trowers & hamlins

QUARTERLY HOUSING UPDATE

Autumn 2022

Contents

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Foreword

As the dust settles on the Government's announcement that next year's rent increases will be capped at 7%, a consensus appears to be emerging that whilst the cap is by no means as bad as many in the sector (myself included) might have feared, there is no doubt that these remain hugely challenging times for the Housing Association sector. Associations face severe challenges that flow directly from inflationary pressures on their supply chain (not only in relation to development but also in relation to day to day housing management and repairs and maintenance) and pressure on operating margins will be acute. So where does this leave the sector?

Development programmes are arguably going to be the first to suffer – it seems impossible to contemplate anything other than focusing (already scarce) resources on front line repairs and maintenance - and I sincerely hope that the current fiscal position of many associations doesn't hold back the excellent work that the sector is doing to tackle thermal efficiency and the move to net zero. In many ways it is a huge disappointment that the debate on the rent settlement hasn't "joined the dots" between rent and the entire costs of running a home - as I have frequently argued rent and fuel costs shouldn't be seen in isolation, and it is a pity that the current rent regime doesn't incentivise investment that would reduce fuel bills.

But in adversity the sector has always looked to innovate, and I think that the continued interest in the sector from institutional investors will offer a way for many associations to maintain their development programmes by partnering with investors; as we have trailed in our "New Money, New Ideas" pieces this year (and continued in this edition) we are seeing a number of structures that are being adopted by Associations that combine the development expertise of the sector with institutional investment to maintain (or grow) existing development pipelines. Just this month we have been pleased to complete two exemplar projects in this space – working with Legal & General Affordable Homes and Metropolitan Thames Valley on their shared ownership development joint venture, and with Hyde on their ground breaking joint venture For Profit RP with AXA. My sense is that 2023 will be the year when these partnerships come of age.

So – against strong headwinds, I firmly believe that capital will be available to maintain development, but it will demand Boards and Executive Teams to think differently and to embrace new models.

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New building control approval for higher-risk buildings

The Building Safety Act 2022 imports a new regulatory regime for higher-risk buildings, but much of the detail has still to be finalised. Here's what we know so far.

One of the promised features of the new building safety regime was a three-stage building control process for "higher-risk buildings" (HRBs). The Building Safety Act establishes the Building Safety Regulator who will establish and implement the new building control stages, but much of the detail has yet to be passed into law.

An outline of the regime is set out in the draft Building (Higher-Risk Buildings) (England) Regulations, published in October 2021. The draft Regulations describe the requirements for what was formerly referred to as "Gateway 2" and "Gateway 3". Gateway 1, which requires consideration of building and fire safety for HRBs as part of local authority planning applications, came into force on 1 August 2021.

The Government undertook a public consultation about the draft Regulations over the summer, but has yet to publish revised drafting or confirm an implementation timetable. Further regulations defining the full scope of HRBs are also yet to be finalised.

HRB work – The draft Regulations apply to "HRB work", defined as the construction of a HRB, works to an existing building that causes it to become a HRB, and any work required to make a HRB compliant with the Building Regulations. Repairs and maintenance works to existing HRBs does not appear to be included.

Building control approval – Gateway 2 is now referred to as "building control approval", which must be approved before HRB works commence. Detailed guidance is provided about documents and information to be provided by the client (or someone acting on the client's behalf) to the Regulator, including to-scale building plans, design documents, construction control plans, fire safety plans, and declarations that the construction and design team are "competent" as defined by the Act. It is anticipated that the Regulator must determine applications within 12 weeks of the application. The Regulator must give reasons for any rejection, and may make any approval conditional on remedial actions or amendments to the key documents. Partial approval may also be sought for any part(s) of a project.

Completion certificate approval – Gateway 3 is now referred to as "completion certificate approval" Completion certificates must be applied for after completion of the works and be approved before the building can be legally occupied. Much of the required documentation comprises finalised versions of the documents provided at building control approval stage. The client, principal designer and principal contractor must also provide declarations that the HRB works have been carried out in accordance with the Building Regulations. As above, it is anticipated that the Regulator must determine applications within 12 weeks, give reasons for any rejection and may impose conditions on any completion certificate. Partial completion certificates may also be sought for any part(s) of a project.

