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Publications —— Summer 2018

Quarterly Housing Update

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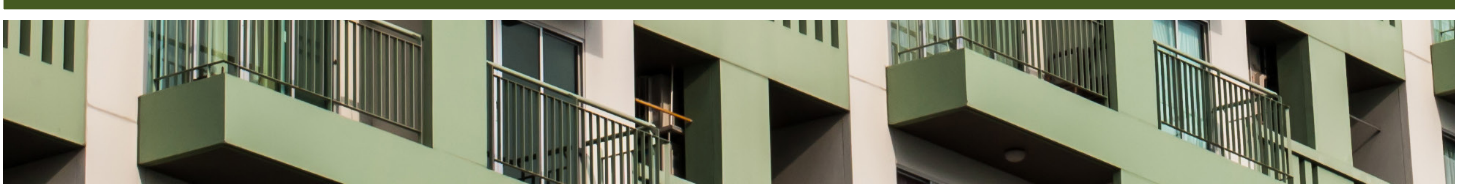

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Foreword

As we approach the CIH Annual Housing Conference, the sector seems to be moving forward with a new found confidence; housing association and local authority build rates appear to be increasing and there is significant investor confidence in the sector – both from traditional debt providers to new investors. Local authorities seem to be particularly active at the moment – not only in the continued growth of housing development companies, but increasingly in their willingness to work in partnership with others (both housing associations and developers) to increase housing supply- a trend we can only see continuing with the imminently flexibilities that are likely to be forthcoming in relation to the HRA debt cap and the use of Right to Buy receipts (and for London Boroughs an attractive GLA grant programme).

We have also seen a (renewed?) focus on housing association's core objectives- witness for example Peabody's decision to convert the roughly 4,000 homes it currently lets at affordable rent to London Affordable Rent and the genuine debate in the sector about how to better engage with residents. Also worthy of mention is the excellent work that the Board Room (a forum of housing association and ALMO chairs) have done in addressing the issues that they see that the forthcoming Green Paper should address. This paper 'Delivering the right homes in the right places' can be found on our website.

I hope that readers who attend will have a productive conference, and I would like to thank my colleagues here for another set of insightful articles.

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Lowest cost pricing – end of an era?

Social landlords running procurement exercises in the economic downturn have been poorly served by traditional lowest cost pricing evaluation strategies. Recent criticism in the Hackitt Report about lowest price tendering suggests the need for a radical rethink in assessing price.

Lowest price tendering results in competitive prices that allow clients to demonstrate they have obtained good value at the point of procurement. However, the downside of this approach often outweighs the financial savings secured, resulting in poorly-performed contracts, disputes and claims as the contractor attempts to recoup costs, or, in extreme cases, contract termination and contractor insolvency. Put bluntly, relying on lowest price can result in a flawed and adversarial contractual relationship.

The Hackitt Report on the building industry has been highly critical of lowest cost tendering, and made a number of recommendations for improved procurement practice in this area. The report identifies the procurement process as the process that "kick-starts the behaviours" seen throughout the design, construction, occupation and maintenance stages, and "sets the tone and direction" of relationships between construction and design team members. Poor procurement creates a "race to the bottom" culture which prioritises "doing things as quickly and cheaply as possible rather than delivering quality homes which are safe for people to live in."

In relation to price, the report states that procurement processes should aim "to obtain best value, rather than lowest cost". The report criticises contracts with low margins for contractors, which it says leads to contractors pushing technical and contractual risk to its supply chain, and risks being handled by people who are unable to mitigate them appropriately.

The report's key recommendations are for clients to aim to construct buildings that have a long life cycle, and consider full life cycle costs at procurement stage. This cultural change needs to be embedded from the outset and, so with this in mind, the tender process should prioritise building safety, and balance upfront capital cost against quality and effectiveness. Safety requirements should be tested effectively during the tender process. Best value should be achieved by establishing collaborative relationships between the construction team, and by encouraging efficiency and productivity, not by using cheaper and unsuitable materials.

So how can contracting authorities put the report's recommendations into practice?

The current public procurement regime already provides flexibility in relation to assessing price. The Public Contracts Regulations 2015 allow contracting authorities a broad margin of discretion when structuring evaluation exercises, which may comprise a price-only assessment or a split between price and quality. Courts are unlikely to interrogate this selection unless the contracting authority makes a manifest error in adopting a particular pricing formula.

Many procurement exercises in the UK favour the "standard differential model", regardless of the price/quality split, in which the lowest price is awarded full marks and the other prices are scored in relation to the lowest score. This practice incentivises bidders to price as low as possible, continuing the "race to the bottom" culture criticised in the Hackitt Report. This approach also creates a higher risk of abnormally low tenders, which contracting authorities are now required to investigate. Although the Regulations empower contracting authorities to reject suspected abnormally low bids where the bidder cannot satisfactorily account for its low prices, in practice this seldom happens, leaving contracting authorities to deal with low-margin high-risk contracts.

The Regulations also provide for an alternative "life cycle costing" model, in which the contracting authority considers all the costs over the life cycle of a building, including (without limitation) energy consumption, maintenance, collecting and recycling and pollutant emissions costs. Though life cycle costing has been available since February 2015, its uptake in the UK has been quite low, suggesting that UK contracting authorities lack the inclination or experience to adopt alternative pricing models.

