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THE HIGHLAND COUNCIL

PROPOSAL TO FORM ARM'S LENGTH ORGANISATION

FOR

COMMUNITY LEARNING AND LEISURE SERVICES

PROPERTY AGREEMENT - OUTLINE OF KEY TERMS

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PROPERTY AGREEMENT - OUTLINE OF KEY TERMS

1 INTRODUCTION

- 1.1 It is understood that the elected members of The Highland Council (HC) agreed at the ECS Committee of 5 August 2010 the principle of advancing to an Arm's Length Organisation (ALO) for the delivery of all of HC's Community Learning and Leisure (CLL) activity. Following upon that meeting, we understand that further information was provided to the meetings of the ECS Committee held on 11 November 2010 and 13 January 2011.
- 1.2 This paper is intended to provide an outline of the key terms which would be included within the Property Agreement - forming part of a wider suite of legal documentation¹ - if the decision were taken to proceed with the transfer of operations to the ALO.

¹ A separate paper - headed "Suite of documentation - outline of key documents" - prepared by Burness provides further information on the key documents which would form part of that wider suite of documentation

2 PROPERTY ARRANGEMENTS - OVERALL FRAMEWORK

Categorisation of facilities within the portfolio

- 2.1 The basic principle underlying the property arrangements is that there should be a separate lease for each of the facilities operated by the ALO, with the following exceptions:
 - 2.1.1 facilities where a lease would offer no advantage from the point of view of rates relief and there are other special reasons why a lease would be inappropriate;
 - 2.1.2 facilities forming part of community schools (either owned and maintained by the Council without a PPP partner; or the subject of either the PPP1 or PPP2 arrangements with a PPP partner).
- 2.2 We understand that an initial exercise has been carried out to split the overall portfolio into four categories:
 - 2.2.1 Categories 1 & 2: where it is clear that a lease would be entered into;
 - 2.2.2 Category 3: where a licence to occupy would be entered into;
 - 2.2.3 Category 4: where no lease or licence to occupy would be entered into, but where there is a need to take account of the possibility that a transfer of operations to the ALO (and associated grant of a lease to the ALO) may be required at some point in the future.
- 2.3 Following upon our discussion with Council officers on 25.1.11, when the underlying principles associated with Category 3 were further explored, the list of properties in the portfolio are to be revisited to determine whether there are any properties currently classified as Category 3 which would be more appropriately classified as Category 1/2.
- 2.4 The legal documentation relating to PPP projects would not normally address a situation where a Council has devolved its sports and leisure operations to an offshoot body - and we are aware from previous projects that developing a robust legal framework to accommodate the principle of an ALO operating community facilities which fall within a PPP project can be a complex exercise, particularly if there is a need to leave the details of the original project documentation undisturbed (eg if the private sector partner has declined to take a cooperative approach).
- 2.5 It should also be noted that the property arrangements associated with facilities which form part of community schools which are owned and managed directly by the Council under a conventional arrangement (ie without a PPP partner) would require to be carefully tailored so as to maximise the prospects for obtaining rates relief - and also to ensure clear boundaries as between the responsibilities of the ALO and the responsibilities

of the Council (as an occupier) in relation to matters such as health and safety.

- 2.6 The detailed proposals relating to the situations outlined in paragraphs 2.4 and 2.5 would be developed as part of the overall exercise if a decision were taken to proceed with the project. Depending on considerations of timing (in particular, the benefits of accessing rates relief for the major part of the portfolio at the earliest possible date), it might be deemed appropriate to leave either or both of those strands to be finalised as a phase two process after the initial transfer date.
- 2.7 The remainder of this paper focuses on Category 1 and 2 properties - which would form a high proportion of the facilities included in the overall portfolio. Essentially, the special cases outlined above would represent variants on the key principles associated with the structure for Category 1 and 2 properties.

