidance⁶⁰ as being the aggregate of any estimated increased construction costs, operating costs and financing costs less the aggregate of any reduced construction costs, operating costs and financing costs. The exclusion of the right to buy sale before or during the construction or refurbishment phase will result in a net reduction in the capital costs of construction or development, the finance costs of the construction or refurbishment and the operating costs during the Service Period. Such a reduction will result in neither a pro rata nor a linear reduction in the Unitary Charge as the Contractor will face the marginal cost of the loss of each unit of accommodation. This is more likely to have a stepped profile (indeed the extent of the marginal costs is likely to vary depending upon the type of unit accommodation). For example, a 10 percent reduction in the number of units of accommodation may lead to a less than 10 percent reduction in the Unitary Charge and further reductions may see the gap widen.
- (c) The marginal costs faced by the Contractor will arise for a number of reasons including diseconomies of scale resulting in the existence of certain fixed construction and operating costs, increased finance costs, for example to the extent that the sale during the construction or refurbishment phase results in undrawn Senior Debt commitment, and cancellation fees. Where the Contract takes account of diseconomies of sale, there may need to be an appropriate threshold which will trigger a proportionate recalculation to manage the process of adjustments to the Unitary Charge. Otherwise, diseconomies of scale triggers will become ad hoc with steep discrepancies in the proportionality of deductions.
- (d) Where the sale occurs before or during the construction or refurbishment phase, there will be a net reduction in the capital costs within the Contract Price as a result. This in turn will result in a portion of the Senior Debt not being drawn down. This net saving could therefore be reflected in a corresponding

⁶⁰ See Section 1.3.1 of the General Guidance

reduction in the Unitary Charge. However, the withdrawal of dwellings should not impact upon the investor rate of return and Senior Debt cover ratios.

- (e) The Estimated Revised Project Costs can otherwise be agreed or determined in accordance with the General Guidance⁶¹.

11.2.4 Service Period Compensation

- (a) Where the right to buy sale occurs during the Service Period after the full Service Commencement Date for the relevant phase the General Guidance⁶² will apply. However, much of the procedural requirements associated with an Authority Change⁶³ will be irrelevant for a right to buy sale. The Authority will initiate the Authority Change at the end of the review period for right to buy sales⁶⁴ and thereafter the Contractor should respond with the Estimate albeit including the Estimated Revised Project Cost⁶⁵. The Estimated Revised Project Cost will be calculated following the procedure in the General Guidance⁶⁶ by reference to the same factors applicable to a right to buy sale before or during the construction or refurbishment phase, save that following completion of the construction or development works and the achievement of the full Service Commencement Date for the phase in question, the whole of the relevant portion of the Senior Debt attributable to that phase will have been drawn down. As a consequence the Estimated Revised Project Costs will relate solely to the operating costs, having been calculated in the same way as revisions to the operating costs arising from sales before or during the construction or refurbishment phase⁶⁷. The financing costs relating to the Works will continue to be payable. The withdrawal of dwellings during the Service Period should likewise not impact upon investor rate of return Senior Debt cover ratios.

⁶¹ See the drafting in the General Guidance, Section 5.2(b), (c) (save for (ii)(B)), (d), (e) and (f) all suitably amended to take into account the concept of a review period for right to buy sales

⁶² See Section 12.3

⁶³ See Section 12.4 of the General Guidance

⁶⁴ See Paragraph 11.2.2 above

⁶⁵ See the drafting in clause 12.4(c)(iv) of the General Guidance

⁶⁶ See the drafting at Section 12.4(d), (e), (f) (without the withdrawal of the Notice of Change), (g) and (k)

⁶⁷ See Section B1 above

- (b) The Authority will continue to be in receipt of PFI credits which will enable the Authority to maintain the level of the Unitary Charge notwithstanding the occurrence of right to buy sales. However, the Authority will be denied the ongoing income from the units of accommodation to fund the housing revenue account and in turn any part of the Unitary Charge not funded from PFI credits.
- (c) The loss of the units of accommodation and the retention of the Unitary Charge (save for the reduction in relation to marginal costs) may, depending upon the drafting of the payment and performance mechanism, lead to an increased proportion of the Unitary Charge being subject to deductions for Unavailability. This should be avoided.

