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QUARTERLY HOUSING UPDATE

Summer 2020

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Foreword

Welcome to the summer edition of Quarterly Housing Update. It goes without saying that the past quarter has been a quarter that none of us have ever known the like of before, but what has struck me above everything has been the resilience of the affordable housing industry and the countless stories of how social landlords (both housing associations and local authorities) have "gone the extra mile" and have been far, far more than "just a landlord".

Readers will have seen from our website that we have dedicated guidance on the myriad of issues that Covid-19 has thrown up and I have therefore taken a conscious decision in this edition to focus on matters other than Covid-19 (although, perhaps inevitably, it has proved impossible not to mention it at all!).

I do think that what the breadth of articles in this edition does demonstrate, however, is that as society "returns to (a new?) normal" there are a number of key policy and operational challenges facing the sector in the not too distant future. Hopefully this edition will serve as a guide to what is coming next.

I hope that you all get a degree of rest over the summer months.

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Building a safer future: recent developments highlight direction of travel

The Ministry of Housing, Communities and Local Government has published its response to its consultation on Dame Judith Hackitt's, 'Building a Safer Future' report and recommendations. Last summer's consultation sought feedback on Government proposals for law reform of the building and fire safety regimes. The response seeks to clarify areas of ambiguity raised in the consultation and provides further detail about the reform agenda.

All 53 recommendations of the Hackitt Review will be adopted in a new Building Safety Bill to be tabled this year, although exact timetables have yet to be confirmed.

> *"There will also be a phased transition period for existing buildings to be brought into line with the new in-occupation obligations."*

We have set out below some key points from the response that housing associations will need to get to grips with over the next coming months:

In-scope buildings

The Government has confirmed that the new regime will cover all multi-occupied residential buildings of more than six storeys or 18 metres, whichever measurement is reached first. The scope will be extended in due course to other types of tenanted buildings, based on "emerging risk evidence". While these aren't named, we know from last year's consultation that the Government is eyeing other non-residential buildings where people sleep, including schools, hospitals and prisons.

Regulator

As expected, the new national Building Safety Regulator will sit within the Health & Safety Executive (currently designated as the shadow Regulator), and report to the Secretary of State for Housing. A new Chief Inspector of Buildings will be appointed, and the Regulator will be supported by Fire and Rescue services, local authority building control, the HSE, a register of Approved Inspectors and external consultants. There is still a question mark over who will staff the new Regulator and whether the industry has sufficient current expertise to ensure there will be sufficient people to fill the new roles and do the work on the industry side of things too.

Dutyholders

The new regime will adopt the CDM-style list of Dutyholder roles during the construction phase. Further detail has been provided about some Dutyholder roles; "Designers" includes anyone who instructs a person under their control to prepare or modify a design, whereas "Contractors" includes anyone who manages or directly appoints construction workers. The Government will encourage all Dutyholders to become signatories to its new Building Safety Charter.

Gateways

Gateway 1 – The scope of Gateway 1 has been extended from its original coverage of buildings of 30 metres or more to include all buildings over 18 metres/6 storeys in height. Local authorities reviewing Gateway 1 applications will need to consult with Fire & Rescue Services on a statutory basis. The Government has promised an additional £20 million for Fire & Rescue Services to enable them to increase fire inspection and enforcement capability.

Gateway 2 – Clients will need to ensure that the Principal Contractor and the Principal Designer demonstrate the necessary competence to discharge their duties effectively during the design and construction of in-scope buildings. Gateway 2 applications will be assessed "within a reasonable timeframe" but the Response does not provide specific timescales. Helpfully, the Regulator will be able to permit staged approvals for complex projects, provided that the safety case can be demonstrated.

Gateway 3 – To progress to Gateway 3, the Client, Principal Designer and Principal Contractor will be required to co-sign a declaration confirming that the building complies with building regulations to the best of their knowledge. The Regulator will permit partial occupation of in-scope buildings before they are completed, subject to suitable fire management and safety strategies being in place. Failure to pass a Gateway is likely to result in a "hard-stop" for the project and will therefore be of critical significance to clients and contractors alike.

Safety case

The Response sets out further detail on the requirements for the Safety Case, which must be maintained throughout the design and construction phase and the occupation of in-scope buildings.

Dutyholders and Accountable Persons must include written explanations and justifications of the approach being taken to risk management, and reference supporting evidence. As with fire risk assessments under the Fire Safety Order, Accountable Persons will be required to identify potential hazards and at-risk persons, evaluate the risks, decide on necessary controls and mitigation measures, and record, evaluate and monitor the risks on an ongoing basis.

Building Safety Manager

The BSM is employed by the Accountable Person and has day-to-day responsibility for safety at and around the HRRB. It can be a legal entity or a natural person, and the administrative cost for duties during occupation must be "proportional, transparent and fall to those who benefit from the reforms".

Golden thread

The "golden thread" of building information must be maintained digitally and made accessible to key stakeholders. While the Government has not yet mandated Building Information Modelling (BIM) for the new regime, most respondents to the Government's consultation agreed that BIM should be used, and in some cases expanded, to meet the new requirements.