Change control applications – The Regulations impose a new change control process in respect of HRB work, divided into "major changes" (which must be approved by the Regulator before the change is carried out) and "notifiable changes" (which must be notified to the Regulator and can be carried out unless the Regulator responds within 14 days). It is anticipated that the Regulator will determine a change control application within 4 weeks, must give reasons for any rejection and can impose conditions on any approval.

Mandatory occurrence reporting – The draft Regulations require clients and key dutyholders to establish and maintain a reporting system for "safety occurrences", defined as anything relating to the structural integrity or fire safety of a HRB which, if built, would be likely to present a risk of significant deaths or serious injury.

Golden thread information – A key component of the new building safety regime was the concept of a "golden thread" of building safety information for HRBs, developed during the design and construction stage and made available to those responsible for the building during its occupation. The draft Regulations define "golden thread information" as an electronic portal containing all information submitted with all building control, change control and completion certificate applications and any mandatory occurrence reports. Clients will be required to provide golden thread information to the Accountable Person or responsible person for the building as a pre-condition of applying for a completion certificate.

Key building information – The draft Regulations also define a list of key building information which must be given to the Regulator for storage in an online portal. The information must also be provided to the Principal Accountable Person before the completion certificate application is made.

Review and appeal – The Regulations also set out the review and appeal process for any decisions made by the Regulator or its inspectorate, though key dates for reviews and appeals have yet to be finalised.

Format of applications – The Regulations state that the Regulator shall give directions as to the format of any applications and supporting documents, including any requirements for electronic submission. Given the requirements for information to be passed between different parties and organisations, it is anticipated that most documents will need to be provided electronically.

The new regime will require extensive changes to the construction industry. It is anticipated that most building contracts and consultant appointments will require redrafting. Contracting parties will need to agree who is responsible for submitting applications, appropriate duties of care for any information provided and how any delays or required additional works will be handled. It is hoped that the Government and the Regulator will act soon to finalise the details of the regime, so the industry can get to grip with the changes.

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Managing gender critical beliefs

There has been a spate of cases recently on gender critical beliefs which demonstrate how easy it is for the beliefs of one individual to conflict with those of another, and how important it is for employers to promote an inclusive workplace, even for those whose beliefs may be offensive to others.

The Equality Act 2010 (EqA 2010) provides that individuals are protected from discrimination on the grounds of their religious or philosophical beliefs.

For a belief to qualify for protection it has to fulfil the five criteria set out in Grainger plc and others v Nicholson. It has to be genuinely held; be a belief and not an opinion or viewpoint; be a belief as to a weighty and substantial aspect of human life and behaviour, and attain a certain level of cogency, seriousness, cohesion and importance. Finally it has to be worthy of respect in a democratic society, not be incompatible with human dignity and not conflict with the fundamental rights of others.

Gender critical belief is protected

Last year the Employment Appeal Tribunal (EAT) held in Forstater v CGD Europe and others that the claimant's gender critical belief was a philosophical belief which qualified for protection.

Ms Forstater was a visiting fellow of a not-for-profit think tank focussing on international development. Her belief is that a person's sex is a material reality that should not be conflated with gender or gender identity; that being female is an immutable biological fact and that a trans woman is not, in reality, a woman. She also believes that, while a person can identify as another sex and can change their legal sex under the Gender Recognition Act 2004, this does not change their actual sex. She engaged in debates of this nature on social media. Following an investigation, her visiting fellowship was not renewed, and she brought a claim for discrimination on the grounds of her philosophical belief.

The EAT noted that freedom of expression is one of the essential foundations of democratic society, and that a belief only needs to satisfy a very modest threshold to be protected under Article 9 of the European Convention on Human Rights (ECHR) (which protects the right to freedom of thought, conscience and belief). The EAT looked at whether a person falls outside the scope of protection under Article 9 by virtue of Article 17 (which prohibits the abuse of Convention rights to engage in any activity aimed at the destruction of the rights and freedoms of others).

Case law has held that Article 17 only excludes the "gravest forms of hate speech" which incites violence or hatred aimed at destroying the Convention rights and freedoms of others. The EAT concluded that Ms Forstater's beliefs did not fall into the category of those excluded from protection by Article 17.