There are a number of other pricing models that incentivise sustainable pricing behaviours. One such model is the "optimum pricing" model, where the contracting authority sets out the optimum price that it considers appropriate for the contract, based on its market research and consideration of its budgetary constraints, and the tender closest to the optimum price receives the highest marks. As with the life cycle costing model, this requires contracting authorities to undertake market research about the true price of the contract, rather than simply ranking the prices received and giving full marks to the lowest score.

Moving away from a lowest price tendering system requires contracting authorities to explore efficient working practices through the life of the contract. The use of partnering contracts such as PPC2000 and TAC-1 can encourage collaborative working practices, as recommended in the Hackitt Report. However, this requires clients to commit to long-term contract management, rather than assuming that a low upfront price will deliver the best result.

Given the high profile of the Hackitt Report, the link between lowest price tendering and safety risks will continue to be debated. With this in mind, UK contracting authorities should be encouraged to review their current price evaluation models, and consider different procurement methods that achieve best value without compromising safety.

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Sleep-ins – a tipping point for care provision?

Trowers & Hamlins and Agenda Consulting carried out an independent survey between 19 February and 9 March 2018 looking at the payment of sleep-in covers and whether providers are paying the national minimum wage for time spent. 109 organisations responded which makes this the most comprehensive survey undertaken on this subject.

This survey supplements the survey we carried out last March on sleep-in shifts. In November last year HMRC set up the Social Care Compliance Scheme (the SCCS), and the comparative data shows that the landscape has changed dramatically. The survey reveals an increased awareness of the sleep in issue, but also highlights the potentially damaging costs and consequences for providers, many of whom simply do not have the budget to make up the National Minimum Wage (NMW) shortfall.

There is evidence that more providers are paying the NMW for sleep-ins, a trend which is likely to continue.

Who pays for sleep-ins?

The survey last March showed that commissioners had only agreed to fund 14% of service at NMW rates, and refused to pay or refused to even engage with the issue on 67% of services. The results of the latest survey show there has been a significant rise in the number of services the commissioners have agreed to fund at the NMW from 14% to 49%. However, this still means that the majority of sleep-ins services are not funded by commission.

37% of providers have asked commissioners to fund the historical NMW liability, and the majority of those have found that they do not even want to discuss it.

The back pay bill?

The impact of back pay is potentially very serious. It is difficult to estimate what the back pay liability is; the aggregate of those providers who responded place it at a total of £102.88 million and the respondents to the survey are employers of an estimated 7.4% of those working in social care.

Nearly 70% of providers feel that the issue means that viability to businesses is at risk, as only 6% of providers have budgeted for back pay liability.

What's the effect on care?

Surprisingly, the mean proportion of all services which will become unviable within the next year across those who gave data is 52%. This will affect 30% of people who rely on services from these providers. Nearly half (46%) of all providers believe they would have to make redundancies.

So far, providers have decided not to bid or negotiate for 273 new contracts because of their financial situation. Many are looking at mergers and reconfiguring care services. There are business opportunities for housing providers here.

The pressure on the social care system is nothing new, but is the lack of funding of sleep-in pay issue a tipping point? Whatever the outcome of the much-needed debate into the future of care services, it seems clear from the findings of the survey that a solution will have to be found sooner rather than later.

If you would like a full copy of the survey please contact eburrows@trowers.com

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Are you keeping your investors appropriately updated?

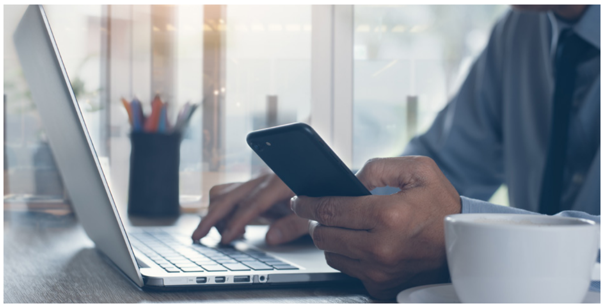
For those housing associations who have publicly listed bonds, updating the market and your investors is a necessary part of the treasury function.

There has been comment that the social housing sector is not providing the level of reporting and information which is preferred by investors. Investors consider transparency to be an essential part of maintaining confidence in the sector, and most information which investors are looking for should be readily available – it simply requires publication in an investor-appropriate manner.

Issuers will need to comply with requirements contained in the contracts establishing the bonds but also with their obligations under the relevant parts of the Financial Conduct Authority's Listing Rules and under the Market Abuse Regulation.

As with any lending relationship, it will be commonplace, for example, for an issuer to have to provide copies of its annual financial reports to the bond trustee on behalf of investors. However, the issuer will also need to ensure that these are released to the market more generally, through uploading them via the National Storage Mechanism and also through publication on a regulated information service. Most issuers from the housing sector opt to publish relevant news via the Regulatory News Service (or RNS), as this is one of the FCA's approved providers. Many issuers also publish information on their website, often using a dedicated investor relations page.