11.2.5 **Capital Receipts**

The Authority should receive and retain the full purchase price generated by the sale (the open market value less discount or the cost floor, whichever is the greater). Having accounted for the capital receipt in the normal way, it is always open to the Authority to use the balance of any receipt to make an advance payment of the Unitary Charge. However, it is difficult to envisage any advantage to the Authority in doing this as the effect, if applied to the Senior Debt, may be to incur costs associated with the advance payment of the Senior Debt under the finance documents and incur breakage costs in relation to any interest rate hedging agreement which the Contractor may have entered into.

11.2.6 **Termination Threshold**

As mentioned in the case of the voluntary withdrawal of units of accommodation⁶⁸ the loss of units of accommodation from the Contract may result in numbers of units being reduced below a threshold beyond which the Contract ceases to be viable in financial and/or management terms. This is equally applicable to right to buy sales. In which case a threshold will need to be agreed which will give either party a right to terminate the Contract. The threshold will be agreed on a project specific basis, probably by reference to assumptions in the financial model. This will include the

impact on the Contractor's fixed costs, the effect on the projected IRR and the Senior Debt cover ratios. Where termination occurs, it should be treated as a voluntary termination by the Authority with compensation being paid by the Authority in accordance with the General Guidance⁶⁹.

11.2.7 Leasehold Sales

- (a) Where the right to buy comprises the acquisition of a flat or other leasehold interest, then the adjustment of the Unitary Charge will also need to take into account that it is not withdrawn from the Contract. Rather the unit will remain within the payment and performance mechanism but that the nature of the service to that unit will change from a full Service to the more limited service applicable to leasehold units⁷⁰. The marginal change in costs and diseconomies of scale may therefore be less pronounced.
- (b) It is conceivable that at the end of a right to buy review period (at least in the early years) the parties may need to cater for right buy sales before, during and after the construction or development phase and freehold and leasehold sales.

11.3 Right to Manage

11.3.1 Background Legislation

- (a) The tenants of an Authority have the right conferred upon them⁷¹ to require that the Authority enter into a management agreement with a tenant management organisation ("TMO"). The notice exercising the right to manage may only be served by a TMO which is a representative and accountable organisation serving a defined geographical area with a membership of at least 20 percent of both secure tenants and other tenants of the Authority in its defined area⁷².

⁶⁸ See Section B1 of this Guidance

⁶⁹ See Section 20.5 of the General Guidance

⁷⁰ See Section 10 of this Guidance

⁷¹ By Section 27AB Housing Act 1985 and The Housing (Right to Manage) Regulations 1994, 1994 SI No 578 ("1998 Regulations")

⁷² See Regulation 1(4) and 2(5) of the 1994 Regulations

- (b) A right to manage notice must relate to not less than 25 dwelling houses let under secure tenancies⁷³. The management agreement requested by the TMO may include one or more housing management functions of the Authority⁷⁴. If the notice is valid and accepted by the Authority, an "initial feasibility" study followed by a "full feasibility study" is undertaken to determine whether or not a TMO will enter into a management agreement with the Authority. During this time the TMO undergoes an intense period of training and development. If the "full feasibility study" determines that it is reasonable to proceed with the management agreement then, following a positive ballot of tenants the Authority is required to enter into a management agreement⁷⁵. The whole process can take in the region of two years to complete.
- (c) Regulation 8 of the 1994 Regulations requires the inclusion of a break clause in all housing management agreements entered into by an Authority to enable tenants to exercise the right to manage. The definition of management agreement⁷⁶ is sufficiently broad to cover a PFI contract and such a break clause should be inserted in the Contract. The effect of the break clause will be to allow the TMO to take on the range of functions identified in the management agreement with the Authority.

Where an existing TMO(s) provides services to accommodation which is intended to be the subject of the Contract, the Authority should give careful consideration to the relationship between the management agreement and the Contract before determining the boundaries of the accommodation to be included within the Contract.

11.3.2 Change Mechanism

- (a) It is conceivable that the right to manage may be exercised in relation to the whole or part of the units of accommodation which are the subject of the Contract at any time during the Contract period.