The issue of whether or not she had been discriminated against was remitted to the tribunal. It found that her tweets had had a significant influence on the decision not to continue her fellowship. The tribunal found that none of the manifestations of her beliefs were objectively offensive or unreasonable and that it was not necessarily the case that crossing the line on a single occasion into inappropriate expression would have been sufficient to justify action being taken against Ms Forstater.

Protection of a belief stands apart from the question of discrimination

The EAT held in Mackereth v Department for Work and Pensions and anor that the claimant's belief that a person cannot change their sex/gender at will, and a lack of belief in "transgenderism", were protected under the EqA 2010.

Mr Mackereth, a Christian doctor, started employment with the DWP as a health and disabilities assessor requiring him to conduct face-to-face assessments with benefits claimants. He explained that his beliefs were such that he would not agree to use the preferred pronouns of transgender service users, as required by the DWP's policies. The DWP decided it could not offer him a non-customer facing role and that it would not be possible to ensure he only assessed non-transgender service users. Mr Mackereth left and brought claims for discrimination and harassment.

The tribunal found that Mr Mackereth's beliefs did not satisfy one or more of the Grainger criteria and that, even had they been protected, he had not been less favourably treated. The DWP's provision, criterion or practice (PCP) that assessors had to use service users' preferred pronouns was a necessary and proportionate means of achieving its legitimate aims of ensuring that transgender service users were treated with respect and providing an equal opportunities service.

The EAT held that the fact that his beliefs were "likely to cause offence" did not warrant their exclusion from protection, but agreed that he had not suffered discrimination. Although a belief may be capable of protection, it will not give an individual employee the right to act in a way that conflicts with their employer's legitimate requirements.

Practical measures

In another recent decision, Bailey v Stonewall and others, a barrister with gender critical philosophical beliefs was found to have been discriminated against by her chambers. This is clearly an issue which employers need to be aware of and practical measures include:

- Putting a policy in place prohibiting any behaviour which could amount to unlawful discrimination.
- Telling employees that, although they are entitled to hold their own beliefs, they must be aware that they are not shared by everyone. Advise them to consider whether they need to express their views at work, and to consider how they do so. Employers should also encourage them to value and respect differences.
- Making it clear to employees that the expression of discriminatory views on any work-related social media is unacceptable and grounds for disciplinary action.
- Although employees are entitled to hold their own views, this doesn't mean they can manifest them inappropriately. Any complaints should be taken seriously, investigated and dealt with.

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Procurement Bill – update on legislative reform

On 11 May 2022, the Government introduced the much-anticipated Procurement Bill (the Bill) into the House of Lords where it received its first reading. The Bill follows an extensive consultation process on procurement reform following the UK's withdrawal from the European Union and is currently undergoing legislative scrutiny through the Committee Stages in the House of Lords.

Representing the Government's post-Brexit reform of the legislative framework, the Bill sets out significant and wide-ranging changes to the existing legislation. As trailed by the Government's Green Paper on Transforming Public Procurement (the Green Paper), and the subsequent response to the consultation process (the Response), the Bill seeks to incorporate all relevant procurement rules into a single framework, moving away from the current "patchwork" approach to regulation under the current procurement rules, and consolidating a number of existing Regulations (including the Public Contracts Regulations 2015, the Concession Contracts Regulations 2016 and the Utilities Contracts Regulations 2015).

Perhaps unsurprisingly, the Bill includes significant linguistic and stylistic differences to the existing regime (which represented a copy-out approach of the European legislation into domestic law), and contracting authorities and bidders alike will need to familiarise themselves with the new approach to both style and form adopted throughout the Bill.

This article sets out some of the key changes arising in the Bill.

Identifying suppliers

The Bill has made the much anticipated move to awarding on the basis of the "most advantageous tender" (rather than the most "economically" advantageous tender as required under the existing rules), with the intention that contracting authorities are able to take a broader view of what can be included when evaluating tenders.

In practice, this is a matter of style over substance, as contracting authorities already have significant flexibility under the current regime to take into account criteria including (amongst others) technical merit, functional characteristics and social, environmental and innovative characteristics (Regulation 67, Public Contracts Regulations 2015). This change is therefore about emphasis rather than substance.