Procurement

The response cites the Government Construction Strategy and the Trial Projects Delivery Group who report successful use of collaborative and partnered approaches to construction. Public sector bodies are encouraged to use the Crown Commercial Service's Construction Works and Associated Services Framework Agreement to instruct works to its in-scope buildings, in advance of the new legislation. Disappointingly, no formal recommendations have been made in respect of procurement, though further guidance is expected from the Government's Procurement Working Group (of which Trowers & Hamlins is a member).

Further details and guidance will have to wait until the Government tables the new Bill.

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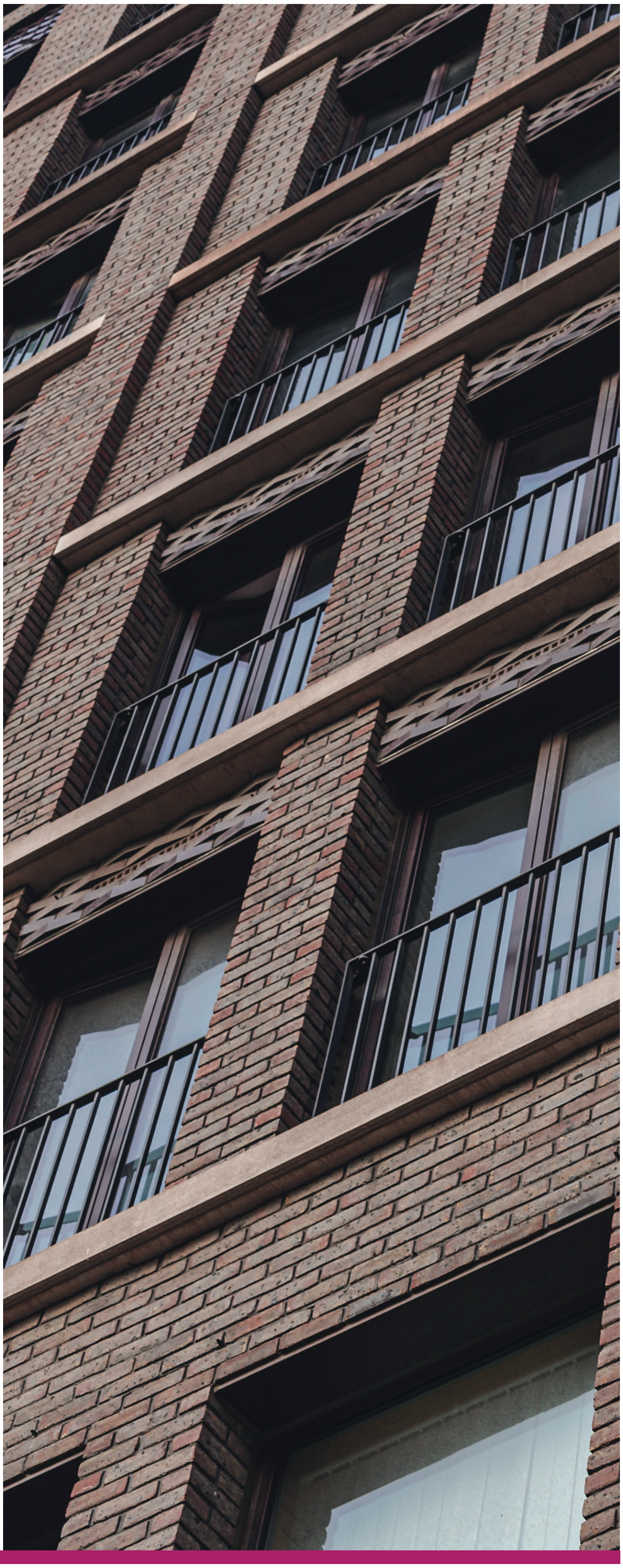

LIBOR: changing times

There is no escaping the topic of LIBOR since the Financial Conduct Authority (FCA) first announced its intention to phase out LIBOR as the key interest-rate benchmark for sterling in 2017.

Housing association treasury teams (in fact, all corporates) must start to consider their funding portfolios in light of the proposals. To assist, we have tried to summarise the vast amount of commentary out there and make some recommendations as to the next steps.

Alternative benchmark

The FCA intends to cease using its powers to compel banks to submit contributions to support the publication of LIBOR at the end of 2021.

> *“Its intended replacement, SONIA, is an overnight interest rate benchmark which is an average of interest rates banks pay to borrow sterling overnight from each other.”*

The Bank of England publishes the rate daily based on actual transactions.

To use SONIA to calculate interest, current practice is to use the overnight rate compounded in arrears (Compounded SONIA) over an “observation period” that starts before the interest period (of say, three months) and finishes before the end of the interest period (with, for example, a five day lag for ease of calculation).

Many lenders would prefer that a “Term SONIA” rate be developed. This would be a forward-looking term reference rate based on overnight SONIA but far more similar to LIBOR than Compounded SONIA (LIBOR also being a forward-looking term reference rate). Fundamentally, a Term SONIA seems a more straightforward replacement. There are no Term SONIA rates available at present, nor has the market been able to develop plans to do so. FCA guidance cautions that the market should not depend on this.

