

CHESHIRE EAST COUNCIL

Joint Extra Care Housing Management Board

Date of Meeting: 12 December 2016
Report of: Lynn Glendenning, Commissioning Manager
Subject/Title: Avantage Insurance Sharing Proposals

1.0 Report Summary

- 1.1 The Private Finance Initiative (PFI) Contract (The Contract) with Avantage was signed in October 2007, when Avantage was commissioned to design, build and manage five extra care housing schemes across Cheshire.
- 1.2 As part of the Contract, Avantage must take out specific insurances on behalf of itself, the Authority (Cheshire East Borough Council and Cheshire West & Chester Borough Council) and other parties where appropriate. A cost was assigned to these insurances – the Base Cost. If the actual cost of these insurances is significantly greater or significantly less than the Base Cost, the Authority and Avantage will share the costs or savings.
- 1.3 When the first savings became payable, it was realised that there is a contradiction in the definition of Base Cost within the Contract. A paper was submitted to Joint Extra Care Housing Management Board (JECHMB) in September 2012, which recommended using the higher figure in the contract. Avantage refused to accept this and have been in discussions with the Authority since that time. Those discussions have now resulted in a formal proposal from Avantage as detailed below.

2.0 Recommendations

- 2.1 It is recommended that Joint Extra Care Housing Management Board:
 - Delegate authority to officers to accept the offer from Avantage
 - A value of £101,680 which is midpoint between the Council's position and Avantage's position be used
 - The agreed figure be inserted in the Contract
 - The agreement is backdated to the beginning of the Contract
 - This figure is utilised to calculate the monies owed to the Councils
 - Immediate payment of the monies owed to the Councils is requested.

3.0 Reasons for Recommendations

- 3.1 These discussions have been ongoing since 2012. In that time, Avantage have not responded to any requests to pay amounts owed to the Councils. The Avantage Board was reported as being confused as to why the Councils would not accept their first proposal (to use £83,360 as the Base Cost figure) and meetings held with them resulted in both the Authority and Avantage restating their respective position with little further discussion.
- 3.2 Avantage's proposal is an attempt to resolve the situation and is made in the light of the dramatic fall in the cost of the insurances since DIF purchased TIF HoldCo, the majority shareholder of the Junior Debt, in November/December 2014. The reduction in the cost of the insurance is shown in the table in 11.6.

4.0 Wards Affected

- 3.1 Cheshire East
Crewe St Barnabas, Handforth, Middlewich
- 3.2 Cheshire West & Chester
Rossmore, Winsford Over & Verdin

5.0 Local Ward Members

- 5.1 Cheshire East
Crewe St Barnabas – Cllr Damian Bailey
Handforth – Cllrs Barry Burkhill and Dennis Mahon
Middlewich – Cllrs Simon McGrory, Michael Parsons and Bernice Walmsley
- 5.2 Cheshire West & Chester
Rossmore – Cllr Pat Merrick
Winsford Over & Verdin – Cllrs Michael Baynham, Don Beckett and Tom Blackmore

6.0 Policy Implications

- 6.1 None.

7.0 Implications for Rural Communities

- 7.1 None.

8.0 Financial Implications

- 8.1 The financial implications are covered in detail in Section 11 of this report. In essence they boil down to a simple financial choice of accepting the sum now on offer or alternatively accepting both the cost and financial risk of pursuing the higher amount stipulated in the contract. Any monies received using this route would inevitably take longer to recover and the Authority would not only have to bear any recovery costs but also run the risk that it may not recover the sum proposed by Avantage.

9.0 Legal Implications

- 9.1 The Contract states that the Base Cost that represents the insurance cost is £120,000, that being the figure agreed by the parties at the Bid Date (April 2006, 19 months before the contract was signed) and set out in the Base Case. The Base Case consists of a financial model that is a schedule to the Contract. Avantage claims that the figure in the Base Case is £83,360 and that there is therefore a conflict in the contract. Since the Contract terms have precedence over the Contract schedules it is arguable that the true figure should be £120,000.
- 9.2 The Council's Finance Department has subsequently flagged that there is an additional contingency in the Base Case that in fact means that the figure should be £120,000 rather than £83,360. This further undermines Avantage's contention that there is an inconsistency in the contract.
- 9.3 The position remains that although the definition of Base Cost as applicable to insurance is unambiguous to the Council it remains contentious to Avantage as it favours the Council. Changes to the contract can be made by means of a change control mechanism should the Council be minded to agree a compromise. If Avantage invokes the dispute procedure, which is the next contractual step, there would be expense both in terms of cost and internal and external resources required to pursue the claim. The findings of the dispute resolution procedure would be binding on the parties and there is no guarantee that the dispute resolution would follow the Authority's interpretation of the Contract. Any reference to dispute resolution would inevitably impact on the working relationship between the parties.