Flexibility in the procurement process

A key Government objective in drafting the Bill has been to improve flexibility in the procurement process. Flexibility in the approach to procurement processes has been captured in the Bill by slimming down the numerous regulated procedures currently in use and including an option for two main competitive tendering procedures: an "open procedure" (single-stage, open to all) or the new "competitive flexible procedure". The Bill also retains the option to make direct awards in certain prescribed circumstances.

In terms of the new competitive flexible procedure, contracting authorities will largely be free to structure their processes however they see fit, subject to compliance with the new principles of public procurement set out in the Bill. Additionally, the Bill sets out certain characteristics which will need to be adhered to in the design of a competitive flexible procedure, including:

- the process must be a proportionate means to award the contract (considering nature, complexity and cost);
- the process may limit numbers of participants (generally or per round);
- the process may allow for award criteria to be refined; and
- bidders who did not participate in (or who were excluded from) an earlier round in the process must be prohibited from participation.

Further guidance is anticipated on the competitive flexible procedure (including example procedures), but we anticipate that this may be of particular interest to contracting authorities who are keen to adopt a lean negotiated process.

Transparency

As a quid pro quo for the additional flexibility set out above, contracting authorities are expected to comply with enhanced transparency obligations throughout the procurement process, and into the duration of public contracts awarded. Notably, the number of mandatory notices relating to tendering exercises and contracts awarded has significantly increased, and there are several voluntary notices that contracting authorities will also have an option to publish in various circumstances.

Notice	Compulsory / Voluntary
Planning and Pipeline Notice	Compulsory for contracting authorities who consider that they will pay more than £100m under relevant contracts in the coming financial year
Planned Procurement Notice	Voluntary – equivalent of a PIN (although not used as a means to call for competition)
Preliminary Market Engagement Notice	Voluntary – sets out intention to carry out pre-market engagement
Tender Notice	Compulsory where a contracting authority intends to award a public contract under clause 18
Contract Award Notice	Compulsory before entering into a public contract – sets out intention to enter into contract
Contract Details Notice	Compulsory – sets out that a contract has been entered into
Contract Change Notice	Compulsory – must publish before modifying an existing public contract (except in prescribed circumstances)
Contract Termination Notice	Compulsory – must publish within 30 days of termination (including termination by a party, discharge, expiry, recission and set aside by court order)
Dynamic Market Notices	Compulsory where a dynamic market is to be established
Transparency Notice	Compulsory where there is a direct award under clause 40 or clause 42
Payments Compliance Notices	Compulsory – must publish payment compliance information every 6 months in respect of prescribed values, and confirm compliance with prompt payment provisions
Below Threshold Tender Notice	Compulsory where a contracting authority intends to advertise for the purpose of inviting tenders for a below threshold procurement

It is clear from the above that contracting authorities will need to quickly get to grips with the new processes and publication requirements set out in the Bill, and we would encourage contracting authorities to avail themselves of the future learning and development programme promised by the Cabinet Office in respect of the new regime.

For a more detailed consideration of the Bill and its key changes, we have published an Essential Guide to the Procurement Bill which can be found here.

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The cost of living crisis

The economic outlook is challenging. Businesses, organisations, and individuals who have managed to withstand the challenges and impact of successive lockdown measures, now find their financial wellbeing is threatened by the "cost of living crisis".

The combined adverse implications of rising energy costs, inflation and interest rates affect all; individuals on universal credit, employees, the self-employed, business owners, large corporates, charities and other non-profit organisations, in all sectors.

For businesses, this could affect cash flow simultaneously with obligations to repay government support such as Bounce Back Loans and Coronavirus Business Interruption Loans. Pandemic related moratoriums on creditor action have ended and those who are owed money are likely to take swift action to recover unpaid debts.

For individuals, the cost of energy as we head into autumn and winter is causing alarm which is only partially abated by the government's recently announced price cap. An ONS survey at the end of July 2022 found that 24 million people were reducing energy use in their home between March and June 2022, and around 16 million cut back on food and essentials.