Interplay between the leases and the property agreement

- 2.8 For each of the facilities falling within Category 1 or Category 2, a lease would be entered into between the Council and the ALO at a peppercorn rent (£1 per annum, if asked) for 25 years. The use of a lease for each property serves a number of purposes:
- 2.8.1 It allows the boundaries of the subjects of let, as well as rights of access or emergency escape over other areas, rights of use reserved to the Council for other premises, rights of use for the ALO over shared car parks and other common areas/facilities - and other special rights/reservations relating to each individual property - to be clearly identified and recorded on a property-by-property basis.
- 2.8.2 It allows the Council to exercise powers of control (as landlord) in relation to a number of property-specific issues eg each lease would include a tailored use clause stating that the subjects of let may only be used for particular purposes, with any proposal to change to a different use outwith those parameters having to be referred to the Council for consent. Similarly, the lease would include the usual provisions prohibiting the ALO from making alterations to the building without first obtaining Council consent.
- 2.8.3 It provides the ALO with a clear property interest in each of the facilities, which
- 2.8.3.1 helps to produce a clear-cut position from the point of view of rates relief;
- 2.8.3.2 allows the board of the ALO to plan ahead with greater confidence (as compared with an approach which allowed the Council to terminate the ALO's right to occupy - as in a typical licence to occupy - at short notice);

- 2.8.3.3 produces a more acceptable position for the ALO as a charity, having regard to the principle that a charity ought not to expend funds on a building which could revert to the landlord (thus allowing a non-charity to gain the benefit of the charity's expenditure on eg upgrading works) at short notice;
 - 2.8.3.4 helps to address any concerns which a charitable foundation (or other grant funder) might raise in relation to applications for funding support, by demonstrating that the ALO has a secure position in relation to its ability to occupy and manage the building.
- 2.8.4 It provides the Council with a backstop position - allowing the Council to terminate the lease and thus recover unencumbered ownership of the property - in the (admittedly unlikely) event of the ALO committing a serious breach of its obligations or encountering serious financial difficulties.
- 2.9 The conventional approach would be to include within each lease the detailed obligations of the landlord and tenant with regard to maintenance and repairs. In the context of this type of project, however, that approach ignores the budgetary constraints which apply for both the Council and the ALO, and the practicalities of how problems of major repairs within a particular property would be dealt with at a practical level. In relation to those and a number of other issues, it is much more satisfactory to put in place a regime that takes account of the portfolio as a whole eg expressly allowing for the need for both parties to set priorities across the portfolio to guide how limited budgets can best be applied; and recognising that if a need for a major repair arises in a particular property, the pragmatic solution might be to transfer operations to a different facility rather than expend limited funds on a property where usage levels were already low. Accordingly - and in line with the approach which we developed in the Glasgow Life (Culture & Sport Glasgow) project, which is generally recognised as a model of best practice - we would strongly recommend that the suite of documentation should include a Property Agreement, setting out the approach on these and other issues which is to apply *across* the portfolio, and with each individual lease having cross-references to specific provisions within the Property Agreement on matters which are best dealt with on a portfolio-wide basis.

Properties currently held under a lease

- 2.10 It is understood that, in a few cases, the property is held by the Council under a lease, such that what would be granted to the ALO would be a sublease rather than a lease. The head landlord's consent would be required to the grant of the sublease, and the timescales associated with the applications for consent would require to be built into the overall project plan if the decision were taken to proceed. It should be recognised that the existing lease may be due to expire prior to the end of the 25-year period from the transfer date; the period of the sublease in that event would have to be shorter than 25-years to reflect the remaining period of the head lease. A further point to note is that

the Council would require to continue to pay the rent to the head landlord under the head lease, notwithstanding that (assuming the standard pattern is to be maintained) the rent payable under the sublease to the ALO would be only £1 per annum.

Properties which are subject to an existing lease or leases at the transfer date

- 2.11 Where there is an existing lease of the whole, or (more likely) part, of a property to a third party, the effect of granting the lease to the ALO is that the ALO would be interposed as the immediate landlord of that third party, with its lease being effectively converted into a sublease. The implications of that in relation to matters such as the rental income from the subtenant, responsibility for compliance with obligations owed to the subtenant and so on, would require to be approached on a property-by-property basis, with detailed consideration of the terms of the existing lease in each case.

Other special circumstances

- 2.12 Where major works are in progress - or have recently been completed - in relation to particular properties, appropriate provisions may require to be incorporated in the Property Agreement. There may also be other properties where there are complex arrangements relating to common areas, or other special circumstances. Again, this would need to be approached on a property-by-property basis.

3 PROPERTY AGREEMENT - OUTLINE OF KEY TERMS

- 3.1 In the course of our meeting with Council officers on 25.1.11, we identified a number of alternative approaches which could be taken in relation to various aspects of the property arrangements, and the advantages and disadvantages of each from both the perspective of the Council and the perspective of the ALO. The outline below reflects the outcome of those discussions. It should be noted, however, that the outline remains subject to adjustment in the light of further deliberations and discussions; inevitably there would be a degree of fine-tuning as the overall project took shape, if the decision were taken to proceed.
- 3.2 The key terms currently envisaged for the Property Agreement are set out below, under each of the main headings.

