trowers & hamlins

QUARTERLY HOUSING UPDATE

Summer 2022

Contents

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Foreword

I am delighted to collate a further collection of articles that – once again – demonstrate the breadth of issues currently facing the housing sector, and with the cost of living crisis front and centre of many providers' thinking I would particularly draw your attention to two articles that look at the "hot topic" of service charges.

It would be remiss of me in this foreword not to mention the Government's suggested extension of the Right to Buy to Housing Association tenants. Whilst it seems like only yesterday that the Housing Association sector struck its Voluntary Right to Buy "deal" with the 2015 Coalition Government, it seems that we still don't have answers to many of the challenges that the voluntary scheme (and indeed the subsequent West Midlands pilot) posed – not least the real practical difficulty in replacing any homes sold on a like-for-like basis. Extending the Right to Buy also needs to be properly funded (something that the Government's announcement didn't address) – and with it addressing the very risk of exacerbating shortfall in the delivery of affordable housing by diverting government funding away from new affordable housing supply. There is also the fundamental issue about the legal basis for all of this and how this might be "imposed" on the sector. Lastly, it's vital that any uncertainty created by the announcement does not risk undermining the current interest in new forms of investment in the sector and so risk further reducing supply. So a headline grabbing policy announcement, but one which could have a profound impact on the sector and its ability to help those most in need of housing if not properly thought through.

As we go to press, Government have also published a further raft of legislation that will have a material impact on the housing sector, including legislation to further strengthen the RSH's powers and to establish the post-Brexit public procurement regime. Government have also published its White Paper exploring reform to the Private Rented Sector. Our team of experts will be publishing briefing notes on the new legislation and the White Paper and we will be covering these issues in the next edition.

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The Charities Act 2022 – what housing associations need to know

The Charities Act 2022 received Royal Assent on 24 February 2022. It introduces the most significant changes in charity law since the Charities Act 2006.

The changes have been a long time coming, with the genesis being Lord Hodgson's review of charity law carried out in 2012 followed by the Law Commission's review of technical issues in charity law, published in 2017. The Law Commission made 43 recommendations to the Government for change and 36 of them have been accepted and carried forward into the Charities Act 2022.

The changes will not take effect immediately however, and will require further secondary legislation before they become effective. This will happen in stages over the next 12 to 18 months. Nevertheless, it is important to be aware of these changes before they take effect.

The overall intention of the Charities Act 2022 is to simplify charity law and make charity law more streamlined and easier to navigate for charities.

Summary

For RPs established as registered charities these changes are going to have direct relevance. For RPs structured as exempt charities, they may act as corporate trustee of smaller charities or hold permanent endowment assets on trust and the new law will be relevant to those arrangements.

For RPs, some of the most notable changes are going to be:

- Changes to the requirements relating to disposals by charities which allow more people to provide the necessary advice and for the format of that advice to be more streamlined. Also, changes to the rules on disposals to connected persons, so that fewer transactions should require Charity Commission consent.
- Trust corporation status to be automatically conferred on corporate trustees however they are appointed.
- Further relaxation of the rules around permanent endowment, allowing corporate charities to make use of a statutory power to release funds from the restriction.

Disposals

For RPs that are registered charities, the Charities Act disposals process can be unnecessarily prescriptive and costly to follow. In fact, we have converted a number of registered charity RP clients to an exempt charity structure specifically to avoid having to follow the Charities Act disposals process. It will therefore be welcome news that there is some simplification to the process.

The Charities Act 2022 replaces the definition of "Qualified Surveyor" with "Designated Adviser". The amended definition is widened to include fellows of the National association of Estate Agents and fellows of the Central Association of Agricultural Valuers. In simple terms this allows a broader range of people to provide the required Charities Act advice to an RP.

Additionally, the Charities Act 2022 now allows board members, officers and employees who are appropriately qualified to provide that advice. They can do so in the court of their employment with the charity, therefore removing the need to obtain external advice.

The Charities Act 2022 removes the requirement to have to follow a surveyor's advice on advertising, providing more flexibility to the board which may be helpful in specific circumstances.