It is therefore likely that both personal and corporate insolvency numbers will rise. As a consequence, registered providers may well have dealings with insolvent businesses within their own supply chains, and individual customers affected by the cost of living crisis.

Supply chain insolvency

The ripple effect of insolvency in a supply chain can far reaching. Unsecured creditors, e.g., those who have supplied goods or services and await payment, or those who have pre-paid for goods and services and are yet to receive them, risk receiving pennies for every pound they are owed, and often such payment is not made until years later. Sub-contractors who predominantly work for one employer can often be owed such a significant sum that non-payment triggers their own insolvency.

Generally, an insolvent entity will either cease trading or sell its business to a new entity who may seek new terms of supply, disrupting the supply chain. Creditors who have pre-paid for goods or services but not received these may need to fund an alternative, putting pressure on their own cash flow for unbudgeted expenditure.

What steps should registered providers consider now?

- Monitor the supply chain – this might include regular credit checks, as well as frequent communication within the supply chain. If there are any issues suggesting financial difficulties, react promptly.
- Contingency planning – can you be flexible to adjust provision of the goods and services you require to assist the supply chain if needed? If you have essential suppliers, what is your plan if these cease?
- Be prepared to do your bit – as well as paying suppliers to agreed timescales (which should help trickle cash down the supply chain), protect your own cash flow by taking action to review bad debts and implement credit control measures fairly and robustly.

What should registered providers do if a supplier becomes insolvent?

Creditors may receive notification of insolvency before or after the insolvency commences. Different types of insolvency have different consequences. For example:

- A company in administration has the benefit of a complete moratorium, preventing legal proceedings and enforcement against it.
- Creditors cannot prevent a company going into liquidation but do get to vote on who becomes the liquidator(s).
- Creditors vote on a proposal for a company voluntary arrangement (CVA), and if approved, even those who voted against are bound by the arrangement.

Therefore, any notifications should be reviewed to determine what participation is required. Mostly, creditors will need to provide details of the sums owed to them (usually by submitting a 'proof of debt' form) and may be asked to cast their vote in relation to certain matters.

There may be other consequences, such as the impact on ongoing legal proceedings, the ability to recover items in the possession of the insolvent entity, or the ramifications for contractual arrangements and future supplies. Specialist advice should be sought.

Customer insolvency

The cost of living crisis is going to put more pressure on income. This may cause difficult choices. For example, does an employee pay their energy bills to heat their home, or fuel costs to get to work? Rent is usually high in a priority list, but registered providers may see larger number of late payments and defaulting tenants.

For affected individuals, good debt advice will be essential but can be difficult to obtain. The Citizens Advice Bureau, the National Debtline, and Step Change (among other organisations) all offer free debt advice and are all well versed in ensuring people are managing priority debts and accessing all the financial assistance that may be available.

There are several insolvency measures that registered providers may encounter:

- For those in need of a breathing space, a temporary moratorium can be obtained. These were introduced in May 2020, giving individuals a short time in which they are protected from creditor action, to take advice and decide on next steps.
- Individual Voluntary Arrangements (IVAs) can enable payment plans with creditors to be formalised.
- Debt relief orders (DROs) or bankruptcy help people draw a line and move forward free from historic debt.

Conclusion

With the Bank of England forecasting rising inflation well into 2023 and potentially beyond, and geo-political uncertainty linked to the high cost of gas in Europe, the economic outlook is certain to cause concern for some time, notwithstanding any government support that may be available. As a result, registered providers may encounter insolvency and should promptly consider any implications to manage the impact.