⁷³ See Regulation 2(1) of the 1994 Regulations

⁷⁴ Section 27 Housing Act 1985

⁷⁵ See Regulation 4 of the 1994 Regulations

⁷⁶ Section 27 Housing Act 1985

- (b) However, the Contract should contain a change mechanism to deal with adjustments to the Unitary Charge following the exercise of the right to manage. As mentioned previously, the right to manage can be exercised in relation to 25 or more dwellings and in relation to which of the Authority's functions as the notice exercising the right shall specify. As a consequence therefore, theoretically the right can be exercised in relation to as few or as many functions and units of accommodation as the TMO specifies and the Authority (following the feasibility studies) accepts.
- (c) The consequences of the grant of a management agreement by the Authority to a TMO should be to exclude the units of accommodation from the Contract in relation to those parts of the service covered by the management agreement.
- (d) It is recommended that the General Guidance⁷⁷ relating to Authority Changes should be applied in relation to the right to manage. It is unlikely, although possible, for the right to manage to be exercised before or during the construction or development phase. In which case the recommendations in relation to Authority Changes and Compensation Events as they apply to the right to buy should equally apply to the right to manage.
- (e) Where the right to manage is exercised during the Service Period the recommendations in relation to Authority Changes or the same as those applied to the right to buy⁷⁸.
- (f) When the management agreement with the TMO expires, the Authority may wish to include the services formerly provided by the TMO with the Contract. The consequences of this will again be an Authority Change.
- (g) As with right to buy sales, the Authority will continue to be in receipt of PFI credits notwithstanding the occurrence of the exercise of the right to manage. However, the Authority will, unlike with the right to buy, continue to receive rental income to fund the housing revenue account and in turn any part of the

⁷⁷ See Sections 5.2 and 12.3 of the General Guidance

⁷⁸ See Section 12.3 of the General Guidance and Section B2

Unitary Charge not funded from PFI credits. On the other hand, the Authority will also pay allowances to the TMO to cover its management activities. Furthermore, as there will be no disposal there will be no capital receipt for the Authority.

- (h) The exclusion of the dwellings from the Contract in relation to those parts of the Service covered by the management agreement is the only feasible course of action open to the Authority and the Contractor. The Contractor should not be expected to take the risk of the performance of the TMO by way of the acceptance of the TMO as an Operating Sub-Contractor. There will also be an issue on the interface between the TMO and the Contractor in relation to the respective parts of the Service provided by each. In the circumstances, it is quite reasonable for the Authority to accept the risk of interruption to the Service and/or loss of damage caused by the TMO. These would be by way of a Compensation Event during the construction and refurbishment phase and provisions of similar effect during the Service Period. The risk and cost of damage to the Assets should also fall to the Authority by way of indemnity⁷⁹ and responsibility for insurance excesses and deductibles and increased premia⁸⁰. The Contractor would also need to be exonerated from deductions for inadequate performance.

11.3.3 Termination Threshold

As in the case of the voluntary withdrawal of units of accommodation and the loss of units through right to buy sales, the reduction of the number of units in the Contract, through the exercise of the right to manage, may reduce the number of units of accommodation to a threshold beyond which the Contract is not sustainable either in financial or management terms. As a consequence, the same solution will prevail⁸¹, namely voluntary termination with compensation payable accordingly.

⁷⁹ See Section 23 of the General Guidance

⁸⁰ See Section 24 of the General Guidance

12. **AUTHORITY FUNCTIONS**

12.1 **Introduction**

12.1.1 In PFI contracts relating to local authority housing there are certain functions retained by the Authority which may impact upon the Contractor and the Contractor's project risk analysis. In general terms, and subject to limited exceptions, an Authority may not lawfully delegate the discharge of its statutory functions to a person outside of the Authority. The Contract therefore will need to address the exercise of the retained functions by the Authority to the extent that they may impact upon the Contractor and the Contractor's risk analysis. The impact of allocations will arise whether or not housing management is part of the service.