In addition to the annual financial statements, comments from the Investment Association and in the market suggest that many investors would prefer associations to release financial information on a more regular basis. Some issuers in the sector opt to publish quarterly updates.



Issuers should be particularly careful that they understand their obligations (and the obligations of their employees and advisers) regarding the publication of "inside information" – i.e. precise information which has not been made public but which relates to an issuer of securities and which, if made public, would be likely to have a significant effect on the price of that issuer's bonds. In the context of a bond issuer that is on-lending the proceeds of the issue to other members of its group, this is likely to include information which concerns those other members

There are some circumstances where an issuer (or other members of its group) may have to prevent the disclosure of inside information where disclosure might prejudice its legitimate interests. There are strict controls around when this is permissible, one of which is that the issuer must be able to ensure the confidentiality of the information whilst withholding it from the market. Insider lists should be prepared and kept up to date to ensure confidentiality is maintained. This becomes even more important in potentially tricky situations where a significant corporate event (such as a merger, or perhaps a resignation) is in the early stages of consideration and must be carefully managed.

If an investor is inadvertently made an "insider" (i.e. given inside information before it becomes publicly available) and then deals in the relevant securities then they may well commit an insider dealing offence, which is to be avoided!

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The new planning framework

Successive governments have introduced repeated and wide ranging reforms to the planning system all with the headline that the revised system will be faster and easier and will result in the much needed delivery of new homes. Despite this, the promised reform to 'fix our broken housing market' still seems some way off.

From 5 March until 10 May 2018 a new draft NPPF was released for consultation with the stated aim to ''transform planning policy' and deliver "the right homes in the right places".

The revised NPPF seeks to focus on outcomes achieved by local authorities in their housing delivery targets. The Government rightly wishes to scrutinise not just the number of housing units consented to within a borough but the number of homes actually delivered. This is to be monitored through the new standardised housing delivery test which is to be measured against a council's housing requirements. If delivery falls beneath 95%, local authorities will be required to prepare an action plan to assess the causes of under delivery and identify actions to increase numbers in future years. If delivery falls beneath 75% then the presumption in favour of sustainable development will be triggered and the planning application can then be judged against the NPPF as opposed to the local plan. This means local policies restricting development will be given significantly less weight in the decision making process and, in theory at least, lead to a greater number of permissions being granted.

Although the greater focus on delivery is to be applauded, housing delivery and the granting of planning permission are inextricably linked. Anyone involved in obtaining planning permission, and particularly in London, will know that one of the biggest delays in having permissions granted is often down to disagreement on site viability and the under delivery of affordable housing. This has been exacerbated since the introduction of CIL and Mayoral CIL which being non-negotiable seek to squeeze additional blood from the same stone.

Within the draft NPPF, viability receives a cursory mention. Firstly, paragraph 34 declares that as well as local authorities' plans needing to set out the contributions expected in association with particular sites and types of development, plans should also set out circumstances where further viability assessment may be required for determining individual applications. Secondly, paragraph 58 states that no viability assessment should be required for an application where the proposed development complies with all the relevant policies in an up-to-date development plan. Where one is required, it should be publicly available.

While the NPPF may be short on viability detail this is addressed via revised planning policy guidance (PPG) which was released on the same day as the NPPF. The draft PPG represents a radical shift in that it seeks for viability assessments to be incorporated into the plan making stage meaning every site should be assessed for viability in this stage of the process.

In a system which is chronically under resourced and with a number of planning authorities not yet even having published a local plan the suggestion is that using a typology approach to group sites with shared characteristics such as location, use or size, average costs and values can then be used to make assumptions about how the viability of each type of site would be affected by all relevant polices. It seems unrealistic that any other than the most capable and motivated plan makers will have the capability to engage with landowners, developers, infrastructure and affordable housing providers to secure evidence on costs and values to inform viability assessment at the plan making stage. Given that, in the absence of evidence a site should not be allocated, this policy may actually have the effect of reducing the number of sites coming forward.

More notably, the draft PPG suggests that it is important for developers and other parties buying land to have regard to the total cumulative cost of all relevant policies when agreeing a price for the land. The price paid for land is not to be seen as a relevant justification for failing to accord with relevant plan polices. This is particularly relevant given the recent Parkhurst Road Limited decision where a High Court judge has backed a north London council in its refusal of permission for a 96-home scheme because of a lack of affordable housing on the basis that the developer had overpaid for a site. It seems that viability appraisals will no longer be a method by which additional land value can be sought at the expense of affordable housing.

Bringing viability into the plan making stage appears rather fraught given lack of site and development specific information which may lead to broad brush appraisals. Additionally given the substantial amount of time spent negotiating viability appraisals in the current application and appeals stages of the planning process, and the very complex nature of these negotiations which are analyses based on complex valuation principles, this process is likely to be time consuming and costly for local authorities to undertake.

Equally, if site viability is to be defined in the plan making process, and site value to be determined by policy requirements, there is a real risk that sites will simply not come forward if they prove to be financially unviable. Landowners in the past have simply held onto their assets waiting for the system to change. The suggestion of a two year time limit to implement consents is unlikely to assist delivery. With the detailed CIL assessments required to obtain reliefs that need to be undertaken early on in the process and the complexities of discharging reserved matters and pre-commencement conditions, planning permissions are likely to lapse before they can be implemented. Far from streamlining the process, the requirements seem to place an even greater burden on councils and developers.