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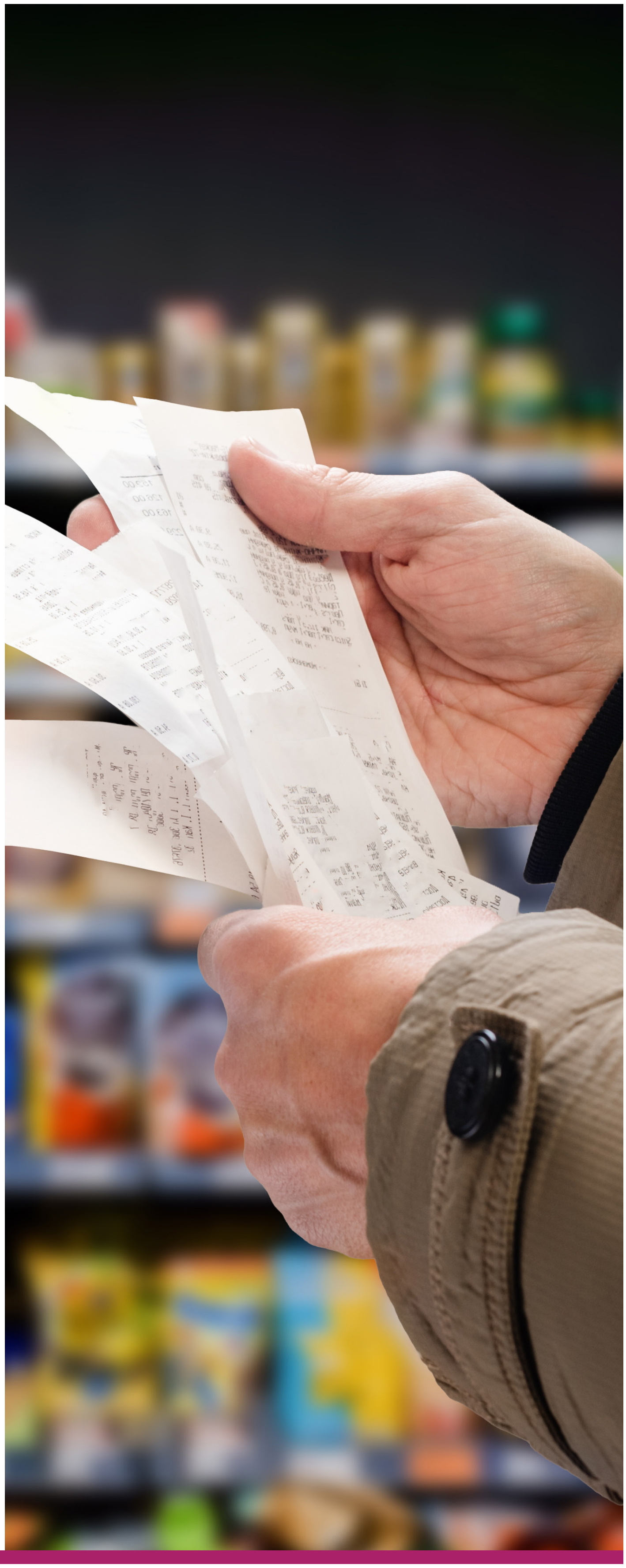

New money, new ideas: Part 3 – pay it forward

Could institutional forward funding be part of the answer to financing the development pipelines of Registered Providers at a time of capital constraint?

As traditional Registered Providers (RPs) continue to face a challenging financial landscape – including the prospect of a two-pronged squeeze on their business plans arising from the proposed rent cap on the one hand alongside increasing cash demands from building safety and energy efficiency works on the other – the search for additional sources of capital to fund their development pipeline has rarely been more pressing.

Some RPs have already sought to plug this funding gap by undertaking sales of tenanted stock portfolios, notably comprising shared ownership reversions, to for-profit RPs owned by institutional investors. This has released significant amounts of capital which can be immediately recycled into funding new developments alongside other expenditure priorities.

Yet, where tenanted stock disposals are not appropriate or desirable, there are other ways of more directly channelling such institutional funding into the development pipeline to enable traditional RPs to fulfil or even expand their development ambitions, even in a climate of financial uncertainty.

Forward purchase

The easiest method is to secure a back-to-back forward purchase of the new affordable homes from the prospective investor (i.e. a "turnkey sale" arrangement), on the condition that the selling RP will take back a long term management agreement or management lease of the homes simultaneously with completion of the sale.

Here, the RP manages and funds the development itself, but has the contractual comfort of knowing that all costs will be immediately reimbursed upon practical completion of the scheme, which is when the homes are transferred to the investor for a pre-agreed price. The sales risk in relation to the shared ownership element can also be transferred to the investor, further delivering an immediate cash injection into the RP's business. No consultation is required as there are no tenants at the point of the sale completion.