Routine maintenance and repairs

- 3.3 The Council would have responsibility for all minor repairs and maintenance, with the tenant's responsibilities being limited to monitoring the condition of the buildings, taking reasonable care to minimise damage/deterioration (including action/inaction by ALO staff and/or others using the building which would cause damage/deterioration; and taking measures to minimise the incidence of vandalism), and advising the Council promptly whenever minor repairs/maintenance were required. Response times by the Council would be set via a Service Level Agreement (SLA).
- 3.4 There might be a need to limit the Council's obligations as regards minor repairs and maintenance to an annual budget (set on a year-by-year basis) - but on the basis that if the failure to carry out repairs/maintenance were to impact on usage levels or other aspects of the operation of a given facility, there would be a mechanism within the Service Delivery Contract whereby the ALO could request adjustments to the services fee (to reflect reduced income which the ALO could demonstrate was directly attributable to the condition of the building) and/or adjustments to the services specification or performance standards to reflect the effect on the ALO's ability to operate the facility at the previously anticipated usage levels.
- 3.5 The ALO's responsibilities in relation to health and safety would not extend to any risks associated with the condition of the building (subject to the monitoring/reporting obligations referred to above), and the Council would indemnify the ALO against claims (eg injury suffered by members of the public) arising from the condition of the building as distinct from operational aspects. The ALO's obligations in relation to health and safety - focusing on operational aspects - would be set out in the Service Delivery Contract.
- 3.6 The usual pattern would be for a schedule of condition (recording the state of repair at the time of grant of the lease to the ALO) to be prepared for each property. In the present case, we understand that the Council does not consider that the costs of carrying out surveys across such an extensive

portfolio would represent best use of funds. Accordingly, rather than the Council taking on an obligation to maintain each property in at least the same condition as it was at the time when the lease was granted, we would suggest that the lease should refer to the property being kept (subject to the point noted in 3.5) in a reasonable state of repair, to a standard which does not significantly impact adversely on its use for the intended purposes (as set out in the user clause within the lease).

Major repairs and upgrading

3.7 As regards major repairs and upgrading, it is appropriate to distinguish two categories:

3.7.1 pre-planned works of major repairs/upgrading; and

3.7.2 a requirement for major repairs which arises unexpectedly eg as a result of failure of major plant or a serious structural defect which suddenly emerges.

For the purposes of these provisions, replacement of major items of plant/machinery would be included within the definition of “major repairs/upgrading”.

3.8 In relation to the first category (pre-planned works), the Property Agreement would reflect the following key principles:

3.8.1 The Council would advise the ALO prior to each financial year of the budget which it was setting aside for major repairs/upgrading;

3.8.2 The Council and the ALO would discuss the various priorities, and agree which properties were to have the benefit of the expenditure having regard to the effect of substandard properties on delivery of the services under the Service Delivery Contract ; as well as more detailed issues round the scope of works and likely timing;

3.8.3 Any impacts in relation to temporary closure of a facility would be reflected in discussions relating to the services fee, services specification and performance standards;

3.8.4 If costs for individual projects were to escalate unexpectedly, the Council could, in consultation with the ALO, revisit the wider works programme eg so as to postpone works to another property

3.9 In relation to the second category (unexpected major works), the Property Agreement would reflect the following key principles:

3.9.1 The Council and the ALO would discuss whether the expenditure on major works could be accommodated by revisiting the works programme and/or by drawing funds from the Council’s overall budget;

- 3.9.2 If the expenditure could not be accommodated, then the Council and the ALO would discuss adjustments to the services fee, services specification and performance standards.
- 3.10 There might be circumstances where the ALO was able to access external funding to support some or all of the costs of major repairs or upgrading. The Property Agreement would accommodate that possibility, with the Council and the ALO jointly agreeing the specification and other aspects associated with execution of the works - taking account of the ALO's interest as end-user; and the Council's interest as owner and as the party responsible for future maintenance and repairs.