These changes together should streamline the disposals process and reduce cost for registered charity RPs in complying.

The Charities Act 2022 now also provides that a disposal of a short, fixed term or periodic tenancy to an employee to use as their home is not considered a disposal to a connected person. This should be helpful for RPs, since previously granting a tenancy to an employee required the specific consent of the Charity Commission.

It is though worth noting that disposals to a wholly owned trading subsidiary are still considered a disposal to a connected person. So, Charity Commission consent would still be required for intragroup disposals of land.

"The overall intention of the Charities Act 2022 is to simplify charity law and make charity law more streamlined and easier to navigate for charities."

Trust corporation status

In order for a sole corporate trustee of a charity to be able to deal with land and appropriately discharge its responsibilities it must have trust corporation status. Until now, trust corporation status would generally only be conferred where the sole corporate trustee had been appointed by the Charity Commission.

The Charities Act 2022 has the effect of conferring trust corporation status on any sole corporate trustee which is itself a charity irrespective of how that trustee was appointed. It further states that the sole corporate trustee will have trust corporation status even if it was appointed prior to this amendment coming into force, although it will not be treated as having trust corporation status retrospectively. In other words, a sole corporate trustee does not need to be reappointed in order to obtain trust corporation status but there is no retrospective conferral.

So, all charitable RPs acting as sole corporate trustee will benefit from trust corporation status going forward.

Permanent endowment

The Charities Act 2022 now provides a statutory power to release permanent endowment to all corporate charities where the market value of the endowment fund is £25,000 or less. This allows any charitable RP with permanent endowment of £25,000 to remove that restriction without Charity Commission consent.

The Charities Act 2022 also includes a new power for a charity to borrow money out of permanent endowment without needing to obtain an order of the Charity Commission. Up to 25% may be borrowed from the permanent endowment, and it must be repaid within 20 years. The Government states that this may be a helpful alternative where a charity does not necessarily want to completely remove a permanent endowment restriction.

For more detail on the changes being introduced, please refer to our Essential Guide to the Charities Act 2022 which we have published to help everyone get to grips with the new law.

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Affordable Rent and variable service charges

Affordable Rent was introduced in order to help increase social housing provision, and expand availability to people who were unable to afford market level rents, but who did not generally qualify for allocations of existing social housing due to pressures on waiting lists. Affordable Rent is set at tenancy outset, at up to 80% of local market levels inclusive of service costs.

When the Affordable Rent policy was originally introduced by the Government in 2011, it was never intended to be run with separately delineated service charges – Affordable Rents were supposed to be single 'global' rent figures which incorporated both rent and service cost elements in a single charge to tenants (the policy intention being to mimic private sector tenancies). This single rent figure then provided a solid base for a CPI +1% increase limit each year.

The key as to why this article is being written is that no complications re annual reconciliations, and estimated and actual costs were intended under Affordable Rent. However, many social landlords – under financial pressures and needing to recoup increasing service costs – adopted variable service charges in relation to their Affordable Rent properties.

This did not sit well with the Regulator's Rent Standard.

Regulation

As a matter of regulation, the Regulator expects a landlord of an Affordable Rent property to increase the rent (inclusive of service costs) by a maximum of CPI plus 1%. It is not acceptable to apply the CPI +1% to the rent element only and charge a variable service charge on top without any adjustments to that charge to ensure it does not breach the CPI +1% cap (this will, of course, be less of an issue if the service charge costs are within the CPI +1% envelope).

As Affordable Rent is not intended to have separate service charges, there is no detailed guidance on this in the Rent Standard or accompanying Government policy on social housing rents, but arguably the CPI +1% increase is meant to relate to the inclusive rent actually charged and not just the estimated inclusive rent. If this is the case, a variable service charge will require a reduction where earlier cost estimates prove to have been too high, leading to a knock on reduction in that (inclusive) rent to which CPI +1% may be added.

Let's take a hypothetical example of an initial rent of £90 and estimated service charge of £10 (on a variable basis). If the actual service costs only come to £8, the CPI +1% should be charged on £98 not the £100.