12.2 **Allocation of Tenants**

12.2.1 One of the principal functions retained by the Authority is the allocation of persons to the units of accommodation. Although technically elements of this function can be contracted out⁸², since the accommodation which is the subject of the Contract will be a proportion of the whole of the Authority's housing stock, it will not be appropriate for the Authority to delegate the function. Contractors' concerns with regard to the allocation of tenants are threefold:-

- (a) prolonged periods when the units are vacant;
- (b) tenants who are perceived as a greater risk to the upkeep of the units and/or require more "intensive" management; and
- (c) high turnover of tenants.

12.2.2 All of the above will impact upon the Contractor's costs and are to a large extent out of the control of the Contractor. Whilst it is accepted that the Contractor cannot have a veto over the identity of individual tenants, it is also accepted that the Authority should not have a "carte blanche" to allocate tenants on a subjective basis. It is in the

⁸¹ See Section 11.1.1

⁸² The Local Authorities (Contracting Out of Application of Housing and Homelessness Functions) Order 1996, SI 1996 No 3205

interests of both the Authority and Contractor to ensure the sustainability of the accommodation which is the subject of the Contract. Therefore, it is recommended that the Authority and the Contractor agree a form of allocations policy on Contract signature which will be periodically reviewed over the Contract period. The form of allocations policy may be the current Authority wide policy or a specific policy for the Contract which complies with the Authority's statutory duties⁸³. The periodic review of the policy by the Authority may result in a change to it and such a change should be addressed through the Authority Change⁸⁴ provisions in the General Guidance with an adjustment to the Unitary Charge (either up or down) to reflect the Estimated Revised Project Costs. However, this will only have a limited use since it will be difficult to quantify the Estimated Revised Project Costs directly resulting from the Authority Change. It will be only in exceptional circumstances that the Estimated Revised Project Costs will be quantifiable and predominantly where the change in policy directly gives rise to the prolonged periods of vacancy or a higher turnover of tenants. Alternatively, a policy change may give rise to increased numbers of tenants who may require more intensive support or adaptations⁸⁵.

12.2.3 The other aspect of the allocations of tenants which may impact upon Contract risk is the procedure for nominating tenants. The Contractor's concern will be prolonged periods during which the dwellings may be vacant with consequent increases in the Contractor's costs. The Authority will be concerned with the time taken by the Contractor to make a vacant unit available for a new tenant. This will be a performance standard in the payment and performance mechanism and should be set by reference to Best Value Performance Indicators⁸⁶. However, an Authority should give consideration to ways in which the Contractor may be incentivised to make a dwelling available within a shorter period than the performance standard specifies.⁸⁷

12.2.4 The Contract should contain a procedure by virtue of which the Authority will nominate to the Contractor tenants to which the Authority has allocated units of

⁸³ See Part VI Housing Act 1996

⁸⁴ Section 12.3 of the General Guidance

⁸⁵ Although such may give rise to a Change to the output specification in any event

⁸⁶ See Section 3 Local Authority Guidance for an explanation of this

⁸⁷ For example, through sharing of income for the shortened period

accommodation which may become vacant. It is likely that such procedure will contain the following characteristics:-

- (a) timescales within which the Authority will be notified of a vacant dwelling⁸⁸;
- (b) timescales within which the vacant dwelling must be made available by the Contractor for occupation by a new tenant⁸⁹;
- (c) timescales by which the Authority must nominate a proposed tenant(s) for the dwelling in accordance with the agreed allocations policy;
- (d) the grounds upon which the tenant may reject the dwelling;
- (e) any repeated procedure which may be necessary;
- (f) the timescales within which the Contractor must offer a tenancy agreement in the agreed form;
- (g) the overall timescale for nominations beyond which the Authority assumes the risk of the costs of vacant dwellings.

12.2.5 Therefore the Authority should nominate within an agreed timescale, allowing for a suitable period for legitimate rejections. These timescales should be agreed on a project specific basis. The financial consequences should be addressed in the Contract as if an Authority Change had occurred, albeit that the procedure should be restricted to the Contractor providing the Estimated Revised Project Costs resulting from the failure to nominate within the agreed timescale. Any dispute of the Estimate may be referred to the Disputes Resolution Procedure and in the absence of the need for any Capital Expenditure, the Estimated Revised Project Costs will result in an adjustment to the Unitary Charge⁹⁰.