If a site does not offer a reasonable return then developers and their funders will simply not take the risk. The reliance on the private sector to deliver a public sector duty in the form of social housing is a failing model. Arguably, there needs to be a complete shift in mind set on delivery of housing as opposed to constantly attempting to change the system, placing ever more burdens on local authorities and costs on developers. It will be surprising if these reforms achieve the delivery targets needed without more radical intervention.

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The future of heat networks: what can we learn from the new draft London Plan?

Heat networks have become an increasingly common feature of large-scale development programmes in recent years. This has principally been driven by planning requirements which aim to reduce carbon emissions and improve energy efficiency in new-build developments.

In November 2017, The Mayor of London published a new draft London Plan (the Plan), updating the existing strategic plan for London highlighting priorities to tackle carbon emissions and air quality. The Plan focusses on moving away from gas combined heat and power plants (CHP) and towards heat networks powered by waste heat, and renewable technologies.

While the Plan is London-specific, the issues it addresses are common to all urban areas in the UK and flags the enhanced role that heating infrastructure will play in meeting Government targets to reduce carbon emissions.

The Plan outlines increased requirements on development proposals to use design solutions to prevent or minimise exposure to air pollution and to address problems of poor air quality. Large-scale development areas must aim to be "Air Quality Positive" by implementing measures to actively reduce air pollution. This could be achieved by the provision of low or zero emission heating, together with other measures like improvements to public transport or cycling infrastructure.

Major developments are also expected to achieve net zero carbon emissions. This means reducing carbon dioxide emissions during the construction and operation stages. Developments must aim to use less energy, manage annual and peak energy demand during the construction process, exploit local energy resources and generate, store and use renewable energy on site.

The zero-carbon target for major residential developments in London has been in place since October 2016 with a target of on-site carbon reductions of at least 35% beyond Part L of the Building Regulations 2013. Under this regime, gas CHP technologies have tended to generate large carbon savings. However, the Standard Assessment Procedure 2012 for assessing carbon savings is due to be updated in the coming year, and the new emission factors are likely to significantly reduce the carbon reduction benefit of gas CHP. This is largely due to current assessment factors assuming gas CHP is displacing heat generated by fossil fuels, but as the grid decarbonises and more energy is generated from renewable sources, this rapidly decreases. This means that currently available CHP technologies are unlikely to achieve the 35% carbon reduction required to meet the zero-carbon target.

The Plan notes that London will need to shift from relying on natural gas as its main energy source to a more diverse range of low and zero-carbon sources, including renewable energy and secondary heat sources. The London Environment Policy recommends that developers should investigate generating and storing renewable energy onsite, as well as using it onsite, to contribute to London's security of energy supply.

Although it is not due to be implemented until autumn 2019, the Plan is a material consideration in planning decisions for current or future development projects. Landlords and developers must therefore take the Plan into consideration (together with current policy and any specific local policies) when developing energy strategy and planning applications. While planning decisions on energy strategy remain at the discretion of the relevant planning authority, any applications made in compliance with the Plan are likely to be considered favourably.

The Plan does not affect planning applications that have already been approved in accordance with previous policies. That said, landlords and developers may consider seeking variations of existing permissions where there are advantages to changing a proposed heating system to reflect the requirements of the Plan.

Despite its London-centric scope, the requirements and targets reflect central government commitment to improving and diversifying heating solutions. There remains a drive towards district-wide heat networks, which the Government is aiming to roll out with the injection of over £300 million of funding first made available in 2015 to local authorities across the UK for this purpose. However, the big challenge for new large-scale developments will be defining what will replace gas CHP as the heat generation technology. There are emerging alternative options (using renewable technologies, heat pumps or connecting to a secondary or waste heat source) but these are likely to be more complicated to implement than has been the case with gas CHP and will depend on the scale and location of the particular development.

The Plan is currently still under consultation with an Examination in Public shortly to commence where comments received during the consultation period (which ran earlier this year) will be reviewed by the Independent Planning Inspector, appointed by the Secretary of State. The anticipated timeline is that the Examination in Public will take place in autumn 2018 and the finalised new London Plan will be published in autumn 2019. It remains to be seen whether the Mayor and/or the Government will give a further steer on the future of heat networks and expectations for new-build developments in this interim period. Watch this space.

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What is a property guardian?

The use of property guardians on developments is increasing. Although there is no legal definition of a property guardian, the term is generally understood to relate to an arrangement whereby a property owner enters into a contractual relationship with a guardian service company, and that service company organises for individuals to live at empty properties as licensees, in order to protect the property from arson, vandalism or trespassers.

From a tenancy perspective, the primary risk to the property owner is that the individuals living at the property may be tenants rather than licensees, and may therefore be more difficult to move on when the property is required to enable development to commence. Indeed, the Courts have found property guardians to be tenants with the protection of the Housing Act 1988.

Generally under these arrangements, the occupation of the property is managed on a day-to-day level by the service company, so the property owner cannot directly control how the occupancies are managed. While the owner can approve, a form of residential license to be issued to occupants (as part of its contractual arrangement with the service company), ultimately whether a license exists is not simply a matter of what is written on the occupancy document. The context and surrounding circumstances feed into whether a license or a tenancy has been created.