Impact

Borrowers, including housing associations, need to be assessing the exposure to their organisation of LIBOR withdrawal and, where possible, seeking to mitigate risk. Anecdotally, we hear most borrowers seeing this as a lender side issue – as well they might given the control that banks have over interest rates and loan pricing. However, the FCA's stated view is that borrowers should be engaging with their lenders on the issue. Its position is that market participants should be able to run their business without LIBOR from the end of 2021.

New funding

In late 2019, the FCA announced that no new LIBOR cash-based financial products could be offered beyond 30 September 2020. On 29 April 2020, this deadline was extended to the end of the first quarter of 2021 as a result of Covid-19.

When entering into new loans at the very least borrowers should understand their funder's view on LIBOR transition, and ideally the document should incorporate fallback drafting allowing for a transition to a SONIA-based rate in the future. The majority of new loan agreements still only reference LIBOR, though Riverside announced the closing of the sector's first SONIA loan in April. Other borrowers are looking to follow suit, but many lenders are not yet ready to offer SONIA-based lending products.

> *“The FCA's expectation is that by the end of Q3 2020, lenders should be in a position to offer non-LIBOR linked products to their customers so we would expect more SONIA-based borrowing through the second half of the year.”*

Existing documents

The FCA's view is that centrally-set legislation or “grandfathering” exemptions which allow for LIBOR's continuation are unlikely.

The Loan Market Association's “exposure draft” documents use existing Compounded SONIA calculation methodology. Existing loan documents will require very significant amendments if a switch to this backwards-looking formula is mandated.

We are aware that many lenders have provided notes setting out their current policy in relation to LIBOR transition. In almost all cases, these notes have no legal status and the terms of the loan contract will bind the parties. Many newer facility agreements have clauses dealing with "replacement of the screen rate" relating to the unavailability of LIBOR and in most cases, these are drafted as an "agreement to agree". In such a case as a matter of contract law, these are not enforceable (for either side).

Ultimately, this could mean that there are unpalatable consequences (including ultimately the frustration of a loan contract for uncertainty) in the event that the parties cannot reach agreement on how interest is to be calculated in the event LIBOR is not available. In a worse case scenario, this could result in the effective loss of funding available under any affected agreement. Older agreements may even be silent on the subject.

Even where interest rate fallback provisions exist, these may not be a solution, if for example the fallback drafting was only ever intended for use in a situation where LIBOR was temporarily (rather than permanently) unavailable. Another potential risk is if LIBOR continued to exist, but in a radically different form. If only a few panel banks provide submissions (the FCA fully expects numbers to dwindle from the end of 2021), loan pricing could be adversely affected.

The FCA are recommending that from Q4 2020 onwards lenders should include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion to SONIA ahead of end-2021.

> *"We recommend that associations engage their lenders on this subject as soon as possible to achieve a smooth transition."*

In addition, borrowers and lenders will need to work together to agree a process to amend legacy agreements, which should be standardised as far as possible for speed and cost reasons.

Associations should also be reviewing their loan portfolio now to confirm any existing interest rate fallbacks or clauses governing replacement methodology so that their position on their current book is clear and readily available in the event that advice is required.

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Renegotiating LSVT sharing agreements

We are seeing a steady stream of stock transfer housing associations re-negotiate their historic sharing agreements that originally formed part of their transfer agreement. For both housing associations and local authorities alike, these sharing agreements can be re-imagined in ways that can bring tangible benefits to both parties and can release resources for additional housing provision.

Of course, many of the sharing agreements (generally comprising a Right to Buy sharing agreement, a development (or disposal) clawback agreement and a VAT sharing agreement) may no longer be in force – for most associations, these sharing agreements were time limited and so in many cases may well have either ceased to have effect or might be coming to an end in the foreseeable future (in which case there may be little merit in seeking to re-negotiate terms).

For those that remain, it must be remembered that the sharing agreements create legally binding obligations so they can only be changed with both parties agreement.

> *“It is therefore important that in formulating a re-negotiation of a sharing agreement that it creates a “win-win” for both parties.”*

This is all the more important for re-negotiation proposals put forward by a housing association, bearing in mind that in most cases the local authority may have little or no incentive (nor any obligation) to enter into a dialogue about re-negotiating terms.

What are the options?

Based on our successful experience of renegotiating these arrangements on behalf of both housing associations and local authorities, we would suggest one or more of the following ideas can create tangible benefits for both parties.

One off payment – For some local authorities, the local authority might be willing to receive a one off cash payment in lieu of future potential receipts under one or all agreements; this option can work well where the local authority is facing budget constraints and where the housing association is looking to achieve complete freedom in relation to its asset management strategy.

Longer term agreed purpose – In other cases, it may simply be a case that the local authority can be persuaded to waive its entitlement to future receipts under one or more agreements in return for the housing association agreeing to use the receipts for an agreed purpose (for example we have worked with housing associations that have agreed to commit receipts to fund new affordable housing in the local authority's area, for community purposes or for the provision or remodelling of temporary accommodation (the latter being a potentially attractive proposition for a local authority given the increased demand for (and cost of) temporary accommodation.