There is then also a problem where the costs exceed those estimated. On the basis that the form of tenancy agreement includes variable service charge terms, then under the legal terms and conditions of the tenancy agreement the full amount of the higher cost would be recoverable, but if the landlord charged the full amount, that is then likely to exceed the regulatory CPI + 1% permitted annual increase.

Practical issues

In addition to the potential to limit increases, the calculation of the new financial year's rent is also inherently difficult because of the need to provide rent increase notices before the end of the tenancy year – it is difficult to calculate CPI +1% if you do not yet know the outcome of the annual reconciliation.

As will be reasonably apparent from this article, there is a risk that unless there is an element of under-recovery of service charges from what would be fully recoverable under the tenancy, it is difficult to ensure compliance with the regulatory CPI +1% limit on increases whilst complying with the core features of a variable service charge.

London Affordable Rent

The Mayor of London's launch of LAR was intended to try and increase the affordability of London's new social housing developments, as it was recognised that Affordable Rent's 80% of local market levels was often unaffordable in the Capital.

The rent charged on a LAR property is set by using a published benchmark level. Benchmark rents are lower than 80% of local market level and are intended to be more akin to a social rent. Where a service charge is payable, this is on top of the benchmarked rent.

What is less understood in the sector, is that LAR properties are still Affordable Rent properties for regulatory purposes. This means they are governed by the section of the Rent Standard which relates to Affordable Rent, rather than the social rent section. Social landlords developing properties at LAR therefore, and hoping to recover service costs via a variable service charge, should remember that as LAR are an Affordable Rent, recovery is capped at 80% of local market level inclusive of service costs (and with a CPI +1% cap on annual increases thereafter).

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Building Safety Act update

The Building Safety Act received Royal Assent on 28 April 2022, following a three year public consultation and legislative process. The Act itself was finally published on 13 May 2022. Here's what you need to know about the new legislation.

The Act implements most (but not all) of the recommendations of the Building a Safer Future review, commissioned in response to the Grenfell Tower fire in 2017. The legislation imports a new centrally regulated regime to govern the design, construction and maintenance of the built environment, and represents the most radical change to the building industry in fifty years.

The new Act establishes national Building Safety Regulator, sitting within the Health and Safety Executive, with responsibilities for monitoring the safety of all buildings in England. The Regulator has wide-ranging powers to regulate standards for buildings and construction work, including powers to investigate and prosecute breaches.

The Act establishes new "Dutyholder" obligations for clients, designers and contractors working on most building works covered by the Building Regulations, including a general requirement that all those appointed to undertake building works are "competent".

The Regulator will oversee a new three-stage building control approval regime for the design, construction and major refurbishment of "higher-risk buildings" (defined as residential buildings of two or more units that are at least 7 storeys or 18 metres tall and including hospitals and care homes meeting those height requirements for their design and construction stages). The Regulator becomes the building control authority for all higher-risk buildings and will establish and supervise a new building safety inspectorate.

New roles of "Accountable Persons" and "Principal Accountable Persons" will be responsible for registering higher-risk buildings and ensuring that building safety risks are managed during their occupation. However, the requirement to appoint a Building Safety Manager to help manage higher-risk buildings has been removed from the final legislation.

The Act imposes implied terms into tenancy agreements covered by the Landlord and Tenant Act 1985, requiring tenants to comply with landlords and Accountable Persons carrying out building safety activities. Landlords will be given access to enter dwellings for building safety purposes, subject to reasonable notice, and may apply for court warrants to enter properties.

In the most heavily publicised part of the Act, landlords' ability to recover leaseholder service charges for non-cladding remediation works has been severely limited. Courts will be empowered to make corporate bodies liable for remediating building works and make compensation payments to residents. Associated persons of liable bodies may also be required to make financial contributions, including where the original body has become insolvent.

The Secretary of State is given wide powers to establish a building industry scheme for developers, requiring them to make financial contributions towards remediation works. Non-compliant developers may be blacklisted from submitting planning and building control applications. Over 35 developers have committed to join the scheme, pledging £3bn towards a remediation works fund.