License or tenancy?

A court could look at:

- Whether occupants have exclusive possession of the property, or any part of it, and can exclude the landlord or its agents. Does the occupier have the only set of keys, for example, and is their residence without interruption? This should be avoided. Licensees should be subject to frequent landlord/agent inspections and visits (whether or not the occupant is themselves present), and should be moved around the property as appropriate to its use – for example as it is being redeveloped, refurbished or redecorated. Where there are works being undertaken, it will be easier to show exclusive possession has not been granted, as the works access will be ongoing and frequent.

- What type of property the occupier is living in. It is easier for exclusive possession to be found where the occupier is living in a single self-contained dwelling, as opposed to a commercial property where the primary purpose is manifestly not housing.

- How are occupants are selected. If, for example, groups of people who know each other enter into the occupancy agreements at the same time and then live in the same property this could be more akin to a tenancy (subject to an analysis of other relevant circumstances).

- Whether the occupant is paying something akin to rent (even if this is described as a license fee or accommodation charge)

What if it goes wrong?

If the court finds that an occupant has an Assured Shorthold Tenancy (AST) rather than a license, the primary outcome will likely be a delay in obtaining possession of the property. An AST can only be ended using the processes in the Housing Act 1988, the most likely of which will be the mandatory possession procedure under Section 21 of the Act.

Section 21 possession orders however, are only available where the landlord has complied with various obligations, for example, relating to the provision of tenancy and property information and the protection of any deposit monies. The property owner is unlikely to have complied with these requirements because the intention was not to create a tenancy.

Practical considerations:

Developers looking at these arrangements should:

Assess whether property guardian services are appropriate for a particular building. The courts will look for sham arrangements trying to avoid granting security of tenure. If a building is subject to phased works, then guardian services may be a practical solution for minimising risk of property damage. If on the other hand, a self-contained dwelling is simply empty for a period of time and there is no real need for repeated landlord access, then perhaps guardianship is not appropriate.

Given that the property owner is not in day-to-day control of the occupancy of the building, the contractual arrangement with the service company should place the burden of obtaining vacant possession of the property on the service company. This will include arranging for legal actions in its capacity as agent for the owner, and covering associated costs. This is not a magic pill however – while it limits the owner's exposure to the inconvenience and cost associated with possession actions, it will still need to adapt to the delayed timetable – this could be particularly costly where redevelopment works have been scheduled and the owner has entered into time critical legal arrangements with third-party contractors.

Many property guardian service companies promise that they can deliver up vacant possession within a matter of days of receiving notice from the property owner. In reality, this claim is founded on a relationship of trust between the company and its guardians, rather than any legal right. Many established, long-term guardians will move on when asked to do so and are reliant on maintaining a good relationship with the company to ensure they are offered a new home. However, if the relationship breaks down, it could take many months for the company to recover vacant possession.

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Is it time to call time on retentions?

Retentions are contractual arrangements whereby a percentage of sums due to a contractor are withheld by the client, and paid out only when specific milestones are completed in the construction or defects rectification process. Retentions are widely utilised in the construction industry, and all major forms of construction contracts such as JCT, NEC and PPC contain retention provisions. Retentions are popular as an incentive for the contractor to avoid delays in completing projects, and provide employers with a readily accessible and liquid source of funding if defects arise.

However, retentions have a significant impact on contractors' cash flow, which can exacerbate late payment to the supply chain. Many contractors will increase their tender prices for construction projects to protect themselves against potential problems caused by the delay in payment, which means that clients are effectively paying for their right to withhold payment.

The use of retentions has been debated at length in the construction industry, including a formal government consultation conducted last year. The consultation reported widespread delays in repayment of retention monies, negatively impacting on sub-contractors and suppliers who are often the last to be paid. Recent legislative attempts to improve fair payment practices, such as the amendments to the Late Payment of Commercial Debts (Interest) Act and the Public Contracts Regulations, do not appear to have improved payment practices. Neither do voluntary payment measures such as the Construction Supply Chain Payment Charter and the Prompt Payment Code appear to have been widely adopted.

Following the consultation, the Government tabled the Construction (Regulations Deposit Schemes) Bill with the express purpose of tackling poor payment practices in respect of retentions, and the Bill is due for its second reading in October 2018. The Bill proposes a mandatory retention deposit scheme, which would operate in a similar manner to the tenant deposit scheme imposed on residential landlords to protect tenant deposits. The intention of the Bill is to assist with improving cash flow through the supply chain and to prevent the consequences of major contractor insolvencies (where retention sums are not ring-fenced and sub-contractors miss out on payment). The impetus for the Bill was strengthened following Carillion's recent insolvency, which has affected over 30,000 sub-contractors. The Bill is reported to have cross-party support of over 120 MPs, and the backing of around 76 industry trade bodies across the supply chain, though the timetable for its implementation is still unclear.

In addition to the Bill, the Government's consultation committee also considered several alternative options to the standard retention model:

- Project Bank Accounts – Ring-fencing of money in a separate account to provide protection for all parties against upstream and downstream insolvencies. This model has found its way into some standard contract forms like PPC 2000, but there is limited evidence of its use in practice.