This does, of course, require a willingness for creativity and long term partnership working on both parties – but given the ever increasing cost of temporary accommodation we suspect many local authorities would be willing to explore proposals where (perhaps uncertain) income was sacrificed in order to deliver long term revenue savings.

> *“It is also worth remembering that new affordable housing supply is an ever increasing political priority and local members are often keen to find new means of increasing affordable housing.”*

Joint venture housing company – As a variant on the previous model, parties could look to establish a joint venture housing company and for the local authority to funnel its share of receipts into that housing company; whilst this may not necessarily be the optimum outcome for the housing association it would meet the objectives of delivering more housing (of whatever tenure) in its locality and the housing association could also benefit from providing development services to the joint venture. The option may also prove attractive to the local authority by providing an ongoing revenue stream from the joint venture.

Re-negotiation of an agreement

If negotiations proceed to a re-negotiation of a sharing agreement, then it is probable that the housing association will need to seek lender consent to the amendments; either because existing loan agreements mandate that amendments only be made to the agreements with lender consent or else because the revised terms impact on the housing association's business plan (which may be the subject of separate consent requirements).

Whist we suspect it unlikely that a lender would resist an amendment that would favour the housing association it is nevertheless important that the consent is formally documented.

Opening up historic agreements for renegotiation won't be for everyone, but as we have seen, for many housing associations these sharing agreements offer access to resources that can be better focused on the housing needs of their area.

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Charging to a security trust deed: specific or numerical apportionment?

Housing associations are increasingly active in the capital markets as a means of raising finance for their development programmes. Debt issuance can have significant implications for effectively structuring property security.

When housing associations issue debt on the capital markets, properties are charged to a security trust and allocated to the beneficiaries.

Specific apportionment (SA) allocates specific properties for the benefit of specified beneficiaries. Properties can be charged to the security trust on an unallocated basis and then allocated at the time of issue. This is the traditional mechanism for conventional bond issues.

Numerical apportionment (NA) allocates a percentage of the total pool to each beneficiary; there is no specific list of properties held by any particular beneficiary. NA is gaining traction for capital market transactions, particularly for Medium Term Note Programmes (MTNs).

A growing trend?

In 2019, LiveWest and Clarion Housing Group issued MTNs underpinned by numerically apportioned security. NA facilitates quick access to markets and is particularly aligned with MTNs. The speed of issuance is an advantage for pricing and flexible financing, justifying the expense of setting up and managing a new trust.

Due diligence obstacles are minimised if a new security trust is established with a ring-fenced numerically apportioned pool with minimal fluctuations, save for sales. If the time/costs allowance for a due diligence process and the need to reissue a prospectus on each issue can be dispensed with, this is attractive. If the pool is supplemented regularly, funder consents may not be required for substitution or withdrawal where this does not impact on the number and value of units. But compliance with reporting requirements is essential.

Due diligence

Once security is numerically apportioned, substitution between facilities is costly and if consents are required for substitution or release, they may be required from all beneficiaries. For early numerical pool issues, due diligence may be minimal but certifications do become outdated. Security is also required to supplement the pool to cover sales off; additional due diligence may mean delays. Adding new security to an existing numerical pool may require due diligence for both the new security and existing properties may require assessment by all participants.

Valuation reports may be required for all properties in the pool as properties are not held specifically. For SA, valuation is required only in respect of specifically apportioned properties. Bonds and MTN programmes are subject to regular valuation requirements, which is partly what makes it possible to issue quickly. Both NA and SA can achieve this, provided due diligence and valuation criteria are met.

Solutions

Balancing the advantages of NA against the costs of running two security trusts and the property security and valuation challenges is crucial. A viable solution may to restructure a security trust deed with SA as the principal mechanism but allowing flexibility for NA. During market uncertainty, being able to benefit from both options is an advantage.

As always, having clean property security ready to charge at maximum value is critical to success.

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Local authority owned registered providers

Over the last year we have seen an increasing number of local authorities begin the process of establishing their own registered providers of social housing (RPs). These have been either direct subsidiaries of the local authority, or subsidiaries of established local authority housing companies. What has prompted local authorities to consider delivering social housing in this way?

We have seen two primary motivations. The first is access to Homes England or Greater London Authority grant. While local authorities can access grant in their own right, Housing Revenue Account (HRA) constraints (either existing, or the requirement to re-open one) can make it difficult for local authorities to deliver grant-funded schemes which are financially viable in their own name.

We typically see local authority owned RPs funded through a combination of grant and on-lent Public Works Loan Board monies (the recent interest rate rise does not yet seem to have had any significant impact on project viability). Grant funded homes let by local authority owned RPs can be subject to the Right to Acquire (where the other conditions in the Housing and Regeneration Act 2008 are met), but tenants would not be eligible for the Right to Buy. The Government has, of course, considered various ways of extending a version of the Right to Buy to RP tenants – most recently through the concept of a 'shared ownership' Right to Buy – but none have yet been implemented.