This is most easily done where the RP already owns the site and is directly procuring the construction of the scheme, so that the full range of collateral warranties can be offered to the investor (as is customarily required in the context of institutional funding). Moreover, the investor's preferred specification and any other bespoke requirements could be worked into the procurement of the construction supply chain.

But even where the RP is itself acquiring the homes from a housebuilder or developer on a turnkey basis (for example, as part of a Section 106 package), if adequate terms can be negotiated with the housebuilder, then a similar warranty and handover package could be offered to the investor as part of the onward forward sale.

Forward funding

If the scheme is particularly large or if cash reserves are particularly constrained, it may be possible for the RP to structure such onward sales on a forward-funded basis, where the investor acquires and pays for the land at an early stage (typically at "Golden Brick" level) and then also pays for the construction costs throughout the remainder of the build programme. This would effectively mirror the familiar Golden Brick acquisitions which RPs have been entering into for many years, as RPs have sought to leverage their relatively lower cost of capital to secure better pricing terms with housebuilders.

Such forward-funded sales would have the dual benefit of securing the investment at an early stage, whilst also requiring the investor to cashflow the development costs – something which may become increasingly attractive to RPs facing a sudden tightening of surpluses.

Meanwhile, the RP performs the development management role (albeit on behalf of the investor rather than for itself) which would enable the RP to maintain its working relationships with key housebuilder or developer partners, leverage the expertise of its existing development team, and also potentially charge a development management fee to the investor. Since the RP would likely retain some repairs and maintenance risk as part of the future management arrangements, its interests in ensuring that the homes are built to the right quality would be aligned with the interests of the investor.

Whilst RPs have in the past shied away from alternative approaches to financing their development pipeline, now might be the time for them to start considering institutional forward funding as a way of securing their development pipelines and ensuring that new affordable homes continue to be delivered in line with programmes in spite of the reduction in available reserves.

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Economic Crime (Transparency and Enforcement) Act 2022

If you own land through or transact with an entity registered outside of the UK, you may soon start to see a new restriction on the title register to that entity's property. We explore where that has come from and what it means for you.

The Economic Crime (Transparency and Enforcement) Act 2022 (ECTA) came into effect on 1 August 2022, in the wake of Russia's invasion of Ukraine and government concern over transparency of overseas investments in UK real estate. Prior to ECTA, only companies registered at Companies House were required to disclose their beneficial ownership in the UK. Traditionally, this privacy has been one of the key drivers (in many cases along with tax treatment) for use of entities in other jurisdictions where such details do not need to be disclosed.

Whilst it is outside the power of the UK's government to change what information other jurisdictions require to be made public, it can exercise some level of control over dealings of land in the UK and it is doing so by requiring HM Land Registry to place a new restriction on the title register to all property owned by legal entities governed by the law of a country or territory outside the United Kingdom (known as OEs). This will refer to the application of Schedule 4A of the Land Registration Act 2002. The restriction prevents registration of transfers, leases for more than seven years, or charges , unless the OE is registered, exempt, or the disposition is made in certain specified circumstances (including where the transfer of land owned by an OE is made in pursuance of a contract made before the restriction was entered onto that OE's title.). There are two forms of restriction:

1. For OEs who have become registered proprietor pursuant to an application made between 1 January 1999 and 31 July 2022, which will take effect from 31 January 2023; and
2. For OEs who have applied to become registered proprietor on or after 1 August 2022, which will take effect immediately.

So, what does this require? For the vast majority of OEs, it means registration under ECTA and an ongoing annual duty to update the information held by Companies House. The register is held by Companies House. An OE must take steps to identify its beneficial owners and submit this information to a registered verification agent who will make the application to Companies House for entry on the register. Crucially, registration at Companies House will provide an OE with an OEID number which can be used to prove registration. From 5 September 2022, HM Land Registry will not process any applications to register acquisitions by an OE unless an OEID is provided. Any such applications will according to its own guidance be rejected outright by HM Land Registry, which means that priority for that application will be lost.

Equally, OEs which already hold land must register for an OEID as they will not be able to transfer, charge or grant a lease for more than seven years of such land after 31 January 2023 without being registered. This will also be a criminal offence which can cause officers of an OE to be subject to a fine or imprisonment.