- Retention Bonds – These provide security in the form of a surety to the client, similar to a performance bond. The cost of the bond is non-refundable to the contractors, and removes the cash flow issues association with retentions.

- Trust accounts – Retention monies are held in a separate ring-fenced account and held on trust for all of the supply chain. As with Project Bank Accounts, trust accounts incur additional administration costs. Commercially, they are a less flexible option, as the monies cannot be used for working capital by either party.

- Partnering/Framework Agreements – Employers who establish long-term agreements with contractors can use the award of future work and/or financially incentivising contractors to ensure works are completed on time, without requiring withholding of monies. Prompt payment of the supply chain can also be identified as a performance indicator with linked incentives.

- Zero retentions – Given the popularity of retentions, it seems unlikely that the construction industry would respond to restrictions on their use, which appears to be reflected in the drafting of the Bill. Even where retentions were not used, employers would undoubtedly seek alternative securities to protect themselves in case of delays or defects in work.

The evidence from the Government's consultation reflects that there is no one-size-fits-all approach to retentions, and their use will depend on the nature of the project and the commercial position of the parties. When negotiating retention clauses, clients should ensure that key provisions are drafted clearly to explain how the retention percentage is calculated, and which milestone(s) trigger the release of the retention, where retention payments are linked to practical completion or defects rectification being certified, the contract should state clearly how notices should be drafted and issued to the relevant parties.

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The Renewable Heat Incentive: renewed interest?

The Renewable Heat Incentive (RHI) scheme was launched in 2011, with the aim to encourage investment in renewable heat technologies. Although RHI payments have been available since then, the level of take-up has been disappointing (particularly when compared to installations supported by the Feed-in Tariff). To help address this lack of progress, the Government has introduced several amendments to the scheme that came into force in May this year.

The RHI scheme is run by the Government and aims to encourage applicants to utilise heating systems that generate heat from renewable sources. The applicant will receive quarterly payments from Ofgem based on the heat produced by the renewable system. There are multiple heating technologies that can qualify for RHI payments but the technologies most relevant for landlords of residential properties are likely to include air source heat pumps, ground source heat pumps, biomass boilers and stoves, solar thermal panels or shared ground loop systems.

Changes to the Domestic RHI Scheme

The amendments to the Domestic RHI scheme (which deals with installations heating a single domestic property) have been introduced in two stages under the Domestic Renewable Heat Incentive Scheme (Amendment) Regulations 2018. The first stage came into effect in September 2017 and the second stage came into force on 22 May 2018. Of particular interest are the new rules allowing the Assignment of Rights (AOR) in the RHI payments. This deals with one of the most significant limitations under the Domestic RHI scheme, and should provide a suitable platform to support third party investment in RHI funded systems.

In order to protect building owners from engaging in risky arangements with unverified parties, Ofgem have incorporated several consumer protection measures into the AOR rules. Only 'registered investors', who are members of specified consumer codes (either RECC or HIES), and whose RHI funding contracts have been approved by Ofgem, will qualify for AOR. The changes dealing with AOR will come into effect on 27 June 2018 and some providers are already in the process of applying to achieve 'registered investor' status in anticipation of these new rules.

Changes to the Non-Domestic RHI Scheme

The amendments to the Non-Domestic RHI Scheme (for installations heating commercial premises or multiple domestic properties) were introduced under the Renewable Heat Incentive Scheme Regulations 2018 and came into force on 22 May 2018.

The key change is the introduction of tariff guarantees which seeks to increase investor confidence by allowing applicants to be granted a guaranteed RHI tariff at the point of application to the scheme (instead of having to wait for date of the commissioning of the installation). This will help ensure that investors are not left with a lower tariff than expected once the installation is commissioned.

The new regulations also seek to provide clarity on how shared ground loop systems are dealt with (e.g. where multiple properties are serviced through ground source heat pumps that are connected to one shared ground loop system). If a shared ground loop system serves multiple domestic properties, it will be able to qualify for Non-Domestic RHI payments, therefore receiving payments over a 20 year term as opposed to the 7 year term that applies to Domestic RHI. The regulations state that when these systems serve multiple domestic properties, the RHI payments will be made on the basis of the estimated heat demand of each property as opposed to the applicant having to comply with the metering requirements set out for Non-Domestic RHI payments. This should increase the appeal of shared ground loop systems.

As a response to criticisms of participants taking advantage of the rules, the regulations also restrict the 'heat uses' that are eligible under the scheme, for example, it will no longer cover heating for swimming pools, drying wood-fuels or heat used in the processing of waste, unless specific circumstances apply.

New rules, new interest?

It is clear that these new amendments are seeking to address some of the criticisms that have been aimed at the scheme over the years, especially in relation to the low uptake of the scheme. By introducing concepts such as assignment of rights, tariff guarantees and clarity on shared loop systems, Ofgem is seeking to remove some of the barriers to third party investment. It remains to be seen if the market responds, but landlords should consider the potential for RHI-financed installations as part of their wider asset management plan and as part of any programme that seeks to reduce fuel poverty.

