

Hartford Hall Estate Limited

Extracts from Business Review for Yorkshire Bank

8 May 2006



Hartford Hall Estate

Context

Business overview

Several businesses operate within the "group"

Hartford Hall Estates Limited ("HHE")

- HHE currently in excess of its overdraft limit of £1m (recently reduced from £2.2m)
- HHE has no further unencumbered security available for the Bank
- Cashflow forecast suggests an increased overdraft facility of £3.5m (sensitised peak) is required to finish the development (representing a £1.3 increase on the actual overdraft at 26 April 2006)
- Directors have been asked to provide further funding or security to fund completion of Phase II
- significant creditor arrears exist which are delaying progress on site

Eshott Homes Limited ("Eshott")

- Eshott claims to be owed between £1m-£2m by HHE in relation to construction of Phase I. Claim relates to remedial work, under recovery of costs, costs of housing tenants during remedial work
- HHE claims much of the remedial work was due to poor quality work by Eshott
- Eshott claims the additional work was required as a result of design faults or a lack of communication between HHE and the purchaser of the property
- Eshott's claim is currently being quantified by Gardiner & Theobald, QS, based in Newcastle
- Eshott's claim against HHE is relevant only if HHE is successfully built out as **HHE is currently insolvent and cannot pay any agreed sum at present**
 - despite this, the ongoing support of Eshott is required

Conclusions

Eshott has not been paid by HHE for all work performed to date

Background

- HHE undertook a redevelopment of HHE and subcontracted out the construction work to Eshott Homes Limited on a no profit / no loss basis
- To date, **Eshott claims to have incurred a significant loss building the properties for HHE and, consequently, has been advised to withdraw from site until payments are brought up to date**
 - In addition to the Phase I claim of between £1m and £2m, Eshott is currently owed £840,000 from valuations 44 (March 06)
- **Funding of HHD**
- Funding of the site has been shared between HHE and Eshott: utilising:
 - HHE overdraft
 - development in loan in Eshott
- **Value will only be obtained from HHE work in progress if the estate is completed**
- this requires additional working capital during the build process (peak HHE overdraft of £3.5m)
- If further Bank funding was not available, the Bank would face a significant shortfall and the estate would not be completed.
- If the Bank chooses to fund, however, it must do so in the knowledge that such a strategy has risk, mitigated by adoption of a collaborative approach between the Bank, the directors of HHE and Eshott and Grant Thornton to ensure that the development progresses on time and to budget

Conclusions

A failure of HHE should be considered the worst outcome for all parties

- **Any insolvency of HHE would be very problematic** and give rise to a number of issues which may prove difficult and protracted, including:
 - who owns title to the individual plots of land
 - claims from irate purchasers who have made significant payments on account
 - possible withdrawal of NHBC cover
 - complaints from existing Phase I occupants regarding unfinished roads, landscaping, adoption of sewers
- It is highly unlikely that anyone would purchase a property post insolvency without written assurances that the site would be completed, including the building out of all properties, and completion of road surfacing works, lighting, and landscaping.
- **Completion of such works must be considered highly unlikely in a insolvency scenario.** Any sale of the business, post insolvency, should be considered to be unlikely to realised significant funds
- Completion of the estate by the Insolvency Practitioner ("IP") may prove difficult and/or expensive for an IP since most sub contractors would demand payment of their creditor arrears before completing unfinished works
 - any new sub contractors approached by the IP would be reluctant to take over part completed work as they s would be unable to verify the standard of work completed to date and may subsequently demand premium rates
 - significant funding would be required

Conclusions

The success of Eshott is inextricably linked to that of HHE

- Any failure of HHE may lead to the insolvency of companies within the Eshott group
- Eshott Homes is concerned about its current financial position and responsibilities towards its creditors
- HHE has insufficient funds to pay the March 2006 valuation (no 44) of £840,000 to Eshott Homes
 - only £98k has been paid to date in respect of valuation 44
 - its directors have taken appropriate legal advice and have been advised that Eshott Homes must not incur further credit where there is no reasonable prospect that it will be able to pay for it
 - the directors have been advised that they must take every step to minimise the potential loss to the creditors of Eshott Homes
 - directors further advised of the need to ensure that the position of creditors does not deteriorate going forward
- We concur with the advice provided to Eshott Homes
- As a director of both HHE and Eshott Homes Limited, Ho Sanderson is in a particularly difficult position and must carefully consider the commercial issues surrounding the build out of HHD as a whole
- **Ultimately, the best outcome for both companies will arise from the successful completion of the HHE development, and HHE obtaining planning permission for Phase III**