⁸⁸ This is likely to be addressed as a performance standard

⁸⁹ See Section 12.4 of the General Guidance

⁹⁰ See Section 5.2.3 of the General Guidance

12.3 Enforcement of Tenancy Terms

- 12.3.1 The tenants will remain those of the Authority for the duration of the Contract period. The form of tenancy agreement which the Contractor will, on behalf of the Authority, offer new tenants will be in an agreed form at Contract signature. Any changes to the agreed form proposed by the Authority should be accommodated by the Authority Change procedure⁹¹ with the Estimate Revised Project Costs, so far as quantifiable, being calculated and reflected in the adjustment of the Unitary Charge.
- 12.3.2 Notwithstanding that part of the Service to be provided by the Contractor will involve managing the tenancy agreement on behalf of the Authority⁹² (such as rent collection and reconciling anti-social behaviour), the legal right to enforce the terms of the tenancy agreement will remain with the Authority. The operation and/or enforcement of the terms of the tenancy agreement by the Authority may impact upon the project risk analysis, for example, the Authority's policy on instigating action for breach by the tenant of his or her tenancy agreement, such as for non-payment of rent or anti-social behaviour.
- 12.3.3 Insofar as decisions taken by the Authority in relation to the tenancy agreement are decisions by the Authority as landlord and not in the exercise of the Authority's statutory functions, the Contractor may be appointed as agent for the landlord in relation to those decisions. If this were to be the case, then the risks arising from the decision making (or the lack of it) should lie with the Contractor.
- 12.3.4 If the Authority's preferred course of action is to retain decision making (or part of it) under the tenancy agreement then the Contractor will wish to be certain that such decision making will be exercised objectively and that the Contractor will not be faced with unexpected costs as a consequence. Therefore, it is recommended, that a policy is agreed and contained in the Contract, in relation to decision making under the tenancy agreement in the same way as the allocation of tenants. Such an agreed policy would be particularly appropriate to the collection of arrears of rent and other

⁹¹ Section 12.3 of the General Guidance

⁹² Where, of course, housing management is part of the Service

possession proceedings say, for anti-social behaviour. As with changes to the form of tenancy agreement, any change to the policy by the Authority should be addressed as an Authority Change⁹³. Tenants should be kept informed of any changes to the policy. However, other than in respect of any such change in policy, the Contractor should bear the risk of delays and court decisions (save for delays occasioned by the Authority). In this way the risks associated with the enforcement of tenancy terms (including levels of rent collection etc) should lie with the Contractor.

12.4 **Introductory Tenancies**

12.4.1 The Housing Act 1996⁹⁴ introduced the regime for introductory tenancies. Once an Authority has elected to introduce such a regime every new periodic tenancy granted from then on (except a new tenancy to a secure tenant or an assured tenant of a registered social landlord) must be an introductory tenancy. An introductory tenancy will last for one year⁹⁵, after which it will revert to a secure tenancy. Proceedings for obtaining possession are simplified with the court having no discretion upon making a possession order so long as a valid notice of proceedings for possession has been served⁹⁶. However, the tenant may require the Authority to review its decision to seek possession⁹⁷ and there are regulations in force which govern the procedure to be followed⁹⁸.

12.4.2 It should not be open to a Contractor to require an Authority to introduce an introductory tenant regime, as such a regime will take effect across the whole of the Authority's area. Whether the decision to introduce an introductory tenant regime during the Contract period should amount to an Authority Change will depend upon whether a change to the Service is thereby affected.

⁹³ Section 12.3 of the General Guidance

⁹⁴ Part V

⁹⁵ Section 125 Housing Act 1996

⁹⁶ Section 127 Housing Act 1996

⁹⁷ Section 129 Housing Act 1996

⁹⁸ The Introductory Tenants (Review) Regulations 1997 SI 1997 No 72

- 12.4.3 If an introductory tenancy regime has been introduced, it should be reasonable for the Authority to bear the risk and cost to the Contractor of the Authority failing to adhere to the review regulations⁹⁹.
- 12.4.4 Any additional costs arising from squatters and other unlawful occupiers should always be the risk of the Contractor (where the Contractor is responsible for management of the housing accommodation) and possession proceedings should be covered by the policy.

