trowers & hamlins

QUARTERLY HOUSING UPDATE

Winter 2020/21

Contents

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Foreword

As we approach the first anniversary of the initial Covid-19 “lockdown” it is an opportune time to reflect again on the resilience of the affordable housing sector and the genuine difference that social landlords and local authorities make to the communities that they serve. The sector has continued to deliver new housing at pace and has openly embraced new ways of working, new ways of delivery and accessing new capital.

The theme of change and preparing for the future is embodied in many of this edition’s articles. Rebecca Rees challenges us all to think about how the sector goes about procurement in the future and explores both the Government’s Green Paper on post-Brexit public procurement but also, as she passionately argues, how might the sector move away from the potentially damaging “race to the bottom” price evaluation model. Elsewhere in this edition, Olivia Jenkins and Helen Stuart look forward to how enforcement under the draft Building Safety Bill might play out whilst Manny Waife and Neil Waller explore the transition from LIBOR.

There is, in my mind, no doubt that housing will form a cornerstone of the path to recovery as we emerge (hopefully) into a post-Covid world and so I am really enthused about the work that we’ve undertaken exploring cities and prosperity and how we create the cities and urban centres of the future. If you haven’t done so already, the results of that work can be found here; it is well worth a read.

Finally, I am sure that you would wish to join me in congratulating Sara Bailey, who many of you will know and will have worked with, on her election as the firm’s Senior Partner and who will be taking over from Jennie Gubbins on 1 April. Congratulations also goes to the firm’s trainee solicitors qualifying this spring. I am delighted that we will be retaining all 11, who will be taking up roles across our offices and it is testament to their hard work in an incredibly difficult environment in which to complete their training.

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Service charge recovery for fire safety works – an ongoing dilemma?

The cladding crisis has posed a number of difficult questions for social landlords. One of the most pressing is: can (and should) service charges be demanded from leaseholders for the costs of fire safety remedial works on blocks of flats?

The political dimension

With the Government's recent announcement of an increased £5bn Building Safety Fund to cover the cost of replacing unsafe cladding, you would be forgiven for thinking that questions of service charge recovery are no longer relevant. However, whilst the Fund covers the costs of cladding remediation, it is not currently expected to cover the cost of other fire safety works which may be discovered to be necessary by intrusive inspections (e.g missing cavity barriers and fire stopping), or works picked up by statutory fire safety inspections (eg fire door upgrades).

As things stand, there is ongoing uncertainty as to whether (1) the Government will extend its funding to cover associated non-cladding fire safety works; and (2) social landlords will need to issue to leaseholders large service charge demands, or whether these costs can be paid for in some other way (which itself may require case-specific consideration of charitable vires issues).

The legal dimension

Where social landlords wish to keep their options open to re-charge their leaseholders, the following matters need to be considered:

- Have any statements previously been made to leaseholders assuring them that they will not be re-charged for fire safety remedial works?
- Are the costs to be incurred recoverable under the terms of the relevant leases? (this step may be removed in due course as the draft Building Safety Bill introduces an implied obligation on leaseholders to pay building safety charges)
- Can the reasonableness of the costs (in relation to necessity, cost and quality) be demonstrated with supporting evidence to the satisfaction of a First-tier Tribunal in the event of a challenge brought by a leaseholder?
- Has there been section 20 compliant consultation?
- If there has not been section 20 compliant consultation, would a First-tier Tribunal dispense with the requirement to consult?
- If cladding replacement works are grant-funded, is the Social Landlords Mandatory Reduction of Service Charges (England) Directions 2014 applicable?
- For charitable housing associations, are there obligations under charity law? In most cases this will require recovery where there is a legal right to do so.

The future

Separate from issues as to the scope of the Government's Building Safety Fund, the draft Building Safety Bill introduces a new category of service charge called Building Safety Charges. The draft Bill also introduces the new roles of Accountable Person and Building Safety Manager, as well as numerous regulatory obligations (including the obligation to prepare and register a building safety case with the Building Safety Regulator). Given that the costs of compliance with the new Building Safety regulatory system seem unlikely to be centrally funded, social landlords should be thinking now about how to pay for the costs of compliance.

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Covid-19: vaccination issues for employers

The government's Covid-19 vaccination programme is being watched with intense interest. This much-touted key to the end of lockdown is also generating lots of queries about whether employers can require employees to be vaccinated, and what they will be able to do if people refuse.

Given that we've had quite a few queries about employees refusing tests, it's probable that some will also refuse the vaccine.

The vaccination is being rolled out in stages. It was recently announced that from around mid-April those in the 40 to 49 year age bracket will be invited to have the vaccine. It will then be offered to those aged 30 to 39, and finally to those aged 18 to 29. It's currently anticipated that people falling within these age groups will be vaccinated by the end of July. What this does mean is that it's currently not realistic to expect the majority of staff to have been offered the vaccine until the late summer.