The second motivation is to widen the approach taken by local authorities to the delivery of housing. Affordable housing mandated by a s106 planning obligation must be let by an RP. In some areas, there is a perception that 'traditional' RPs are not coming forward to take these homes, stymying housing delivery generally. In such cases, local authorities see their own RPs as a way of making sure these homes are let and in setting up their RP are facilitating continued affordable housing supply. In other cases, councils have been developing their own mixed tenure schemes (often through a local housing company subsidiary). Having their own RP to take the planning mandated affordable units allows the parent authority to retain a degree of (indirect) ownership and control over the whole scheme. While this has obvious financial benefits, local authorities have also been keen to use such schemes to improve both design and on-going management standards for new build developments in their areas.

As local authorities are all too aware, there are no single initiatives which offer a complete solution to the affordable housing supply problem.

> *"Local authority owned RPs are one of an increasing number of creative ways in which councils are seeking to address the demand for affordable housing, and one which plays its part alongside traditional council housing and local housing company provision."*

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Boosting housing supply – is income-strip a potential solution?

The supply of new homes (of all tenures) in the UK has, for sometime, materially failed to keep up with or even partially meet demand. This failure has contributed to a significant distortion of both market and affordable housing.

This problem is no longer confined to just the south-east, London or a select number of other cities. The proportion of household income required to buy or rent decent market housing is challenging for an increasing number in the UK.

Covid-19 has the potential to add to historic housing supply distortion through a potential combination of higher unemployment, possible wage reductions together with battered public and market finances which have already been deployed to keep the economy on life support.

> *“The question is what tools might be available to boost the numbers of both new market and affordable homes once the health crisis has subsided.”*

Private sector house builders, traditional housing associations and local authorities will no doubt be eager to restart activity. The pension/investment funds are also likely to be interested in investing in both affordable and market rental housing.

Trowers has advised on a number of income-strip arrangements where the public sector has secured investment for town centre and economic assets for a local area. There has been a diverse range of asset classes; from office, research, leisure and of relevance build to rent market homes. Could these be adapted for affordable housing?

Income-strip lease arrangements typically involve a fund financing the construction of a new property asset which is leased to the public sector (or other bodies with strong credit ratings). The lessee pays a rent which is indexed linked (usually with minimum and maximum increase or a cap and collar applied). The lessee also might be expected to have a right to acquire the asset's freehold for a nominal sum at the end of the lease. The public sector could contribute towards the upfront capital cost of the new asset which might reduce the rent it pays and/or reduce the term of the lease.

Could rental housing be delivered through an income-strip lease arrangement as a post Covid-19 option? Potentially it could, especially if the state's capacity to borrow for housing investment is reduced as a consequence of the UK government committing billions to support the economy during the Covid-19 crisis. It would also require a more flexible approach when subsidy is provided for at least some affordable homes.

Income-strip leases are attractive to funds as they provide them with safe low returns which are broadly indexed linked (a safe pension investment). This attraction does create a risk for the lessee as RPI/CPI and rent inflation can and does diverge; with this exacerbated for affordable tenures.

> *“If an affordable housing provider/local authority entered into an income-strip arrangement with a fund, they could contribute to some of the upfront capital costs of the new homes with the intention of paying a lower annual rent to the pension/life fund.”*

In practice, the housing provider may have a need to seek public subsidy if there was a material divergence between the affordable rents they collected against the indexed annual rent they had to pay the fund. Providers and local authorities might also be expected to have scope to manage some divergence from their existing resources.

Income-strip arrangements would, at best, only play a relatively small part in affordable housing delivery. However, it potentially could be an important part, especially if future UK governments are, following Covid-19, constrained in what they can borrow and spend.

The tenant's right to buy/acquire their affordable home is only likely to be acceptable to the funds if some form of guarantee is given that this would not affect the housing providers or local authority's ability to repay the fund.

Housing provider/local authority subsidiaries would have fewer challenges for market or other non-affordable rental tenures. Structures have been successfully adopted which address enfranchisement and other previous fund concerns about residential income-strip housing.

Unfortunately, the Covid-19 health emergency is likely to disrupt society for sometime. We cannot assume that 'business as usual' will automatically resume without changes.

> *"This means we all might need to think about possible solutions and innovations to continue the delivery of decent homes."*

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Insolvencies on construction projects – part 2

The construction sector has reportedly had the highest insolvency rates of any UK sector in the past 12 months due to Brexit.

We previously examined how employers might seek to limit the effects of insolvency at the pre-contract stage here. But in the event a contractor does become insolvent during a project, there are a number of legal and practice issues that need to be considered.

There are many reasons why a contractor may become insolvent. The main triggers are:

- cash flow issues caused by late payments, bad debts and most construction contracts providing for stage payments in arrears;
- low margins in the sector meaning that profit can be obliterated by unexpected delays or increased costs in the works which the contractor may take the risk of; and
- the collapse of a main contractor triggering a domino effect on subcontractors, as seen with Carillion's insolvency.

All of these factors have been brought into sharp focus with the impact of Covid-19 on projects. It seems inevitable that, despite the available government support for businesses, we will see a sharp increase in the rate of insolvencies in the sector. Indeed the UK government has announced proposals to amend certain aspects of insolvency law in response to Covid-19, which we have reported on here.

