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Mears Group

Purchase and Repair Project

Briefing Note

1 Background

1.1 This note sets out the key documentation and structural considerations in the creation of a joint purchase and repairs platform between Mears Group ("**Mears")** and local authorities to

1.1.1 establish a jointly owned investment vehicle;

1.1.2 raise external finance for that vehicle;

1.1.3 acquire housing assets in that vehicle;

1.1.4 arrange for their refurbishment, long term management and repair through a private sector entity to preserve stock value; and

1.1.5 create a suitable long term ownership model for the authority to ensure value for money (**"the Project"**).

1.2 The briefing note does not describe any of the areas which a local authority, in engaging in the Project (a "**Council**"), would need to consider from the perspective of internal approvals and governance. For example, it does not deal with questions of powers of competence, vires, internal standing orders and constitutional issues nor does it consider what procurement processes it may need to engage in to select a partner such as Mears. Mears assumes that the Council will deal with these points appropriately so that, if it chooses to engage in the Project, it will do so having received all necessary approvals to render the transaction lawful and beyond challenge.

1.3 If a local authority, having satisfied itself on the matters described in 1.2, wishes to engage with Mears then the next stage would be to enter into a suite of contractual documentation.

1.4 The suite of documentation can broadly be split into three categories:

1.4.1 “Corporate” documentation setting out the obligations of the parties to the joint venture and dealing with decision making, value and profit sharing at the end of the Project

1.4.2 “Finance” Documentation relating to the raising of external finance to provide the capital resources to finance the acquisition and refurbishment by the funder (“**Funder”**). These are detailed technical documents which follow a precedent form which we summarise briefly below. However, this note does not deal with the specifics of the funding solution. The Mears team will aim to tailor the most appropriate funding solution in the particular circumstances of the authority.

1.4.3 “Property” documentation though which the properties will be acquired, occupied, maintained and managed and the bond repaid over the duration of the project.

1.5 The remainder of this note will summarise the key terms of those documents the detail of which will be subject to negotiation and may require adaptation to address particular points relevant to the local authority.

2 Corporate Documents

2.1 Mears and the local authority will establish a corporate special purpose vehicle and set up an agreement between them as “members” of that vehicle to regulate its management and their position as members. The vehicle will have separate legal identity, such as a limited liability partnership (LLP) or limited company. The choice of vehicle will be considered in detail having regard to the nature of its activities and tax considerations which are beyond the scope of this note.

2.2 The vehicle is set up to be “deadlocked” in terms of decision making so that neither party can override the other and decisions are taken jointly between nominated representatives of Mears and the Council. Voting rights are therefore allocated 50/50 but income and profits are allocated preferentially to the Council.

2.3 The vehicle is not designed to engage in day to day trading activity as activities such as purchase negotiations, refurbishment and lettings will be handled by Mears. It exists to hold the housing stock in the long term.

2.4 Each party appoints an equal number of directors/ representatives to manage the Company and make any strategic decisions. On day to day issues, Mears takes the lead role and refers back key points to the “board” for approval. The Council’s ability to veto decisions on key matters affecting governance is designed to protect itself from an audit perspective and ensure that the vehicle stays true to the agreed Business Plan. The Council can also establish an oversight committee to monitor the activities of its directors to ensure the Council as a whole is aware of progress and its activities are seen as democratically accountable without the Council being able to run the vehicle.

2.5 Any dispute which arises in the decision-making process can be escalated through the organisations with provision made for expert determination. If the deadlock is not resolved the decision in question is not carried.

2.6 All asset rights including housing stock value at the end of the funding period (for example at year 40) can be distributed appropriately between the parties – for example the Council may stipulate that the assets belong to the Council and may be used to alleviate housing shortages or used for the Council’s pension fund – at the Council’s discretion. The Project aims to provide the Council with significant long term asset value which grows over time.

2.7 The Corporate Agreement also contains nominations rights over the stock acquired in favour of the Council. The provisions set out the mechanism for identifying the tenants who will occupy void units. The provisions include a priority scale ranging from homelessness provision to open market disposal (to reflect a changing demand profile over the duration of the project).

2.8 In to give assurances to the Funder that the units will be income producing and voids are addressed very quickly provisions are inserted into the nominations process so that the Council covers void costs of the vehicle in the event that units are not filled within an agreed period.

3 Funding Agreements

3.1 These agreements made between the vehicle and its funders and the description below assumes that the funder will provide long term finance over 40 years and appoint a “Security Trustee” to manage the financial arrangements with the vehicle.