Recently the press covered the story that Pimlico Plumbers will make the vaccine compulsory for their staff, and they are certainly not alone. Many employers appear to wish to make the vaccination compulsory, but will they be able to do so?

It may be possible for an employer, having carried out risk and equality impact assessments, to take the view with staff that having a vaccine is the most reasonable way of mitigating the risk of Covid-19. The matter would be tested if an employee refused and challenged the decision, but until that happens we have no way of knowing whether this would be considered reasonable or not.

In our view it is open to employers to legitimately consider taking this position. We think that this would particularly be the case where employees are working in contact with the general public. Such a policy is not without risk of course as there will be other issues to consider, such as any side effects or long-term effects of the vaccination (if any transpire) as well as potential claims that those reluctant to receive the vaccination could bring.

It may be that an employee could argue that a mandatory requirement to vaccinate is discriminatory. Will being an "anti-vaxxer" be capable of being a religion or belief that gives someone protection under the Equality Act 2010? This is unlikely, however some employees may have religious objections to having the vaccine; some vegan employees may object if the vaccine contains animal products and employees with certain medical conditions may be advised against or choose not to take the vaccine. This means that mandatory vaccination policies may be discriminatory unless they can be justified. In certain circumstances this may be difficult.

If employers decide not to go down the mandatory vaccination route, it will certainly be open to them to actively encourage staff to be vaccinated, and to explain the workplace benefits that vaccination will bring. It would also be a good idea to implement paid time off to enable employees to be vaccinated so that they feel incentivised to do it.

If an employer wishes to implement mandatory vaccination what happens if an employee refuses the vaccine? Would it be possible to dismiss the employee in these circumstances? This would certainly lay the employer open to potential unfair dismissal claims or claims for constructive dismissal on the basis that the instruction to take the vaccine is unreasonable.

> *"As employers don't generally require employees to have flu jabs, or indeed other jabs, could they successfully argue that making a Covid-19 jab compulsory is justified?"*

About 60% of the employers who have responded to our surveys have said that they are likely to put in place a requirement for employees to be vaccinated, especially where they have customer-facing staff. It is possible for an employer to introduce this, but each individual person's circumstances would need to be considered carefully, especially if they don't want to receive the vaccine. While it's early days to decide on this, it's a good idea for employers who want to introduce a policy requiring staff to be vaccinated to think through the issues, and also to start consulting with staff about the benefits of vaccination. We're currently working with a number of employers to agree their Covid-19 vaccine policies.

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Transforming public procurement: Some initial thoughts

The Green Paper on public procurement is a significant output from No 10's Rules Reform Project. It sets out the direction of travel the Government would like to take when shaping post-Brexit procurement law. There is plenty in the Green Paper for the sector to support, whilst there are some proposals that housing providers might want to challenge.

The positives

The reduction of the number of procurement procedures to three should be welcomed, particularly as one of those is a direct award process. The new "competitive flexible procedure" will provide housing providers with freedom to negotiate and adopt a much more nimble approach at the second stage of the process, which will be welcomed by clients and bidders alike.

The recognition that framework agreements and DPS arrangements need to be made more flexible, available to be adopted for a wider variety of works and services and streamlined to reduce costs.

The abolition of feedback letters, the drafting of which has become a mini-industry in itself, is likely to be welcomed by clients. However, the proposals are that client-provided feedback is replaced by the potentially more onerous task (for clients) of embedding transparency throughout the process, so that a disappointed bidder can "pick its own" feedback at the end. Are housing providers ready for that level of transparency and presenting the inner-workings of their procurement practices to bidders in that format? If they are: are their IT platforms?

The establishment of a single digital platform for supplier registration that ensures bidders only have to submit their data once to qualify for any public sector procurement, as well as a centrally managed and maintained debarment register would also speed up and simplify selection of bidders.

> *"The Green Paper also includes proposals that will assist clients in identifying and disqualifying bidders for past poor performance and for failure to pay their supply-chain promptly."*

All of this should reduce the burden of the administrative process and be seen as good news for housing providers.

The ability to require place-based outcomes (e.g. recruitment, training and skills initiatives for local residents) via below-threshold contracts (as well as the ability to reserve contracts solely to SMEs) will be welcome news for housing providers. As anchor organisations in the community, housing providers and local authorities often see procurement as a barrier to the achievement of local spend. New Procurement Policy Note 11/20 now allows housing providers to reserve contracts, on either a county-wide or UK-wide basis (nothing in between), and it is anticipated that this will be increasingly utilised by housing providers going forward. Nevertheless, the importance of underpinning the ability to reserve contracts with a comprehensive community impact plan and effective social value roadmap, so as not to overburden such contracts, cannot be overstated.