Monitor early warning signs

It is important that employers monitor the early warning signs of a distressed contractor such as:

- poor trading results
- pricing which is "too good"
- unpaid sub-contractors or suppliers
- a contractor seeking to renegotiate payment terms
- the late filing of Companies House accounts
- an unexplained slowdown in progress or suspension of works
- unexpected removal of personnel, equipment or materials from site
- high staff turnover negative press reports and industry rumours

If the contractor becomes insolvent

The first step should be to review the contract. How is "insolvency" defined and is there an express right to terminate for insolvency? Absent express wording, an insolvency event of itself would not usually constitute a breach of contract (although it may lead to other breaches). You must strictly follow any termination procedure in the contract and get any required notices right. If you terminate too early, or when you wrongly thought you had the right to do so, you can risk a 'repudiatory' breach of contract, which the contractor can accept and claim damages.

There have been cases where, due to changes in the insolvency legislation, the form of insolvency process used was not covered by the relevant clause and so the employer's termination was deemed wrongful. This is important to bear in mind given the new insolvency measures the government is looking to bring in.

If the right to terminate for insolvency has not yet arisen you can consider your options for terminating for performance issues or at will but advice should be obtained.

Employers will also need to consider the following practical issues:

- getting access to and securing the site to prevent unpaid creditors from taking goods or materials instead of payment;
- undertaking an audit of the materials on site and whether they have been paid for and title has passed;
- Whether or not to complete works. If completing the works, consideration should be given to procuring a replacement contractor or possibly entering into direct contracts with the sub-contractors and the impact of these choices on the delivery of the project and recovering costs in the insolvency;
- contract administration issues and serving the correct termination notices and payment/ pay less notices;
- obtaining design drawings and other build documentation;
- being proactive in having discussions with the insolvency practitioner (they are usually not as scary as they may seem!); and
- beware of direct payments to subcontractors/ suppliers for works that have already been done or materials that have already been supplied. The employer's contract is with the contractor and so its obligation to pay for them is to the contractor.

Post completion insolvency and defects

If you discover defects post completion and the contractor has become insolvent the following options can be considered:

- Issuing proceedings against the insolvent contractor but this is unlikely to be attractive. If the defects are design-related and the contractor's professional indemnity insurance is still be available (i.e. the premium has been paid) you may be able to bring proceedings against the insurer directly under the Third Party (Rights Against Insurers) Act 2010.
- Whether the defect would be covered under any latent defect policies such as NHBC or Zurich.
- Bringing a claim under any performance bond or parent company guarantee (if they have not expired).
- Bringing a claim against sub-contractors or consultants under collateral warranties or (if they are not available) under the Defective Premises Act 1972 (the DPA).

Given the current issues contractors are facing due to Covid-19, employers should monitor warning signs and be proactive in discussing these with the contractor. If a contractor becomes insolvent on your project, the most important thing is to not panic! The contract should be carefully reviewed to ascertain your rights and notice obligations and these should be strictly followed.

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Just about managing? Key considerations in affordable housing management

With the increase in for profit registered providers and other new entrants into the affordable housing market, there is growing demand for property management services offered by organisations with a successful track record. Demand for management services offers existing housing associations the chance to diversify sources of income.

Whilst a property management agreement may seem straightforward in principle, providing services in return for a fee, in practice there are key stakeholders views which need to be considered. This article focuses on management of tenanted properties and considers what the priorities of the other interested parties might be.

Residents

Resident experience of property management is a key priority. Reputation is important for both landlords and managing agents, particularly if the agent is a housing association.

> *“Trust in the ability of an agent to perform, and incentives to perform, will be high up the agenda of any landlord.”*

In order to incentivise performance, key performance indicators (KPIs) or other performance management provisions may be included.

Good performance management indicators will be objectively measurable, subject to regular reporting requirements, and provide for an appropriate remedy mechanism. The parties may consider agreeing an “action plan” for improving performance in such a scenario, or even the possibility of part-suspension of services – this may be more beneficial than the blunt instrument of a full termination right. The right to terminate may be due to a single ‘material’ default, or cumulative ‘minor’ defaults which, when taken together, can have a serious impact on reputation and resident experience.

Delegating all practical obligations is not only beneficial to a landlord, but also means residents have a “one stop shop” for raising queries or concerns.

Exit procedures can be particularly important to the resident experience. However a management agreement ends, it is crucial to have an orderly handover to a new provider. This will require co-operation on handover of documents, notifying tenants, and financial reconciliation. Depending on the arrangement, more complex exit matters may arise such as transfer of employees under TUPE, destruction of data and the removal of trademarks.

The parties may agree to a general no fault break right, which may be more appropriate in a long term arrangement, although a landlord may prioritise certainty of provision of services over flexibility. Where a general break right is exercised, the agent may require a compensation payment instead of the income from the remainder of the contract.

Sub-contracting abilities should be considered too, including potential vetting of appointments of third parties. This applies particularly to those who will have tenant contact.