Claims under section 1 of the Defective Premises Act 1972 (the DPA 1972) will be extended. The Act extends the limitation period where the cause of action arises pre-commencement (i.e. for dwellings already completed) to 30 years. Where the cause of action arises at any other time, the limitation period will be extended to 15 years. The Act also introduces a new s.2A of the DPA 1972 which imposes a duty on those who take on any work on a building that contains a dwelling to ensure that the work does not render the dwelling unfit for habitation. The limitation period for these claims (prospectively) from the date of commencement is also 15 years.

The Act also establishes a New Homes Ombudsman, requires developers to provide new build home purchasers with 15 year warranties for defects rectification, and establishes a new more stringent regime to regulate construction products used in the UK.

The Act is a complex piece of legislation that will affect nearly every aspect of the construction industry. While key aspects of the new regime have already been set out in secondary legislation, there is much detail still to be provided by the Regulator. Please follow our website for more updates and information about the Act.

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The S and G in ESG

Environmental, Social and Governance criteria (otherwise known as ESG) are becoming increasingly important as a measure of the sustainability of an employer's practices.

In the modern world we live in, with challenges such as climate change and a societal push towards greater equality and diversity, employers are expected to drive change and have a sustainable business strategy. ESG is also something which is increasingly driving the financial success of organisations, not least because it has become a key criteria for lenders.

Many employees now expect their employer to demonstrate their responsible and sustainable credentials, so it's important to get it right. This article focuses on the social and governance criteria (the S and G) and gives a broad overview of what these mean in an employment context.

Social criteria

An important element of sustainability is taking into account social considerations. These are often more challenging to implement and to measure but there are many ways that employers can demonstrate that they take social factors seriously. A key part of this is a commitment to valuing staff welfare. Here are some examples of what employers could consider:

- Ensure there are up to date equality, diversity and inclusion policies and training in place.
- Review staff work/life balance and consider introducing or extending agile working practices to enable greater flexibility to work from home for those with caring or other responsibilities.
- Provide access to health and wellbeing support (including mental, physical and financial wellbeing) and offer training to staff on how to help colleagues with wellbeing issues.
- Ensure there are appropriate systems so that any incidents of discrimination, harassment or bullying are dealt with in a timely and effective way.
- Undertake an equality audit and consider appropriate positive action to address areas of under representation or lack of inclusion
- Encourage staff to get involved in charitable activities or community work – this could be separately rewarded or acknowledged as part of an appraisal process.
- Review and update your approach to employee engagement.
- Prioritise changes to improve working conditions for staff and adopt policies in line with the Modern Slavery Act 2015 even if not legally required to do so.

Governance criteria

- A genuine commitment to good governance means much more than compliance with legal requirements. It involves complying with the spirit of the law and voluntarily adopting what is considered good practice. Some of the steps employers can consider when developing their governance are below:
- Adopt codes of conduct promoted by the government or well-respected bodies.
- Be alive to conflicts of interest and ensure there are strong and clear policies to identify and manage conflicts when they arise.
- Ensure ongoing board diversity and put in place systems to achieve future diversity goals.
- Ensure policies and practices are in line with the Bribery Act 2010.
- Ensure the whistleblowing policy is accessible and up to date so that staff can easily raise any concerns about malpractice in the workplace.
- Consider voluntary reporting (e.g. ethnicity pay reporting) to demonstrate the importance your organisation accords to improving fairness and diversity.
- Adopt clear and transparent remuneration policies.

How things have changed

The Covid-19 pandemic has acted as a bit of a catalyst in bringing certain elements of the ESG agenda to the fore. Many employers have adopted agile working policies and, in doing so, have facilitated a more diverse workforce by enabling and encouraging those with disabilities who may have previously struggled with a work commute and office set-up, to work more effectively. Employers have been forced to adopt more flexible working practices, and this has allowed many employees to fit family commitments around their working day in a way that they would previously have been unable to.