Omissions and proposals that housing providers may want to consider further

As currently presented, the current Green Paper is very central-government orientated. There is reference to the new Construction Playbook (only applicable to central government departments) and a number of the assumptions made in the Green Paper fail to recognise the current procurement practice and challenges faced by housing providers and local authorities.

Further, the Green Paper does not recognise that simplicity and flexibility are uneasy bedfellows. By "lighting a bonfire of red-tape", the Green Paper risks creating vacuums in the regulatory framework. These gaps are likely to be filled either by gold-plating, with clients reverting back to what they know from the old rules, or the exploitation of such gaps as clients do as they please: creating divergent practice that is unlikely to be welcomed by or attractive to bidders.

The Green Paper lists other legislation that applies to contract award procedures but which the Government does not propose to abolish or include in the reforms. Section 20 of the Landlord and Tenant Act 1985 (as amended by Section 151 of the Commonhold and Leasehold Reform Act 2002) does not receive a mention but is a significant and related piece of legislation for housing procurement professionals. Co-ordination of a Section 20 leaseholder consultation with a public procurement process extends any procurement timetable by up to six months. The two procedures, whilst capable of combining, do not sit easily together and it would be a missed opportunity if any new procurement legislation did not seek to mitigate the difficulties for housing providers of running the two processes side by side.

A number of housing providers are at the forefront of addressing both the housing and climate crises through the adoption of MMC in its many different forms.

> *"Procurement regulation has never been kind to emerging technologies, and the benefit of adopting a market and value-led approach has never been highlighted as eagerly as in the housing sector at present."*

It could be that the new competitive flexible procedure can help in this regard, and the transparency requirements may help underpin a new information revolution that will help reassure housing providers seeking to adopt a life-cycle costing approach.

Finally, the issue of training and upskilling in the sector needs to be addressed and acknowledged. Public procurement is not just about "buying stuff". It will need a competent, skilled and steady hand to navigate the new public procurement legislation, in whatever form it takes.

Trowers & Hamlins, with input from clients and contacts, submitted its consultation response to the Green Paper ahead of the 10 March 2021 deadline. To see the response click here.

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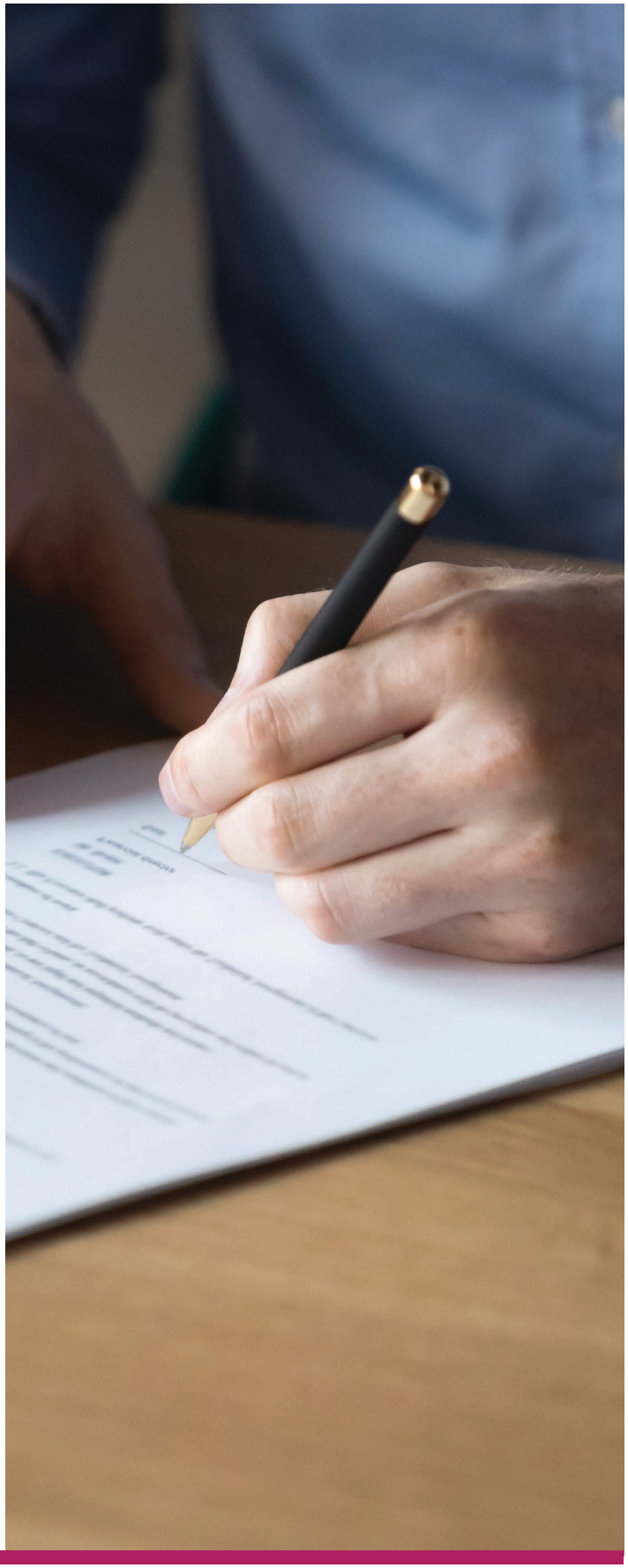

Enforcement under the draft Building Safety Bill

The draft Building Safety Bill (the draft Bill) has sparked widespread discussion in the sector surrounding its proposed measures for enforcing future compliance with building regulations.