⁹⁹ The Introductory Tenants (Review) Regulations 1997 SI 1997 No 72

13. REPAIR AND CONDITION OF THE ACCOMMODATION

13.1 Tenant Actions

13.1.1 Background Legislation

- (a) The environmental protection legislation contains a procedure for direct action by a tenant against an Authority, as landlord, where the state or condition of the tenant's housing is prejudicial to health or a statutory nuisance¹⁰⁰. The legislation may be invoked by the tenant or other occupier of the dwelling. The proceedings are criminal in nature. If successful, the court may make an order requiring whatever work it considers necessary to put an end to the nuisance and/or prevent its recurrence within a stipulated time period. The court therefore has a wide discretion as to the extent it may order remedial works. It is also open to the court to impose a fine and/or prohibit the use of the dwelling if the nuisance renders it unfit for human habitation. The court also has power to award costs and compensation to the claimant. The proceedings are brought against the person responsible for the nuisance or, the owner where the nuisance arises as a result of a structural defect or, where the person responsible cannot be found. It is conceivable that the Contractor may be responsible for the nuisance, but failing that if the action by the tenant relates to structural defects the Authority will be the subject of any action.
- (b) The housing legislation¹⁰¹ contains a duty on landlords of short leases to maintain the structure and exterior of the premises and also the installations for sanitation, water, electricity and gas. The legislation may only be invoked by tenants as the duty comprises an implied term in this tenancy. The proceedings are civil in nature and in addition to the usual damages for breach of covenant it is open to the court to make an order for specific performance of the landlord's repairing obligations. The Authority, as landlord, and the tenant may not contract out of the duty.

¹⁰⁰ Section 82 of the Environmental Protection Act 1982

¹⁰¹ Section 11 of the Landlord and Tenant Act 1985

13.1.2 **Output Specification**

The prevention of such actions will be perceived by certain Authorities as one of their key outputs. It is likely that they will prepare their output specifications by reference to the "fitness for human habitation" requirements in the Housing Act 1985¹⁰². Therefore, any grounds for potential actions by tenants will have resulted in deductions for inadequate performance in advance of any action being brought by the tenant. Once the construction or refurbishment works have been undertaken to the accommodation the likelihood of tenant actions is remote as the Contractor will be incentivised to keep the accommodation in a good state of repair and condition. However, the Contract will still need to address the potential risk and the management of any claims.

13.1.3 **Pre-Full Service Commencement Risk**

Subject to any other agreement to the contrary, any notice served under either legislation prior to financial close should remain the risk of the Authority. As the Service in relation to the housing accommodation is likely to commence from financial close, there may also need to be a transitional period until the completion of the construction and refurbishment works during which the Authority will continue to be responsible for notices. An exception to this principle may be notices which have been served after a remedial period which the Contractor has been given to bring the units of housing accommodation up to the reduced standard (see paragraph 2.3.2 – where the reduced standard is defined as such) or as the result of a default by the Contractor. Authorities may consider requiring the Contractor to organise the works such that "fitness" works and/or units which are the subject of existing notices are brought forward in the programme (subject always to a value for money assessment) or having a two tier structure in relation to "fitness" works, such that the Contractor may be obliged within the agreed remedial period to undertake all necessary works which may be required to comply with a disrepair notice (whether actually served or not), ie the reduced standard. Once the Contractor has been notified of or has become aware of the disrepair (and the works are not undertaken within the agreed remedial

¹⁰² See Sections 189 and 604 Housing Act 1985

period) the Contractor may suffer deductions and be liable under indemnities (as in paragraph 13.1.4 below).

13.1.4 **Post-Full Service Commencement Risk**

Otherwise, any notices served after the completion of the construction and refurbishment works should be at the risk of the Contractor. The more complicated issue is how this risk should be addressed in the Contract. It is reasonable for the Contractor to be required to undertake any works which are the subject of a court order as the Contractor should have undertaken then in compliance with the Output Specification. This can be addressed in the Contract as a straightforward contractual obligation. The issue of compensation, costs and any damages resulting from the failure to remedy the disrepair will be an issue of pricing of the risk and value for money. These may be addressed by an indemnity¹⁰³ from the Contractor to the Authority to the extent that an Authority considers that an indemnity, particularly in relation to an action under the environmental protection legislation, would be enforceable on grounds of public policy (certainly an indemnity in relation to the fine is unlikely to be). Any indemnity should conform to the general guidance¹⁰⁴.