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Meanwhile use

It is tempting to see vacant land and buildings as having long-term value for development purposes, but as being of little value until such development takes place. However, temporary or "meanwhile" uses also offer a range of the opportunities to unlock potential in such land and buildings in the short-term.

The value of meanwhile uses of property is well established in the commercial sector, borne out of a need for maximum value to be extracted from development sites without a permanent use in an increasingly squeezed sector. Temporary uses of vacant property present opportunities not only for financial benefit, but also in terms of fostering innovation, community engagement and place-making. They can help to breathe life into abandoned sites and are viewed by many within the real estate industry as a key antidote to the epidemic of vacant buildings across the country.

Meanwhile uses have proved especially popular in an urban context. Examples include the Olympic Park (where interim uses of up to ten years have been implemented as a precursor to the planned residential development of the site) and Boxpark originally in Shoreditch now in Croydon, with a Wembley location due to be unveiled later in 2018.

They are far from the only ones, though, with numerous examples emerging of vacant properties being temporarily repurposed for use as bars, cafes, event spaces and even wedding venues.

The advantage of the meanwhile use to the occupier is particularly relevant to "pop ups" and other small businesses, who may wish to secure a premises for their developing enterprises without being tied to a burdensome institutional lease. For landlords with a longer-term view, the promotion of meanwhile uses can also be seen as a kind of "incubator" for burgeoning businesses who could then become ready-made permanent tenants for the very same landlords in the future. It is also the transient nature of these uses that is the key to their appeal to the consumers who use them – the fact that the venues which inhabit these spaces will only be around for a short time creates a buzz and excitement fuelled by an eagerness to be part of something that may soon be gone.

Such uses, however, are not without risk. In particular, when entering into any agreement for the temporary use, property owners should give careful thought to when they may require the property back to enable the proposed development or long term use to be implemented. With this in mind, there a number of best practice points to avoid being left in the position where they are prevented from regaining possession of their property at the required time.

When granting a lease or other occupational arrangement to facilitate meanwhile use, property owners would be well advised to ensure that the arrangement is carefully drafted, to avoid any risk of the occupier claiming any right to remain at the end of the initial period of occupation. To ensure flexibility, property owners ought to consider:

- granting leases or licences with a term of less than six months and which contain no option to renew, as such arrangements do not attract security of tenure;
- ensuring that all leases and licences granted for a term in excess of six months are correctly contracted-out of the security of tenure provisions contained in the Landlord and Tenant Act 1954;
- incorporating "lift and shift" provisions, affording the landlord a contractual right to relocate any temporary occupiers to an alternative part of the building or site, should the landlord require early possession of the initial premises granted to the occupier; and
- including a rolling landlord-only break option exercisable upon a minimal notice period.

As well as ensuring that any temporary use arrangements are flexible enough to enable possession to be regained without difficulty, there are also operational considerations for landlords while the meanwhile use is ongoing including:

- Alienation – to maintain control when granting short term arrangements, it may be advisable to include an absolute prohibition against any assignment, underletting, sharing and other dealings. This creates certainty, by enabling the landlord to keep tabs on who is in occupation, and prevents the administrative burden which would otherwise arise in arranging for the transfer of an agreement which may only last for a few months in any event.
- Rent – where a lease or licence is to be granted for a short, fixed term of a few weeks or months, the landlord should consider requesting payment of the rent / licence fee and other costs payable by the occupier (such as any insurance costs or contribution towards utilities) to be paid up front, in a single lump sum, rather than at intervals throughout the period of occupation.
- Reinstatement – landlords will not want their land or buildings to be returned to them in a state of disrepair when the arrangement comes to an end. Alterations by the occupier should be tightly restricted and yield up clauses should oblige the occupier to remove and reinstate any temporary structures, with step in rights for the landlord to carry out the reinstatement itself in the event of default, and to recover the costs from the occupier.

It is clear that meanwhile uses offer a unique means of unlocking temporary value in land and buildings, and there is a willingness on the part of start ups and other entrepreneurs to reap the rewards of trading from unconventional spaces. Property owners have, perhaps, been slower to embrace the shift to more transitional arrangements and may be missing an opportunity to both extract financial value from and inject fresh life into vacant spaces until more permanent redevelopment can take place.

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Market Value – Social Housing

Market Value – Social Housing (MV-SH) is being considered as a third valuation basis for the social housing sector. We explore the reasons behind these proposals, the underlying assumptions and how Registered Providers (RPs) may benefit, particularly with regard to funding arrangements.

Why is this new valuation basis being considered?

Key valuers in the sector (JLL and Savills) say that since RPs no longer have to seek the consent of the Regulator to dispose of social housing assets, there may be a premium being paid on some RP to RP portfolio sales which cannot be appropriately reflected in existing valuations. This premium may be due to opportunities for void units in certain circumstances to be sold to non-RPs.

Due to increased RP portfolio sales, JLL and Savills are engaging with key stakeholders to support this new valuation being included in the Royal Institute of Chartered Surveyors (RICS) "Red Book". If adopted, they believe this could enable increased funding into the sector.