The distinction between those proposals and measures that are already in existence (but arguably not commonly enforced) under the Building Act 1984 (the BA) is explored in this article.

This table sets out a series of prosecutable offences under the draft Bill alongside details of:

- The proposed penalties for committing those offences under the draft Bill; and
- The extent to which (upon enactment) those proposals will amend, repeal or replace provisions currently in force under the BA.

Power of prosecution under the BA

Non-compliance with building regulations has been a criminal offence under the BA for nearly 40 years, as is highlighted in the Table. Local authorities are already able to enforce compliance with building regulations under the BA by exercising powers to:

- issue enforcement notices which require the removal or alteration of work that does not comply with building regulations;
- apply to the Courts for injunctive relief regarding the removal or alteration of any work that contravenes building regulations; and
- prosecute those responsible for contravening building regulations in the Magistrates' Court.

However, there is a time limit for prosecution from the date the offence was committed of two years (under section 35) or one year (under section 36); and the maximum penalty for contravening building regulations under the BA is an unlimited fine (since 12 September 2015; or £5,000 before that date); plus £50 per day for each day that the contravention continues post-conviction.

The scope of available measures for enforcing compliance with building regulations is somewhat narrowly defined in the BA, and this is brought into sharper focus by the broad range of proposals for enforcing compliance under the draft Bill.

Extended power and scope of enforcement under the draft Bill

The draft Bill heavily extends the scope of available power to enforce compliance and/or impose penalties for contraventions, and places much of that power in the hands of the Health & Safety Executive (HSE), as it establishes the proposed new role of Building Safety Regulator (BSR).

Upon enactment, the BSR will have the power to enforce compliance with building regulations under the draft Bill and the BA by (inter alia):

- Issuing "compliance" and "stop" notices under clause 40, which respectively demand that:
  - an actual or likely contravention of building regulations is rectified within the time specified on the notice (pursuant to the proposed new section 35B of the BA); and
  - all work specified within the notice is stopped by the specific date (pursuant to the proposed new section 35C of the BA).

  Those two proposals extend the current power to issue enforcement notices under the BA to circumstances where the contravention has not yet occurred, and is, instead, "likely".
- Introducing the maximum penalty for breach of a compliance or stop notice that is not successfully appealed to the First Tier Tribunal of an unlimited fine and up to two years' imprisonment (under new sections 35B and 35C of the BA and clauses 42 and 91 of the draft Bill).
- Increasing the maximum penalty for contravention of applicable building regulations under section 35 to an unlimited fine and a fine of £200 per day (at the time of writing) for each day that the contravention continues post-conviction.

  The penalty of an unlimited fine is already in force under the BA, but the draft Bill proposes that the daily fines post-conviction are quadrupled in order to mirror inflation since the enactment of the BA in 1984.
- Extending the time limit for prosecution of breaches under sections 35 and 36 of the BA from two years and one year respectively to ten years under the draft Bill.

Other notable powers of prosecution by the BSR

Local authorities and building control approvers will also be subject to heightened scrutiny where they are found to have acted in breach of operational standards rules under the draft Bill, as the BSR will be afforded power to issue improvement notices upon them, or serious contravention notices where that breach may place the safety of persons in or about the building at risk.

The BSR will also have the authority to prosecute individuals of corporate bodies (who have contravened building regulations) and other individuals/ bodies who have defined roles (and scope of duties owed) under the draft Bill, which they have not fulfilled. Penalties upon prosecution are set out in the Table, and include fines and custodial sentences of up to two years. Those penalties appear to be a powerful deterrent.

Potential defences to non-compliance are created in the draft Bill where it was not "reasonably practicable" to perform certain statutory obligations, or where there is a "reasonable excuse". The lack of clarity surrounding those terms is likely to be a cause for future debate.

Comment

The power to enforce compliance with building regulations has been in existence for decades, albeit on a far narrower scale than is proposed in the draft Bill. The dramatic upshift in the proposed power of prosecution, and tougher penalties for non-compliance under the draft Bill, echoes the sentiment of the draft Bill's accompanying explanatory note 3, which confirms:

"the objectives of the draft Bill are to learn the lessons from the Grenfell Tower fire and to remedy the systematic issues identified by Dame Judith Hackitt by strengthening the whole regulatory system for building safety".