Poor resident experience can have implications for an RP’s relationship with the regulator.

Regulator

Part of the remit of the Regulator of Social Housing is to ensure consumer standards are upheld. They, and therefore landlords, will be concerned with performance management. Inclusion of performance management provisions in arrangements can help achieve that goal. To incentivise performance, a landlord may consider linking any management fee to performance against KPIs.

Poor management performance may result in a downgrade by the Regulator for failing to meet regulatory standards. This may have a knock-on effect on the ability to obtain grant funding or other outside debt.

Lenders

If security has been granted over a property owned by a for-profit provider to obtain funding, the lender may have its own requirements relating to the management of the property.

It may require the ability to exercise its security and make a sale with management arrangements already in place. It may not want to give the agent the right to walk away should ownership of the property change hands. Lenders may also want a right of step-in in certain circumstances. To ensure a contractual nexus, a duty of care may be required from the managing agent for the benefit of the lender.

Third party agreements

The procurement and operation of management services may be governed in part by third party agreements.

These might include compliance with nomination agreements, required by local authorities, which will impact on a managing agent's lettings process. Section 106 agreements may impose other ongoing requirements of a local authority, such as ensuring developments remain car-free.

Where property has been bought or developed with the benefit of grant funding, there may be ongoing management obligations requiring compliance with GLA or Homes England capital funding guides (covering issues such as rent levels, forms of lettings and, in limited cases, standards of repair works).

Administration

The landlord and managing agent will share an interest in keeping administration to a minimum throughout the term of any agreement.

This can have an impact on many areas. Will the management fee be fixed, rather than requiring calculation by reference to KPIs (or other factors)? What will be the extent of the KPIs, and the associated reporting requirements? Who will be responsible for pursuing rent arrears?

It may be necessary for the scope of services to be updated or revised over the term of any agreement. Rather than requiring a formal legal variation to existing arrangements, the parties may include flexibility for the landlord to instruct, or the managing agent to offer, additional services, the need for which may become apparent over time.

The affordable housing market contains key stakeholders which may not be apparent to new entrants, and careful consideration of the impact on all interested parties should be given at the outset of instructions.

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No vicarious liability for deliberate disclosure of personal data

The Supreme Court has found that Morrisons was not vicariously liable for the deliberate and criminal disclosure by an employee of personal data belonging to co-workers in Wm Morrisons Supermarket plc v Various claimants.

> *"This decision will come as a huge relief to employers who will no longer have to ensure that they have insurance cover in place to insure against losses caused by disgruntled employees."*

Mr Skelton was employed by Morrisons as a senior IT internal auditor. He had been disciplined for a separate incident when he was asked to send payroll data from Morrisons to KPMG. He was provided with an encrypted USB stick which contained the information. As well as forwarding the information to KPMG, he also downloaded it onto his work computer.

Just before Morisons' annual financial reports were announced, a file containing the personal details of almost 100,000 Morrisons' employees was posted on a file sharing website by Mr Skelton. Soon afterwards, he was arrested and charged with fraud, an offence under the Computer Misuse Act 1990 and under section 55 of the Data Protection Act 2018. The co-workers whose data had been disclosed made a group civil claim against Morrisons for compensation arguing that Morrisons had both primary liability for its own acts and omissions, and vicarious liability for the actions of Mr Skelton.

The Supreme Court overturned the decisions of both the High Court and the Court of Appeal that Morrisons was vicariously liable for Mr Skelton's actions.

Mr Skelton was authorised by Morrisons to transmit payroll data to Morrisons' auditors. His wrongful disclosure of the data was not so closely connected with that task that it could be properly regarded as made by Mr Skelton while acting in the ordinary course of his employment. The fact that his employment gave him the opportunity to commit the wrongful act was not sufficient to lead to vicarious liability on the part of his employer.

> *"The Court reasoned that an employer will not normally be vicariously liable in situations where the employee was not engaged in furthering his employer's business, but rather was pursuing a personal vendetta."*

Although the case was decided under the previous data protection regime, the GDPR and the Data Protection Act 2018 are based on broadly similar principles, and it will still be possible for vicarious liability action to be brought.

However, following the Supreme Court's decision employers will still be able to avoid vicarious liability by demonstrating that appropriate measures have been implemented in accordance with data protection legislation. There will be no liability where an employee is pursuing "a personal vendetta of his own" or "an act entirely of personal vengeance".

It's worth noting that the GDPR makes compliance more onerous now for data controllers, and if there is a failure to safeguard data and to have proper measures in place to curb the wrongful acts of rogue employees, they will run the risk of huge fines and data subject compensation claims.

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New certificates of compliance

Many directors of companies within the housing sector will be asked, for the first time, to prepare "section 172 statements" confirming their compliance with the statutory "section 172 duties".

Although section 172 of the Companies Act 2006 was one of the most hotly debated aspects of the changes (well maybe only within legal and governance circles) enacted in 2007, it is fair to say that its impact has not lived up to the hype. This could be about to change!

What is section 172?