Employers also now have an enhanced awareness of mental ill health. The pandemic was a challenging time for many, and lots of people suffered, and continue to suffer, from mental health issues. Employers have had to react to this, and put in place support mechanisms to help their employees cope. Along with this increased awareness of the ill effects of mental health problems and the measures which can be put in place to alleviate them, employers have found that there is a renewed focus on employee wellbeing, and many are now putting tailored wellbeing strategies in place.

The future of ESG

The importance of ESG has already evolved so that many of the concepts have become legal requirements. For example, outside of the employment context, there is a raft of new legislation on climate change. Within the employment context, there are also various pieces of legislation (for example, the Bribery Act 2010 and gender pay gap reporting requirements under the Equality Act 2010) which put ESG consideration on a legal footing.

However, this area is ripe for further evolution, and it's likely that, over time, there will be many more mandatory requirements on employers to make them act responsibly and sustainably. In the meantime, there are lots of steps forward thinking employers can take to demonstrate strong ESG credentials. Whilst these are largely voluntary (for now), they will pay substantial dividends in terms of employer reputation, attracting and retaining staff, and workplace satisfaction and productivity as well as having a positive long-term impact on the financial success of the organisation.

In the meantime, we have developed a Trowers Toolkit which focuses on the S and G in ESG and which can help your build and refine your existing strategies.

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Service charges in the cost of living crisis

With the current rise in inflation, tenants and leaseholders of registered providers are facing the largest service charge increases in a generation. With recently issued service charge demands facing almost unprecedented levels of scrutiny, here's what landlords can do to protect themselves against a significant reputational and financial risk..

The law and regulation of residential service charges is highly prescriptive and fraught with pitfalls for the unwary. With the current consultation by the Royal Institution of Chartered Surveyors on extending the Service Charge Residential Management Code to Registered Providers, the level of scrutiny is only likely to increase. However, with the right procedures in place, landlords can take confidence in knowing that service charges demanded will ultimately withstand challenge.

Practice and procedures

In order to ensure that service charges are legally recoverable, landlords should put in place procedures to ensure the following:

- Leases should be checked to ensure that the terms of the lease allow for recovery of the service charges demanded.
- Section 19 of the Landlord and Tenant Act 1985 Act (LTA 1985) provides that a service charge is only payable to the extent that the cost is reasonably incurred and only where the works are carried out to a reasonable standard. In the event of a dispute, leaseholders can apply to the First-Tier Tribunal (Property Chamber) for a determination as to reasonableness. In order to support the reasonableness of the service or works undertaken, landlords should ensure they have a paper trail to demonstrate both that the decision to incur the costs and the amount charged was reasonable (including evidence of market testing).
- Section 20 of the LTA 1985 requires a landlord to undertake a prescribed consultation process for works on a building if those works will cost more than £250 per leaseholder, or for works or services if the contract is for a term of more than 12 months and the works or services will cost more than £100 per annum per leaseholder (called a qualifying long term agreement). Landlords should ensure they have strict processes in place to ensure compliance, which means a joint and co-ordinated effort involving the development, procurement, repairs and maintenance, leasehold and finance team functions.
- Where Government funding is obtained for the purposes of undertaking works of repair, maintenance or improvement, the Social Landlords Mandatory Reduction of Service Charge (England) Directions 2014 (also known as Florrie's Law) caps service charge recovery at £15,000 for a dwelling within a London authority, or £10,000 for a dwelling not situated within a London authority.
- The Social Landlords Discretionary Reduction of Service Charge (England) Directions 2014 permit (but do not require) social landlords to waive or reduce the service charge payable in respect of works of repair, maintenance and improvement. If Registered Providers wish to have the ability to waive or reduce service charges in exceptional circumstances, a procedure could be put in place to give effect to the 2014 Directions. However, this would need to be dealt with on a case-by-case basis and if the landlord is a charity then it would need to consider the charity law position when setting any policy and making individual decisions.
- When the relevant provisions of the Building Safety Act 2022 come into force, service charge demands for remediation works (including but not limited to defective cladding) will be much more heavily regulated, requiring landlords to positively take reasonable steps to pursue claims against third parties before issuing service charge demands.
- Landlords should consider offering repayment plans or instalment arrangements to leaseholders. Financial Conduct Authority authorisation may need to be obtained in certain circumstances where credit is being offered but there is an exemption enabling landlords to offer payment arrangements payable over a period of not more than 12 months and involving 12 payments or less. However, landlords cannot impose interest or any other charges in order to take advantage of the exemption. Information could also be provided to leaseholders as to alternative lenders.