It is hoped that the BSR takes a more proactive stance to the broad scope of enforcement measures available to it in the draft Bill, as Dame Judith Hackitt's public statements have suggested it will, and that it has the resources and funding to do so. Otherwise, the new and extended measures may be all bark and no bite.

Furthermore, in our view, the key to ensuring building safety going forward will not rest on the sanctions and enforcement of the draft Bill, but in the wholesale change of culture and attitudes we hope it will bring through other measures, such as the focus on competence and the allocation of responsibilities through the duty holder regime.

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The final laps for LIBOR transition

Housing associations, along with other market participants, are approaching the LIBOR home straight.

The Bank of England (the BoE) and the Financial Conduct Authority (the FCA) intend to phase out LIBOR as the key interest rate benchmark for sterling by the end of 2021. Borrowers now have around nine months to remove their reliance on LIBOR, both for new financing arrangements and in legacy LIBOR contracts.

Many of our clients are actively discussing the transition from LIBOR. Naturally, some are further ahead than others. It's also the case that different banks are in different states of readiness.

To help housing associations assess where they are, or ought to be, in the transition landscape, this article looks at some of the game-changing developments and provides a summary of the vast commentary on LIBOR.

2021 Roadmap

At the start of the year, the BoE, FCA and the Working Group on Sterling Risk-Free Reference Rates (the Working Group) released a joint statement on completing the LIBOR transition by end-2021 and a priorities roadmap for 2021 (the 2021 Roadmap). The clear message is that the primary way for participants, including housing associations, to have certainty over the economic terms of their existing LIBOR contracts is to take active steps to transition them.

The 2021 Roadmap sets out the Working Group's top level priorities for 2021 and the sequential steps – financial product-by product – required to meet key milestones. By the end of Q1 2021, all participants must cease using sterling LIBOR in any new lending or other finance products that mature after the end of 2021. Further, it recommends that throughout Q2 and Q3 2021 all participants progress and complete the conversion of existing legacy LIBOR contracts expiring after end-2021 to an alternative rate. By the end of Q4 2021 participants should be fully prepared for the cessation of sterling LIBOR.

Bear in mind that banks will want you to transition on an interest rollover date - so you may well have even less time than you think!

SONIA

The working assumption is that sterling LIBOR will be replaced by SONIA (the sterling overnight index average). SONIA is an overnight rate derived from actual rates paid on overnight deposits, and is published on a daily basis by the BoE. SONIA is known as a near risk free rate (RFR) because, unlike LIBOR, it does not incorporate any mark up in respect of counterparty credit risk.

As SONIA is a daily rate published in arrears, the rate charged in respect of an interest period will be a compounded rate calculated from the daily rates published during the interest period. The actual rate and the amount of interest will therefore not be known until close to the end of the interest period. To allow for this calculation to be made before the interest actually becomes payable, most lenders are adopting the practice of using SONIA published for each day during an "observation period" that begins before the start of the interest period and finishes before the end of it (with, for example, a five day lag for ease of calculation).

In addition, the BoE publishes a daily compound index for its overnight SONIA interest rate. The SONIA compound index for a given London business day is published at 9am on the BoE's interactive statistical database. Each day it represents the total compounded SONIA from a specified base date and is seen as a route to reach the same result as the compounded SONA methodology above.

RFR documentation

The Loan Market Association's (the LMA) "RFR exposure draft" documents use compounded SONIA calculation methodology. These drafts are intended to raise awareness of the issues involved in structuring loans referencing compounded SONIA and have been a useful precedent for day one SONIA loans. Last July, we advised Coastline Housing on its first SONIA based loan facility from Lloyds, which is believed to be the first day one SONIA facility in the social housing sector. The facility agreement was aided by RFR exposure drafts.

In November 2020, the LMA further published "rate switch exposure draft" documents, to facilitate the switch of loans referencing LIBOR to compounded RFRs. Pursuant to the drafts, the switch to a compounded RFR will happen either on an agreed date or when LIBOR ceases to be published or it is officially decided that LIBOR is no longer representative of the underlying market or economic reality.

Whilst we have seen facility agreements integrating large parts of the LMA suite of exposure drafts, we are yet to see standardised drafting emerge, as lenders take slightly different approaches.

There is also not as yet a standard form document or template which can be used to transfer legacy LIBOR loans to SONIA.

Term SONIA

In the joint statement, the Working Group also acknowledged that some parts of the sterling markets may need to model a forward-looking rate, such as term SONIA, and that some providers are beginning to make these available. Term SONIA is a forward-looking term reference rate based on overnight SONIA but looks and feels far more similar to LIBOR.

However, we have not as yet seen any housing association loans being documented on the basis of term SONIA and we do not expect there to be any significant use of this alternative in the social housing finance market.

Other alternatives?

The use of SONIA is not mandatory and it is always open to the parties to agree to move to a different floating rate basis.