Section 172 imposes a statutory duty on company directors to act in a manner which promotes the success of the company for the benefit of its members whilst having regard to a number of factors including the long-term consequences of their decisions and the interests of a range of stakeholders (such as employees, customers, suppliers, the community and environment).

The purpose of the section 172 is to encourage company directors to take into consideration the wider impact of their decisions beyond the traditional emphasis on financial performance. How should directors balance the "success" of their company against the often conflicting interests of wider stakeholders? With no external enforcement or reporting obligations, over time this new duty slipped down (and off) boards' agendas.

What has changed?

As a result of new regulations, certain companies are now required to make a statement on how the directors have met their section 172 obligations as part of their annual strategic report for financial years starting on or after 1 January 2019. The statement must also be published online. We are now starting to see the publication of the first section 172 statements and for those across the sector currently preparing annual reports, directors' attention will be focused on their section 172 duties.

Who must publish section 172 statements?

Those companies who are already required to produce a strategic report will be now required to also report on their directors' compliance with section 172. Such companies will meet two of the following three criteria:

- Turnover above £36 million
- Balance sheet assets above £18 million
- More than 250 employees

There are a number of other companies who may not meet those thresholds but who will still fall within the new reporting requirements. These include (for example) public companies (whether listed or not) or any company within a group which contains an entity which has securities (such as bonds) admitted to trading on a regulated market.

A number of housing groups in the sector will be caught be this new reporting requirement, either as a company which meets the criteria itself or because its group contains a PLC or has listed securities.

What should be included in a section 172 statement?

Guidance published by BEIS and FRC suggest that a simple statement of compliance is unlikely to be sufficient to meet the statutory requirement. Section 172 statements should include an appropriate level of detail sufficient to show:

- The issues, factors and stakeholders considered relevant in complying with section 172
- The methods used by the company to engage with stakeholders
- The effect this had on the company's decisions and strategies during the year

How to prepare?

Directors should ensure that the principles of section 172 are reflected in the company's strategy and built into the culture of the company. This can be supported by policies and procedures which ensure wider stakeholder engagement and an express strategy to engage with stakeholders.

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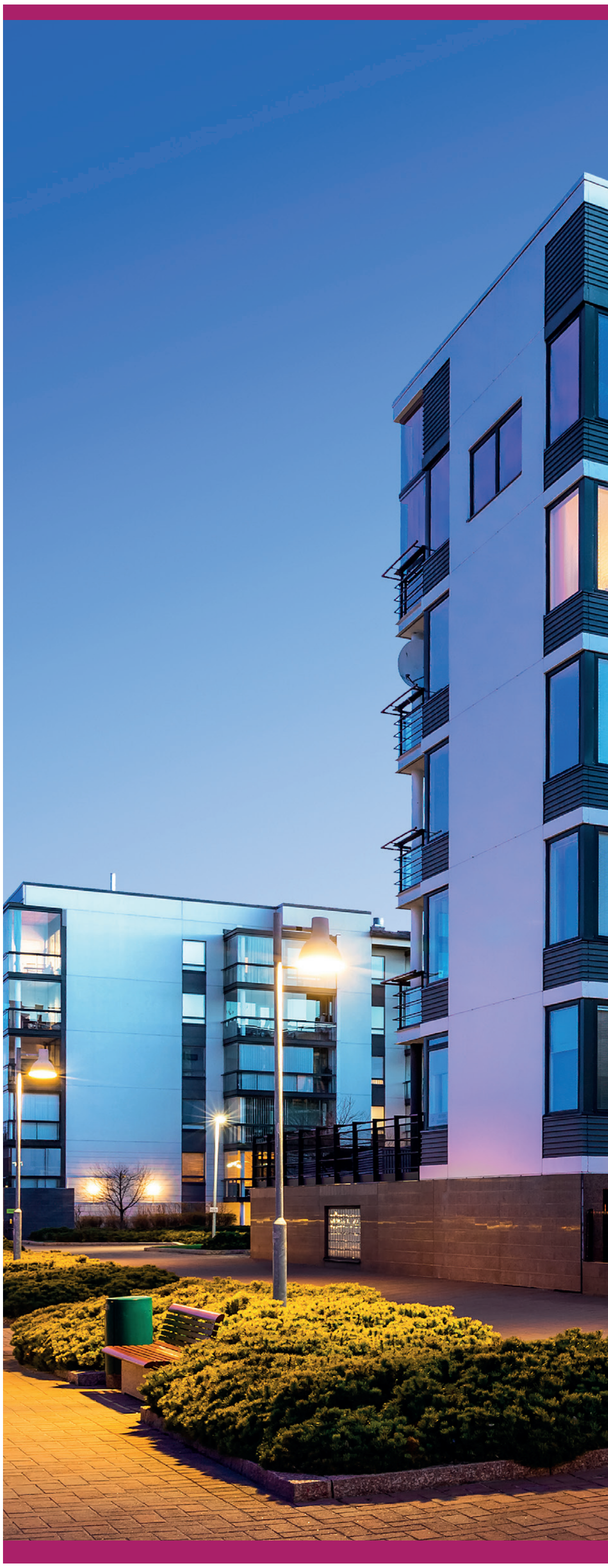

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