Confidence and trust is key

With the above best practice and procedures in place, Registered Providers and their boards can take decisions with confidence. Whilst landlords face little option but to increase service charges in order to cover their operating costs, there are positive steps that can be taken to minimise both cost increases and the reputational and financial risk of successful challenges being made in the First-tier Tribunal, which should help steer the ship through the current choppy waters.

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The Government Social Housing Decarbonising Fund – the second wave

Government funding for Net Zero retrofit Applications for Wave 2 of the Social Housing Decarbonisation Fund are expected to open in August/September 2022. What should landlords expect?

Decarbonising the social housing stock is an integral part of the Government's Net Zero strategy. The costs, however, seem prohibitive – the National Housing Federation and Savills have estimated that decarbonising the current social housing stock in England will cost the sector at least £36 billion*. The Government's Social Housing Decarbonisation Fund (SHDF) is intended to provide £3.8 billion of funding over a ten year period to help social landlords kickstart their retrofit decarbonisation works. £240 million of this funding has already been released via an earlier SHDF Demonstrator and Wave 1 of the funding and the Government has announced a further £800 million for Wave 2.

Minimum property numbers

There has been a significant scale up in Wave 2 funding when compared to previous waves. BEIS have said that Wave 2 is about "delivering appropriate retrofit at scale". In order to achieve this, BEIS are considering including a minimum bid size of 100 social homes per project. Landlords who cannot meet this number will be able to form a consortia with other landlords. This minimum threshold is intended to drive larger-scale projects to deliver economies of scale.

Project lead

In previous waves, bids could only be led by Local Authorities. Housing Associations therefore had to join consortia led by Local Authority leads. BEIS have now indicated that they are changing the mechanism used to allocate the funding which will allow housing associations (and ALMOs that are registered providers) to lead bids.

Low carbon heating

Wave 1 was focussed on three key principles: (1) Fabric First (where heat loss prevention measures were prioritised over other energy efficiency measures); (2) Worst First (allocating larger spending caps to properties with lower EPC ratings); and (3) Lowest Regret (minimising the potential for energy efficiency measures to be replaced in the future in order to meet Net Zero commitments).

Based on comments from BEIS, it is likely that Wave 2 will also include a "clean heat where appropriate" principle. While installations of low carbon heating were allowed under Wave 1, it was not the focus and BEIS did not expect low carbon heating installations to be proposed for the majority of the properties treated through Wave 1[2].

It is likely that an increased proportion of the Wave 2 funding will be focused on the installation of low carbon heating measures such as heat pumps.

Digitalisation

BEIS are also looking to encourage the "digitalisation" of retrofit. Details are still being finalised but BEIS are considering allocating a portion of bid funding solely towards meeting "digitalisation" costs.

This could include data collection measures, the streamlining/standardising of retrofit design or other innovative uses of digital technologies.

Next steps

BEIS has indicated that applications will open in late August/early September 2022. Given the likely competition for funds, early preparation is essential to identify suitable properties, scope projects and agree suitable procurement routes. Landlords will need to be ready for the launch of Wave 2.

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[1]https://www.savills.co.uk/insight-and-opinion/savills-news/320272/decarbonising-housing-associations--homes-to-cost-%C2%A336bn--according-to-national-housing-federation

[2]Section 2.9.1, Social Housing Decarbonisation Fund Competition Guidance Notes, Department for Business, Energy and Industrial Strategy

The impact of new pensions legislation on RPs' obligations under their funding agreements

The Pensions Schemes Act 2021 is having an impact on the banking sector, particularly for employers participating in private sector defined benefit schemes. The collapse of household name employers such as BHS and Carillion has highlighted the catastrophic financial impact pension scheme deficits can have on the viability of a business.