Conclusions

The way forward

- This approach, however, is unlikely to yield any value to the shareholders of HHE and Eshott so there may be little incentive for the shareholders to ensure HHD is a success
- the Bank must, therefore, exert maximum control over both companies
- by supporting HHE's application for planning permission for a Phase III development, the Bank would incentivise HHE directors/shareholders to complete Phase II, and give itself a buffer in terms of a possible security uplift should it not be repaid in full from the completion and sale of properties in Phase I and II

Recommendations

Convert phase I legacy assets into cash as soon as possible

Build out phase II with a collaborative approach

Progress phase III planning approval is critical

- **Phase II** construction should be completed and houses sold but only **under the strictest supervision** by Grant Thornton in conjunction with the existing QS firms (Summers & Inman and Gardiner & Theobold) or a new independent QS. This would involve a hands-on approach, including:
 - weekly site visits and meetings
 - liaison with the directors to ensure full cooperation is received from both
 - pro active approach taken with purchasers to resolve current / future disputes
 - close monitoring of sales effort of Estate Agents
 - continuous reporting to the Bank
- In parallel, efforts should be concentrated on adopting a commercial approach to realised cash from disputes, including:
 - buy back (at £126k) and sale of HP7 at price in excess of £600k
 - examine repaying other deposits (HP14) to free properties for sale to new purchasers
 - accepting a discounted selling price, or
 - undertaking modification work on properties in line with customer requests to complete a sale
- **Phase III** planning approval should continue to be pursued without delay
 - Ho Sanderson should seek indicative support from English Heritage for a Phase III planning application

Recommendations

Any additional funding should be secured by Eshott and accompanied by close monitoring of cash and security

- The **additional funding** required could be provided by:
- extending bank lending to Eshott (which offers the Bank its greater security value) for the incremental lending, or
 - currently the primary incentive for Ho Sanderson to provide further security, allowing the Hartford Hall Development to be completed, is the possibility of **Phase III planning approval**
 - this may generate sufficient income to allow Eshott to be paid for work performed, returning the building contract to the no profit / no loss situation that was originally envisaged by the directors
- additional lending to HHE but only if cross guarantees are put in place between HHE and Eshott Hall Estate to ensure that any additional bank lending is secured (at least in part) on the surplus equity in the Eshott Group

Recommendations

Planning permission for Phase III should be pursued

- HHE has investigated the possibility of obtaining planning permission for a Phase III development on existing land
- A formal application has not yet been submitted but initial discussions have been encouraging
- Chris Petts (GT) and Ho Sanderson met with Peter Rogers of Wansbeck Council Planning department on 18 April 2006. Mr Rogers appeared very pleased with the work carried out at Hartford Hall in terms of architecture, but was critical of some of the quality of construction
- Mr Rogers was concerned to hear that the Hartford project was in severe financial difficulty and indicated that the Council may support a proposal for a "sensible" number of additional houses if it would ensure that the Hartford Hall project succeeded – the Council appears keen to avoid this high profile project failing due to a lack of cash
- A number of conditions, however, were stipulated by Peter Rogers:
 - original architect to be used if possible (David Kendall of JDDK)
 - any additional planning permission would be granted solely to assist HHE generate sufficient additional income to ensure that the project can be completed (it would not expect the granting of additional planning permission to result in HHE generating significant profit on the development)
 - indicative approval required from English Heritage prior to any formal planning application being submitted
 - saturation levels need to be considered - no development in certain areas and no significant loss of trees
 - Approval of future planning application for Phase III is far from certain
 - many residents are aware of the current financial difficulties being experienced by HHE (and the implications those difficulties may give rise to) and so, if properly informed, may take a wider and more commercial view and ultimately support the decision