In particular, we understand that a number of banks are looking at a Bank of England base rate alternative which they may offer to their smaller housing association customers.

RFR transactions

The LMA regularly publishes a list of syndicated and bilateral loans referencing RFRs (such as SONIA).

The purpose of the list is to raise market awareness of the fact that lenders are offering RFR- based lending products and some of the conventions being adopted in those transactions. The latest version was published on 19 February 2021 and included references to a number of housing association transactions.

ISDA Fallbacks – free standing swaps

For those associations with free-standing swaps, their existing ISDA master agreements are unlikely to envisage the permanent cessation of LIBOR. Consequently, new fallback wording will need to be incorporated into these contracts.

To address this issue, ISDA in October 2020 published the IBOR Fallbacks Supplement (the Supplement) and IBOR Fallbacks Protocol (the Protocol), linking-up LIBOR derivatives contracts stretching beyond 2021 with the wider work on the cessation of LIBOR. The Supplement amends the 2006 ISDA Definitions for interest rate derivatives to incorporate new fallback wording. The Protocol, on the other hand, will allow parties to incorporate the new fallbacks into existing swap contracts. The Supplement and Protocol both took effect on 25 January 2021 for those participants who sign up to them.

Clients should take care that any interest rate swap transitions at the same point as the underlying loan. There are also slight differences in the ISDA methodology compared to the loan market, which means that simply adopting the Protocol may not work without further adjustment.

Enhanced FCA powers – “tough legacy”

In June 2020 the Government announced that it intended to bring forward legislation under the Financial Services Bill 2019-21 (the Bill) to amend the existing regulatory framework for benchmarks such as LIBOR. The Bill will give the FCA enhanced powers to help manage and direct an orderly wind-down of LIBOR and help deal with so-called “tough legacy” contracts where reaching agreement with all relevant parties may be difficult.

However, the FCA has made clear that these provisions will apply only to a limited number of contracts. Housing associations are clearly not in scope and should not place reliance on any such mechanism.

Conclusion

All roads lead to the full transition from LIBOR sooner rather than later this year. In the sterling markets SONIA compounded in arrears will likely become the norm for most variable rate loans.

Housing association treasury teams should be actively considering their LIBOR exposure and tracking their location on the 2021 Roadmap. They should also consider whether it may be possible to transition with all their lenders at the same time. This is likely to be tricky as lenders are approaching LIBOR transition in different ways and each facility is likely to have different rollover dates.

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White Paper – Price evaluation models for the housing sector

Over the course of the last two years we have been collaborating with members of the G15, consultants and other interested organisations to explore alternative methods of evaluating price to the most common "lowest price equals highest marks methodology".

The result of this collaboration is the White Paper looking at price evaluation models, which we launched at the end of 2020 as a conversation starter for the sector.

The White Paper looks at how historically the need to secure costs savings and "best value" has translated into the use of a relative price model such as the popular lowest price equals highest marks. The issue with this model is that it can encourage a "race to the bottom" where bidders may be encouraged to submit an undeliverable low price in order to win the contract, rather than a realistically low price necessary to perform the contract and secure quality and safe outcomes.

The focus of the White Paper is therefore on tackling this race to the bottom.

> *"If the rules of the game are changed, we hope that bidders approach to price can be changed too."*

The initial working group has been looking at alternative models to evaluating price, looking at both relative and absolute models.

The White Paper looks at eight price evaluation models in total, starting with the common "lowest price equals highest marks" methodologies, before considering alternative models, including a life cycle costing model which could play a vital role in certain asset management and product procurements.

For each model, the White Paper includes the formula to calculate the score, along with an explanation as to how that formula works (including whether there are any specific pricing rules to consider for that particular model such as a pre-determined "optimum price" or minimum quality thresholds).

The White Paper also demonstrates how each model works against a set of example bid data, as well highlighting points to note for each model, and whether the models are particularly appropriate for certain types of contract (for example, if the working group thought that a model would be particularly good for a framework agreement).

We are asking organisations to undertake pilot tenders using the alternative models in the White Paper and trial them in their procurements over the course of the next twelve months – firstly, by applying the models to previous bid data, and then by trialling the models in live tenders (the latter being most useful as a working assumption is that the alternative models should encourage a change in bidder behaviours and their approach to lowest price tendering).

The White Paper is a "conversation starter" and, with that in mind, the White Paper is available here to get a better understanding of the approach we've taken to the issues and the alternative models that we have explored and feedback with any thoughts. – If there are things in the White Paper that haven't quite worked for you in practice, or if you have other models that you think should be considered by the working group in more detail then do get in touch.

And finally, please do volunteer to be part of the working group going forward and take part in this important conversation!

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Guarantees – a word of caution!

The provision of guarantees by parent charities is a complex area and should be approached with caution. Charitable housing associations should not be inadvertently handing out, or be pressurised into giving, a guarantee without first considering whether it has the necessary powers to be so "generous" with its support. Giving guarantees can be risky for charities and getting it wrong can have significant consequences.