Under the Pensions Schemes Act 2021 the Pensions Regulator has been gifted extensive powers to impose financial penalties and gather information on businesses in order to protect pensioners and stakeholders. These new powers are backed up by criminal offences.

The Pension Schemes Act 2021 also introduces new duties for those involved in running pension schemes and gives the Pensions Regulator new powers to protect pension scheme members.

The new legislation does not impinge on 'defined contribution' schemes per se but only on 'defined benefit' schemes. For many of our RP clients, this will include the Social Housing Pension Scheme (SHPS) (even where salary-related accrual has come to an end) and any stand-alone salary-related pension scheme they may sponsor. The Local Government Pension Scheme falls outside of the scope of these new powers.

Lenders have responded by introducing radically extended representations, covenants and events of default regarding borrowers' pension obligations into loan documentation and any RP entering into a new loan agreement or restating an existing agreement will find themselves subject to a raft of onerous far-reaching provisions. RPs need to carefully consider the impact of these new provisions as these are likely to become market standard.

A well organised RP should find that none of these new obligations present them with difficulties as they are already likely to be in compliance. But borrowers need to take care that they are not inadvertently caught out.

As part of the legislative framework under the Pensions Schemes Act 2021, new regulations are due to come into force in October introducing a duty to notify certain information to the Pensions Regulator. This requirement is far reaching and completely new It will impact RPs participating in salary-related pension schemes. The rationale for these new 'early warning' powers is to alert the Pensions Regulator and pension scheme trustees of issues where there may be a weakening of employer covenant to support a pension scheme.

The new duty extends to notifying the Pensions Regulator of "a decision in principle by the employer to grant or extend a relevant security over its assets, where the grant or extension would result in the secured creditor being ranked above the scheme in the order of priority for debt recovery." A decision in principle "means a decision prior to any negotiations or agreements being entered into with another party". Assets include "in relation to the assets of any employer [they] do not include money".

What will be the implication for our clients?

Let's consider the duty to notify within the context of a routine restatement of a borrower's loan facilities. Happy Homes RP entered into a loan agreement with Cash Bank plc, secured by fixed charges over a pool of housing properties. The board reviews its funding needs and on the basis of a valuation uplift regarding the secured properties, plans to borrow an additional £3million. The Finance Director entered into discussions with the Bank and subsequently signed a term sheet which led to solicitors being instructed to draft a restatement agreement. No new security was required but some of the commercial covenants were amended. In late December, a new restated loan facility agreement was completed by the parties.

Previously, it would not have been necessary to inform the Pensions Regulator or the pension scheme trustees of this amendment and restatement. But now there is an obligation to inform.

At what stage, should the RP inform the Pensions Regulator? The new regulations introduce a two-stage notification process. The first is when a 'decision in principle' is taken. Separately, a notice and accompanying statement has to be provided 'when the main terms have been proposed'. So do they have to notify when the board makes the decision that it should increase its borrowing with the Bank? Or when the Finance Director signs the term sheet? How far back the "decision in principle" needs to extend is nuanced but if it does extend to a verbal discussion by the board then the Pensions' Regulator can expect to be inundated by notifications. What will it then do with that information? How will that information assist it in its regulation of businesses and in its efforts to protect members of the pension schemes? There are some difficult questions that remain to be answered.

The exact content of the notification to the Pensions Regulator also needs to be determined and includes setting out details of any adverse effects on the scheme, any adverse effects on the RP's ability to meet its legal obligations to support the scheme and any mitigating action taken by the RP.

There is also an additional problem for an RP that has issued publicly secured bonds as legislation prohibits disclosing such information other than to those on its insider dealing list. We have not seen any guidance as to how this conflict should be resolved.

Now these regulations have come into effect and until the extent of their application is confirmed, RPs would be wise to err on the side of caution and inform the Pensions Regulator as early as possible of any decision taken in relation to secured lending.