3.2 Funding is raised by the joint vehicle (not the Council or Mears directly). However, the Council and Mears will both need to sign separate commitments to the funders to

ensure that the Project remains financially viable and capable of supporting the funding.

3.3 The funding is given in lumps at the start of the Project and creates a fund for the joint venture vehicle to acquire suitable housing assets and retain them in the joint venture's portfolio for use for the agreed purposes to suit the Council under a management regime which Mears Group handles.

3.4 The documents ringfence all net rental receipts from tenancies which flow up and through the Mears management company to service the bond, allow Mears to hold back an agreed percentage for management maintenance and voids. There is some flexibility to allow the Council "permitted distributions" to cover up front costs and handle conveyancing.

3.5 The agreements set out the conditions precedent that need to be satisfied before each property can be acquired. In practice this is operated through a checklist system to make the acquisition process as efficient as possible. Part of this process is an agreed form certificate of title to be given to the Funder by the conveyancers acting on the acquisition. Each Property acquired is subject to a legal charge in favour of the Security Trustee.

3.6 As with all funding documents, there are lists of defaults which allow funders to require Mears to substitute its management with new management, request the Council steps in to appoint a new manager or, ultimately, withdraw funding.

4 Property Agreements

4.1 The joint venture vehicle appoints Mears to carry out the acquisition and refurbishment of the stock to a required standard.

4.2 Mears acquires stock in accordance with an agreed list of suitable criteria and geographic areas. Once suitable housing units are identified, Mears presents the information to the Council with a plan to refurbish the unit and costings. The Council is then asked to approve or refuse the proposal within a tight timeframe and, if approved, the purchase goes ahead.

4.3 Mears is entitled to a commission per unit on the successful completion of each property acquisition.

4.4 Any refurbishment monies which will be specifically allocated in the financial model and if not used during the buying programme, it can be retained for further refurbishment works during the life of the Project.

4.5 Experience has shown that a high proportion of suitable properties (due to price) will be flats held on a long leasehold basis. Leases with unexpired terms of less than 70 years will be considered provided the details of the lease extension have been agreed.

4.6 The legal costs of the conveyancing process are factored into the financing arrangements.

5 Asset Management Agreement

5.1 Under this agreement Plexus (a registered provider within the Mears group) manages the units acquired for the duration of the Project subject to rights of the joint venture to terminate for poor performance.

5.2 A detailed list of services will be specified in the agreement which are in the nature of repairs, maintenance and income management as well as key performance indicators on management matters.

5.3 Plexus retains an agreed percentage of the gross rent to cover its management and maintenance costs and pays the balance up to the joint venture vehicle, being calculated as sufficient to service the bond. The gross rent figure is indexed on an annual basis by a fixed percentage.

5.4 The agreement contains target KPIs which need to be satisfied. In the event of consistent failure the parties will meet and Plexus will be required to submit proposals for improvement and, if poor performance persists, the funder can require Mears to replace Plexus or the Council to step in.

5.5 Mears retains the right to terminate after the first twelve months of the contract if a material change of law affects its ability to deliver the contracted services for the agreed price.

6 Lease from the joint venture and occupational rights of tenants

6.1 Once each unit is acquired it is leased to Plexus (guaranteed by Mears) so that Plexus assumes repair and maintenance duties. The lease sits alongside the Asset

Management Agreement. This places greater risk on Mears but is also tax efficient for the Project.

6.2 The term of the lease is for an initial period of 20 years subject to an option to call for a further twenty year term. This is more tax efficient and also guards against enfranchisement issues and balance sheet concerns.

6.3 Assignment is permitted to another RP provided that a guarantee from a company within the Mears group is preserved.

7 **Occupational Tenancies**

7.1 Plexus, through the lease, deals with any arrangements with occupational tenants so the joint venture has no direct relationship with tenants.

7.2 Therefore once nominations are made, Plexus will enter into assured shorthold tenancies with tenants for temporary accommodation in order that the Council can discharge its duties in respect of homelessness.

7.3 Such tenancies do not carry rights to buy or rights to acquire in favour of tenants given their particular status in law in providing temporary accommodation.

General Observations

The above description is intended as a very brief overview of a typical Project. In any particular situation both parties will need to engage in detailed negotiation of the documentation to suit the particular intentions of the parties, best fit structure and tax considerations. This note is not intended as an exhaustive appraisal of all such issues nor should it be treated as legal advice on the effect of such Project on the parties.

Acuity is prepared to assist with specific queries to assist as part of any authority's market testing exercise so as to enable an authority to understand the nature and scope of the Project.

Acuity Legal

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