Existing valuations

Most housing stock is valued at Existing Use Social Housing (EUV-SH) or Market Value Subject to Tenancies (MV-ST). EUV-SH has been the sector-specific valuation basis for nearly 30 years and was created for transfer sales from local authorities. Valuers believe that EUV-SH is not flexible enough to take account of the increasingly diverse and complex trading, asset management and funding arrangements which we see today.

Initial discussions around amending the EUV-SH definition to take account of these market trends met resistance due to it being such a long-established and recognised valuation basis. This resulted in the new MV-SH valuation basis being proposed instead.

As part of the proposals, EUV-SH and MV-ST definitions will be left largely unchanged. Some slight updating amendments are proposed to the EUV-SH definition to refer to the new regulatory regime but there will still be an assumption that the relevant units will be let by and sold to a body delivering social housing in accordance with its existing use, so the end result would be no change to the spirit or ethos of EUV-SH.

What is MV-SH and when can it be used?

The definition proposed contains similar assumptions to EUV-SH but with the key difference that it reflects the current regulatory landscape and does not impose an additional assumption that the units can only be used for their existing use, provided that regulation is fully complied with. This would enable valuers to factor in the possibility of void sales outside of the sector.

The new valuation proposal will be offered as a choice to the sector once it has been approved by RICS and included within the Red Book. There is currently no clear date as to when this may happen as the proposal is still in a consultation phase.

Potentially it could be used for accounting, asset management, portfolio sales and acquisitions and secured lending.

However there are factors to consider before deciding whether the use of MV-SH is appropriate in any particular instance, including in particular:

- other regulatory and title restrictions;
- the terms of relevant funding agreements

Will MV-SH find favour with funders?

We anticipate that there will be interest in using this basis in the sector to enhance values where possible. However, its use for the purposes of secured lending will depend on the terms of the relevant funding agreement.

Most funding agreements currently provide that, unless otherwise agreed, social housing stock will be valued on the basis of either EUV-SH or (where appropriate) MV-ST. So for any existing agreements, it is unlikely that this new basis could be used, unless specifically agreed on a case by case basis with the funders concerned. It would of course, be possible to vary the existing terms with the funders' consent but whether or not a funder would agree and on what terms is not clear. For example, a funder could agree to this basis being used in future but on condition that the applicable asset cover ratio is reviewed.

What about new funding agreements?

Will funders agree that this new basis may be used on new transactions? This will depend in part on whether transaction data continues to evidence that stock portfolios are changing hands at a premium to EUV-SH valuations.

We expect that different funders may take different positions, depending on their credit policies and appetite for new lending. For example, "traditional" lenders with an existing portfolio of lending to RPs may behave more conservatively than a new market entrant looking to build up its loan book. This will be an important point to discuss with funders at heads of terms stage on any new deal.

For the moment, dependent on geography, property specifics and whether it is permitted, MV-ST is still likely to offer the highest possible valuation on any secured lending transaction.

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Our Think Tank sessions at the CIH Annual Housing Conference

Making the case for equity investment in affordable housing

Tuesday 26 June 11:30-12:30pm

The past year has seen an extraordinary growth in the amount of new equity funding coming into the affordable housing sector, ranging from the rise of the For Profit RPs and private equity funds through to the new social housing REITs. This session will explore:

- The drivers behind the flow of new capital into the sector
- What investors are looking to achieve
- What it means for traditional RPs and local authorities

Speakers include: Andrew Screen (Managing Director, Resi Capital Management), Simon Century (Head of Affordable Housing, Legal & General Capital), Jon Bull-Diamond (Head of Partnerships, Homes England).

Diversification – just how far have we come?

Wednesday 27 June 9:30-10:30am

With many drivers pushing change over recent years, the sector has undoubtedly become a much more diverse place. Some change has been incremental and some faster paced. There are now more players in the market, a wider range of options for delivery, and a change in attitude amongst many. Just how far have we come? This session will explore:

- Some of the different ways in which those that operate in the sector now approach the delivery of homes, funding and services
- The attitudes of organisations to what they do and what drives them
- The Regulator's view of a changing world

Speakers include: Jonathan Walters (Deputy Director of Strategy and Performance, Regulator of Social Housing), Mervyn Jones (Director, Housing Consultancy, Savills), (Paul Munday, Chief Executive, Funding Affordable Homes).

Local authorities and housing associations unlocking access to NHS Land

Wednesday 27 June 3:30-4:30pm

The UK government has set a national target for the NHS to provide land for 26,000 residential units by April 2020. This policy sits alongside other key NHS policy drivers for efficiency and service transformation arising from the Five Year Forward View and the more recent Carter and Naylor reports. It is clear that the NHS, local authorities, housing associations and the private sector will need to work together to achieve it. But what are the challenges not only to achieving these ambitious targets but also to ensure a better health and social care service is created as a result? This session will examine the issues from the NHS and the housing sides of the debate, considering:

- The NHS perspective: policy drivers and organisational structures
- Successful ventures between the NHS and housing, social services
- Housing's role in NHS targets and how to engage it

Speakers include: Ian Burden (Property Transaction Lead, Capital and Cash, NHS Improvement), Kelly Craig (Senior Policy Manager, NHS Surplus Land Programme, Capital and Land Strategy), Maxine Espley (Executive Director of Health, Social Care and Support, Accord).

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