10.0 Risk Management

10.1 The following risks have been identified:

Risk	Details	Mitigation
Dispute Procedures	If the Authority rejects this proposal, the next contractual step would be dispute procedures.	It is recommended that the proposal is accepted.
Avantage may refuse to backdate the agreement	Avantage may refuse to backdate the agreement.	It is recommended that backdating the agreement is included as a condition of the agreement.
Avantage may not be able to pay the money owed in one lump sum	No payments have been made to date under the insurance sharing clauses in the Contract. Should the figure of £101,680 be agreed, Avantage will then owe the two Authorities collectively more than £186,000 since the start of the Contract. They may not have the reserves to pay this money in one lump sum.	Arrangements could be made to reduce the amount owed to the Authority by making adjustments to the Unitary Charge to take account of the sum due to the Authorities from Avantage.

11.0 Background and Options

11.1 In September 2012, a paper was submitted to the JECHMB describing the contradiction within the definition in the Project Agreement used to decide what figure to use as the Base Cost when calculating the insurance sharing mechanism. The Base Cost is defined as £120,000 in the definitions of the Project Agreement, but a different figure (£83,360) is used in the Base Case (Schedule 27).

11.2 Avantage proposed using a figure of use £49,738 for the year to January 2010 (this is a part year effect) and £83,360 for each year from then on, indexed, as they felt that £120,000 was too high.

11.3 However, the JECHMB report argued that Clause 1.5 Precedence of Documentation of the Project Agreement states that, in the event of inconsistency between the PA and the schedules, the "body of this agreement" takes precedence over all the schedules and appendices. It therefore recommended that Avantage's proposal be rejected, the figure of £120,000 per annum indexed used and the Authorities' share of the Exceptional Savings claimed immediately.

11.4 JECHMB approved the recommendations in the report. Avantage then rejected this position.

- 11.5 There have been many meetings and discussions since 2012 between Cheshire East and Cheshire West Officers, including Legal and Finance Officers from each Council, and between Cheshire East and Cheshire West Officers and Avantage.
- 11.6 On 29 March 2016, Cheshire East received a further proposal from Avantage proposing that a value midpoint between the Council's position and Avantage's position be used, i.e. £101,680. Avantage argued that with the change in ownership of the junior debt, and the inclusion of the Avantage schemes in the new owner's portfolio, insurance premiums had fallen by more than 50% in two years from £67,287 in 2013 to £29,437 in 2016. The effect of this is to increase the savings and therefore the Authority's share of those savings by a considerable amount (see table below).

Year	Premium	Share of Savings using £83,360 (Avantage's Initial Position)	Share of Savings using £101,680 (Avantage's Proposed Solution)	Share of Savings using £120,000 (Authority's Initial Position)
2011	£58,985	£6,194	£18,574	£30,954
2012	£63,174	£5,754	£18,820	£31,886
2013	£63,479	£7,765	£21,329	£37,894
2014	£63,392	£9,798	£23,794	£37,789
2015	£38,466	£32,714	£47,089	£61,464
2016	£29,437	£41,962	£56,683	£71,404
TOTAL		£104,187	£186,289	£271,391
Variation from Contractual Base Cost of £120,000 (Authority's Initial Position)		£167,204	£85,102	-

- 11.7 If the proposal to use £101,680 is accepted, approximately £186,289 would become payable to the Authority. This would result in payments of £111,773 to Cheshire East and £74,516 to Cheshire West. Assuming that inflation increases by the average increase since contract start (2009) and insurance premiums increase by 1% pa, this could result in payment of nearly £1.8M (£1.08M to Cheshire East and £720K to Cheshire West) being payable to the Authorities over the life of the contract.
- 11.8 Failure to accept the proposal could lead to the formal dispute process being invoked which is likely to lead to considerable costs for both Authorities and no guarantee of a successful outcome.

12.0 12.0 Access to Information

The background papers relating to this report can be inspected by contacting the report writer:

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