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New money, new ideas part 2: Shared ownership portfolio transactions

Shared ownership reversionary portfolio transactions (SORPs) are generating interest in the affordable housing market – from both registered providers (RPs) and institutional investors alike – but what are they are and what can they offer your business and your residents?

This article will explore what SORPs are, what the investors behind them can bring to the table and, critically, what they can offer to an RP in terms of funding its development pipeline.

What is a SORP?

A SORP is the sale of a portfolio of the reversionary interest in shared ownership units by an RP to an investor. The product as an asset class is attractive from an investment perspective – providing an index-linked income stream and meeting ESG investment criteria via its social benefits – but what benefits does this bring to the selling RP?

Benefits for registered providers

Only a few short years ago, the term "new entrants" generated a degree of uncertainty among the affordable housing sector, with RPs in particular querying the extent to which investors would protect the needs of the residents. In the short time between now and then the tone of that conversation has changed dramatically, and there is both optimism and even excitement about the weight of investor activity and the impact this structure of transaction could have on the supply of much-needed affordable housing.

Benefits to RPs include:

- Cash: with the ever-growing pressures of building safety requirements, rising build costs and decarbonisation programmes, RPs are finding more demands on their cash reserves than ever. The capital received from the purchasing investor pursuant to a SORP can help RPs address these cash deficits.
- Continuity of management: Whilst the reversionary interest in the shared ownership products will become vested in the purchasing investor, the RP can continue to manage the units via a Management Agreement that the parties will enter into on the day of completion. This can ensure not only a seamless continuity of service and interface for shared owner residents, but also that an RP's managed unit numbers are maintained.
- Growing number of investors: New investor entrants to the sector are increasingly looking to SORPs as a means of deploying capital. This not only drives up the pricing of the prospective SORP portfolios but allows RPs to be selective about the identity of the investor in which they vest their reversionary interests.

Can SORP's address longer term funding gaps for RPs?

Aside from the initial injection of capital from the first SORP transaction between an RP and investor, there is a real appetite in the market for the formalisation of an ongoing, longer-term, strategic partnership between the parties. Under such agreements, both parties can agree to seek to identify opportunities for the funding, acquisition and development of residential shared ownership property. In the same way that RPs can "bring" to investors development opportunities for forward-funding or forward-purchase, an investor can similarly "bring" to the RP opportunities for management services to portfolios into which the investor has injected its equity. These types of agreements – whilst typically aspirational and flexible in nature – indicate a commonality in desired outcome for both the RP and the investor – being the development of, and investment into, new shared ownership developments.

It is for the parties to decide what this strategic arrangement might look like from a commercial perspective, but any such agreement could legislate a set of minimum requirements that must be met including those in respect of:

- geographical scope – to meet any operational needs of the RP;
- gross development value – to ensure the large-scale pipeline of new affordable homes; and
- unit numbers and sales value of such shared ownership units – to reflect any commercial requirements – and the risk appetite – of the purchasing investor.

Such quantitative thresholds can focus minds and drive the parties' targets and ambitions for the benefit of prospective shared owners across the country.

Final thoughts

SORPS will not necessarily be a universal panacea for all RPs and the interests of residents must be at the forefront of any exploration as to alternative funding models. That said, it is widely accepted that RPs are encountering more constraints than ever on the allocation of their capital and this challenge is set against a backdrop of a significant under-supply of affordable housing, and one that is well behind the Government's target of 300,000 new homes per annum.

Whilst the notion of a step change in how new developments are funded can be daunting to RPs who historically have relied on "traditional" methods such as grant and debt finance, the scale of new equity investment that is being deployed in the affordable housing sector shows no sign of abating. It follows logically then that long term, strategic partnerships between RPs and investors in respect of shared ownership reversionary portfolios can provide an answer – at least in part – to the funding of new developments. The strategic partnership can create a cyclical, symbiotic relationship whereby institutional capital is deployed at scale into a regulated, established sector, and RPs utilise that cash – in conjunction with their management and operational expertise – to unlock much needed shared ownership development sites.

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