Since the onset of the Covid-19 pandemic, and particularly with year-end accounts being prepared, we have seen an increase in the number of charitable parents being asked by auditors and others to provide guarantees.

Often guarantees are disguised with softer terms such as a "letter of comfort" or "letter of support" meaning charitable parents may unconsciously enter into a guarantee. It is important to consider the effect of what is being asked for rather than what it is called. Is the housing association effectively agreeing to make charity assets available e.g. to agreeing to make funds available, cover payments, liabilities etc, in the event that the subsidiary needs support?

Many people forget the stringent rules around charities giving guarantees and it should be remembered the initial stance ought to be that a charity will not provide guarantees. Of course, the commercial reality is that sometimes a guarantee may be important to the success of a subsidiary's business and third parties will not contract with the subsidiary without one.

However, a charitable parent must consider the conditions very carefully before moving away from this "no-guarantee" starting position. The circumstances where it may be considered acceptable are limited. For example, the parent should check whether it actually has the power to give guarantees and whether it has an express or simply implied power.

Further, is the guarantee being given to support charitable activities that the subsidiary is carrying out for the parent's benefit or will the guarantee cover non-charitable or commercial activities that the subsidiary is undertaking? This flows from the general principle that charitable funds should not be applied to non-charitable purposes.

As a result of this, it can be tricky for charitable parents to provide a guarantee to its commercial subsidiaries. In such cases it may, if absolutely necessary, be possible for the charitable parent to provide some form of discretionary comfort or support or the parent can look to agree an alternative arrangement, but these things need very careful crafting. If a payment is made pursuant to a guarantee (whatever the guarantee is called) and is given in the wrong circumstances then the guarantee could be potentially unenforceable, result in tax implications for the housing association or, theoretically, give rise to personal liability for the trustees.

Charitable housing associations should therefore, carefully contemplate any form of obligation to provide financial or other support or, cover the liabilities or obligations of another entity and seek legal advice before making any commitment.

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The quirks of charging newly constructed properties

We are increasingly seeing both for profit and not for profit organisations looking to charge new build properties earlier than ever, even where they are not yet registered as the owner.

To be successful requires not only good record keeping but the ability to foresee the difficulties and to pre-empt delays. Here we focus on five problematic areas and explore ways organisations can overcome them when looking to secure new builds:

New home warranty documents

New build properties will need to have the benefit of a new home structural warranty. New home warranties provided by NHBC and Premier Guarantee Cover are widely accepted by funders and investors. In the event that the properties benefit from a warranty from a different provider (or indeed a developer is proposing to offer a warranty from a different provider), you should take legal advice at the earliest opportunity so they may consider the acceptability of such warranties by funders. You may only be issued with a cover note for these warranties at practical completion. A cover note only confirms that cover will be provided and is not the warranty document. Before charging a development, the cover note must be activated by either you or your developer. This can be time-consuming and delays may occur where this is not necessarily within your control.

Planning

The planning make-up of a development may contain multiple phases and, if that is the case, you will need to confirm under which phase(s) the property has been constructed and provide the relevant planning permissions normally either:

- a full permission or;
- an outline permission plus the reserved matters application.

Since outstanding planning conditions are still capable of enforcement with new build properties (the "10 year rule"), you will need to provide discharge of all planning conditions that relate to the property (or at least a confirmation of compliance) from the local planning authority and that includes the discharge of any contamination conditions.

> *"Where outline planning conditions have been discharged, the documentation must clearly demonstrate whether the discharge is in respect of the development as a whole or just in relation to a particular phase is discharged."*

Where it is unclear, additional confirmation may be needed. Whilst planning trackers from developers can be helpful, they do not serve as evidence of discharge.

Section 106 agreements

If your property is subject to a section 106 agreement (and any variations or supplemental deeds), then these also need to be provided to your charging lawyer, regardless of whether or not you are a party to the agreement(s).

A section 106 agreement will bind the land and, potentially, the borrower. In the event that there is a default on the loan which is then enforced, the funder or security trustee and successors could also be subject to any outstanding obligations. This may be an obligation to pay a sum of money, to provide affordable housing, schools or other infrastructure or to enter into a separate nomination agreements.

Confirmation from the local planning authority/authorities that all obligations within the section 106 agreement, both financial and non-financial have been satisfied will need to be obtained. Obtaining confirmation from the local authority may take several months or more, particularly in the current climate. Should there be financial or other obligations outstanding without an adequate mortgagee exclusion clause (MEC), this may result in the property not being acceptable as security, a reduction in valuation or the additional cost of buying an indemnity insurance policy. Where there is an adequate MEC in the agreement(s), it will provide comfort on the binding nature of these agreements as well as maximise the valuation.