Statutory requirements

- 3.11 Works required to meet statutory requirements would be dealt with in line with the general principles relating to minor repairs or (depending on the level of expenditure) major repairs/upgrading. In the event of a major new requirement arising across the portfolio, the Property Agreement would require the Council and the ALO to agree an appropriate project plan, having regard to any statutory penalties, increased insurance premiums or other risks/liabilities arising from non-compliance, the nature and extent of the works, and the budget constraints to which the Council was subject at the time.
- 3.12 The Property Agreement would include an indemnity by the Council in favour of the ALO in relation to any claim by a member of the public which arose through any non-compliance with statutory requirements. It should be noted that "statutory requirements" for the purposes of these provisions would be limited to statutory requirements related to the building and landlord's fixtures and fittings; statutory requirements related to the day-to-day management of the facility or other aspects of the operations of the ALO would fall within the ALO's responsibilities.

Health & safety

- 3.13 The general approach to health and safety, as regards the buildings, would follow the split of responsibilities as regards maintenance/repairs and statutory requirements as outlined above. As regards legionella, electrical installations, gas, and asbestos, for example, the primary responsibility would fall on the Council, but with the ALO having responsibility for day-to-day management, including routine visual inspections and monitoring. For fire risk assessments, responsibilities would relate to the nature of the specific findings.

Development of new facilities

- 3.14 The Property Agreement would provide that any proposals for the development of new facilities would be the subject of negotiations between the Council and the ALO. As with major repairs/upgrading, due account would be taken of the ALO's interest as end-user and the Council's interest as owner and as the party responsible for future maintenance and repairs. The

Council's approval would be required in relation to the plans and specifications, in any case where the proposals were being developed by the ALO.

- 3.15 It may be that in certain cases a funder who had been approached by the ALO would require the grant of a security over the tenant's interest under the lease; situations of that kind would be approached on a case-by-case basis, but against a general principle that the Council would seek to accommodate any requirements imposed by external funders providing there was no significant adverse impact on the Council's interests.
- 3.16 Proposals for major refurbishment/upgrading might potentially be linked with future energy savings. The Property Agreement would provide that the Council and the ALO should discuss and agree any appropriate mechanisms for the sharing of such savings (via adjustments to the services fee) where the Council had contributed to the relevant works.
- 3.17 As regards projects wholly or primarily funded by the Council, the Property Agreement would reflect the principle of a bidding process, where the ALO would be invited to submit proposals (accompanied in each case by a business case) for the construction of new facilities and other major capital projects. These would be appraised against other bids in accordance with the Council's standard procedures.

Damage by insured risks

- 3.18 The Property Agreement would provide that the Council must maintain insurance over the properties.
- 3.19 The Council would be required under the Property Agreement to repair damage (or rebuild in the event of destruction) caused by an insured risk - unless the Council notified the ALO within a specified period that the Council did not intend to rebuild. The detailed provisions would provide for the ALO to take immediate steps required to secure the area and protect public safety, allow for inspections and the supply of information to the Council to support the insurance claim; as well as provisions requiring the ALO's prior approval if the proposals for reinstatement envisaged a different layout or other alternations.
- 3.20 The Property Agreement would include provision for the services fee, specification and performance standards to be revisited in the event of damage/destruction by an insured risk, to reflect temporary loss of use of the building and (where applicable) the long-term loss of the building from the portfolio operated by the ALO.

Procurement of contractors and consultants

- 3.21 Given the wider context, the Council would have the responsibility for procuring and managing contractors and consultants. The provisions of the Property Agreement would, however, state that the ALO would be entitled to make representations in its capacity as user (or intended end-user) of the

building - and that the ALO must be allowed input into the procurement process for contractors/consultants, and into the supervision of works, accordingly.

- 3.22 The provisions relating to new facilities would allow the ALO the right to participate in final inspections and make representations in relation to snaggings. In addition, the Council would have an obligation under the Property Agreement to take reasonable steps to exercise rights and remedies against contractors and consultants in the event of significant defects emerging.

Addition/removal of properties

- 3.23 The Property Agreement would include appropriate provisions for addition and removal of properties from the portfolio - with appropriate notice being given to the ALO in each case. The services fee, services specification and performance standards would be adjusted through negotiations between the Council and the ALO on each occasion when a property was added to, or removed from, the portfolio.
- 3.24 The Property Agreement would include provisions covering a situation where the ALO's ability to use a particular property was affected by a problem relating to the Council's title or a challenge based on principles of common good. This would allow the Council to contest any claim or take remedial steps and would provide for the parties to negotiate a change to the services specification where appropriate.

Civil emergencies

- 3.25 The Property Agreement would include provisions requiring the ALO to allow use of properties in the event of civil emergencies.