13.1.5 **Access**

The Contract may also need to address any failure of the tenant to allow access to the Contractor in advance of or during the course of an action. This risk will depend upon whether the housing management is part of the Service. If it is then it should be open to the Contractor to obtain access as agent of the Authority under the tenancy agreement. If not, then insofar as the tenant is within the control of the Authority the risk and consequent costs and losses should be borne by the Authority.

13.2 **Right to Repair**

The tenants of the Authority have access to a statutory scheme to require qualifying repairs, namely those prescribed repairs which the Authority is obliged, under repairing covenants, to carry out. The tenant is given the right, if the first contractor (probably the Contractor) does

¹⁰³ See Section 23 of the General Guidance

not complete the qualifying repairs within specified time limits, to require the Authority to appoint a second contractor to carry out the repairs. The tenant is also given the right to compensation from the Authority if the repairs are not carried out within specified time limits after the tenant has asked for a second contractor to be appointed. The right may only be exercised where, in the opinion of the Authority, the costs of repairs will be less than £250. The exercise of the right requires the service of various notices and counter-notices. The quantum of compensation is calculated by reference to a formula which allows the tenant to claim a sum (currently £2) for each day that has elapsed since the repair should have been carried out by the second contractor in accordance with the prescribed timescales. To this cumulative sum is added a fixed sum (currently £10) and there is a maximum amount of compensation payable (currently £50).

The output specification should address the nature of qualifying repairs and timescales in which the qualifying repairs should be undertaken. The Contractor should therefore suffer a deduction from the Unitary Charge should qualifying repairs not be carried out in accordance with the specification. As with tenant actions¹⁰⁵ it is not unreasonable for the Authority to seek an indemnity from the Contractor in relation to costs and compensation, although this should be subject to value for money considerations if the current relatively insignificant sums were to increase (indeed any charges in these sums or the right to repair generally are likely to amount to a Change in Law probably a Specific or Qualifying Change in Law¹⁰⁶).

¹⁰⁴ See Section 23.3 of the General Guidance, in particular Section 23.3.6

¹⁰⁵ See Section D1 of this Guidance

¹⁰⁶ See Sections 13.6 and 13.8 of the General Guidance and Section 13 of this Guidance

14. **DEVELOPMENT**

It may turn out to be a common feature of local authority PFI contracts that such contracts involve a certain amount of new housing development. The use of the PFI in such circumstances will be seen as a regeneration as well as a refurbishment tool. The objective of mixed tenures may also support some development. However, it should be recalled that Authorities are not able to undertake new build development on a PFI basis in the housing revenue account¹⁰⁷. Authorities should also ensure that they possess all the necessary consents for disposal of any land¹⁰⁸.

Apart from these issues, the inclusion of surplus land in a local authority housing PFI contract involves no unique issues when compared with other sectors. Authorities should ensure that the inclusion of any land is dealt with in the way which obtains best value for money for the Authority. The general presumption should be that the Authority disposes of the surplus land unless there is clear value for money benefit from the Contractor taking this risk. Where it is appropriate to pass the land to the Contractor, Authorities should consider the timing of any disposal and the claw back of any unexpected increase in land values. Authorities should also investigate the accounting treatment of any land disposal to ensure that the value of the land is not treated as a deferred asset in the hands of the Authority due to the consequent reduction in the Unitary Charge.

15. **CAPITAL ALLOWANCES**

It is becoming common practice in PFI contracts generally for a Contractor to insist upon the grant of a lease to ensure a sufficient interest in land to claim capital allowances. The grant of a lease of housing accommodation is contrary to current government policy, Contractors will therefore need to consider other means of securing the capital allowances, if available.

¹⁰⁷ Regulation 16 Local Authorities (Capital Finance) Regulations 1997

¹⁰⁸ See, for example, Section 32 Housing Act 1985 and the General Consents issued thereunder