Mortgagee exclusion clauses

Your charging lawyer will consider the adequacy of any MEC.

Where there is a restriction on occupation or use, there needs to be a MEC to achieve the maximum valuation. Whilst deeds of variation can be agreed, negotiation with local authorities or other third parties may take several months.

> *"It is important that MECs should be considered as part of a pre-charging review and not at the point that there is an urgent need to raise finance."*

Restrictions on occupation or use without an adequate MEC will reduce the valuation to an EUV-SH basis or, in some cases, will mean that a scheme is not acceptable security. As well as being in section 106 agreements, such restrictions may also be found in title documents, nomination agreements and sometimes planning permissions.

Community Infrastructure Levy

Where affordable housing is within a local authority where a Community Infrastructure Levy (CIL) charging schedule is in place then it is likely that there is a CIL liability. Given that Social Housing Relief is the mandatory, it may also have been granted over the development. In your charging pack, you will need to provide the Liability Notice and the Demand Notice with confirmation from the local authority that all monies have been paid. In many cases, this level of information will not be held on development files and again may require a separate approach to the local authority.

It is essential to maintain good records and filing systems and to start collating the property charging information and documentation as it becomes available. As new build sites become more complex and require increasing levels of documentation, having accurate and complete development records is the key to a successful charging transaction.

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Biodiversity net gain

Proposals to reform the planning regime to make development subject to environmental gain have been discussed for a number of years. In 2019, the Environment Bill introduced a provision which will require 10% biodiversity net gain to be a pre-commencement condition of all planning permissions granted under the Town and Country Planning Act 1990.

Who will be affected?

If the Bill is enacted in its current form, planning permissions granted under the Town and Country Planning Act 1990 will be subject to this condition, subject to specific exemptions, namely development permitted by a general permitted development order, urgent Crown development or other development carved out by the Secretary of State in secondary legislation. No secondary legislation has been prepared or published yet, but from a review of the Government consultation and responses, potential exemptions may include:

- Householder applications;
- development of specific ownership types which may be disproportionately impacted by the requirement, such as residential self build; and
- brownfield sites that meet specific criteria, including those that do not contain priority habitats or which face genuine difficulties in delivering viable development.

The Bill also provides for the possibility of different provision to be made through secondary legislation in respect of 'irreplaceable habitat', which is likely to comprise protected sites.

The proposals

The Bill provides that planning will be granted subject to a pre-commencement condition that development cannot begin until the developer has submitted a biodiversity gain plan demonstrating that the biodiversity value attributable to the development exceeds the pre-development biodiversity of the onsite habitat by at least 10% – this is referred to as the biodiversity gain objective.

The biodiversity gain plan will need to: calculate pre and post-development biodiversity value of the onsite habitat; set out steps to minimise adverse effects on the biodiversity on the onsite habitat; and detail proposed mitigation if 10% net gain cannot be achieved onsite. Further details relating to the content of these plans, together with procedures for submission, determination and appeal will be set out in forthcoming regulations.

> *"The local planning authority must be satisfied that the biodiversity gain plan contains the required information and that the biodiversity gain objective is achieved."*

If a biodiversity gain plan is refused, the development cannot proceed lawfully.

Calculating biodiversity value

Biodiversity value will be determined through calculating the pre- and post-development values. Conceptually it will be calculated by applying the 'biodiversity metric', developed and published by the Secretary of State. It is anticipated that the application of the metric will be complex and a 'one size fits all' approach will not necessarily be appropriate.

Achieving the biodiversity gain objective

If the developer seeks to achieve the objective through measures onsite then those measures will need to be secured through a condition or a planning obligation, and that mechanism must be maintained for at least 30 years after the completion of development.

If onsite improvements cannot be achieved, the Bill provides a means of compensating for the deficit through one of two ways:

- buying biodiversity benefits achieved on 'Biodiversity Gain Sites'; or
- purchasing biodiversity credit from the Government.

These mechanisms are designed to cater for situations where it is not feasible to achieve the biodiversity gain objective on site, so you can have allocated to the development, registered offsite biodiversity gain. The details on which sites are available to provide this compensatory benefit will be published in a new Biodiversity Gain Site Register.

Viability

Achieving a 10% biodiversity net gain will potentially add significantly to the cost of development. Whilst the Bill is not explicit on how biodiversity net gain will interact with viability constraints and the burden of other planning obligations and conditions, it is anticipated that when the Bill is enacted and secondary legislation brought into force, there will be carve outs from the requirements where it is not financially viable to deliver the full 10% net gain.

What happens next?

The Environment Bill has repeatedly been delayed, and has been deferred from the current parliamentary session, meaning that it will likely be considered in Autumn 2021.

Trowers & Hamlins biodiversity team will continue to monitor the progress of the Bill and the biodiversity net gain regime and we aim to provide regular updates on how it is implemented in practice and considerations for developers and local planning authorities that might result.

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