Trowers can help with the necessary contract wording to help you navigate this emerging area of law.

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Housing associations and the Unencumbered Asset Test Ratio

Registered Providers have historically been considered a very low credit risk for lenders, due in a large part to the entrenched regulatory framework under which they are governed. RPs are also an appealing category of borrower, as they boast long-term stable cash flows, and many have secured a 'sub-sovereign'/quasi-public status by ratings agencies.

As such, social housing finance is typically a 'no default' sector and the continued lender confidence in the sector alongside the burgeoning impact investment market and growth of for-profit RPs has paved the way for new lenders and investors to join the market.

Traditionally financing is secured against an RP's portfolio of social housing units; and the market has streamlined the charging process through the use of security trusts where multiple lenders (or agents in the case of syndicated loans) can join as beneficiaries under the same trust, with charged properties capable of being allocated between beneficiaries without the need to release and recharge.

Some of (relatively) new lenders to the sector are offering unsecured lending, doing away with security trusts, property due diligence and managing property allocations; and established high street lenders are now also offering tranches of unsecured lending (alongside secured lending). Much of this unsecured lending may be taken out by RPs on a "just in case" basis to plug a liquidity gap in obtaining or refinancing long term debt via the capital markets.

Typically, under any unsecured lending arrangements, an RP is required to keep a specified number of assets free of security (known as "unencumbered assets"), which forms for the basis of a new financial covenant known as an "Unencumbered Asset Cover Ratio".

Cover ratios require RPs to maintain assets which are not subject to fixed security in favour of any other lender at a minimum level which is measured as a ratio against the amount of the debt provided by that lender.

Below are some of the commercial principles to consider when negotiating an unencumbered asset test:

1. What restrictions are there on the type of assets which can be included as part of the unencumbered assets? Will a lender permit shared ownership units to be included in the calculation or include a maximum threshold? Can the RP include commercial property such as its head office; or commercial units within residential estates? What about non property assets such as cash collateral?
2. Is the calculation of unsecured debt limited to the amount of all drawn loans or should it include committed but undrawn facilities? Given the volume of unused liquidity in the sector, this could have a significant impact on the amount an RP can draw under a facility with an unencumbered assets test.
3. Should the calculation of unsecured debt include any mark to market exposures? For RPs with fixed rate loans and embedded swaps, the impact of including the mark to market exposure in the financial covenant should be considered.
4. Should the unencumbered asset value be calculated on the existing use value of an RP's social housing units (EUV-SH), or will the lender permit units to be valued (or revalued) on the higher market value basis? Uncertain market conditions, rising volatility and increasing pricing no doubt have the potential to cause a shift in the current trends. The flexibility afforded by unsecured lending may well become more popular for borrowers; and represent an opportunity to differentiate for funders seeking to increase their market share across the sector.

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Maintaining security of deposits

In light of the recent change in NHBC policy wording, how can Registered Providers ensure that deposits released on exchange of contracts are repaid if the developer defaults or becomes insolvent?

Following months of economic turbulence and anticipation of market downturn, developers are increasingly asking Registered Providers (RPs) to release deposits on exchange in affordable housing deals to assist the overall project cash flows. Even in the good times this was fairly common practice and was considered acceptable by both parties as long as the deposit was adequately secured in some way. By releasing the deposit, RPs could leverage their relatively lower cost of capital to assist the developer's cash flow, usually in return for a slightly lower package price.

One of the most frequently used methods for securing repayment of the deposit was for the developer to include the optional pre-completion contractor insolvency cover under NHBC's Buildmark Choice warranty. The longstanding policy wording had until recently covered repayment of deposits or other payments already made under the contract, usually up to 10% of the contract value.

But for schemes registered with NHBC after 1 April 2022, a revised policy now applies and deposits are no longer covered. The official reasoning being that the previous policy wording was considered to be a moral hazard, incentivising excessive risk taking by RPs. The revised policy still offers cover for cost overruns where the RP steps in to complete the construction of the dwellings following insolvency of the developer, as this was assumed to be the key concern for RPs on development acquisitions.

Whilst NHBC have said that they will still provide security for released deposits on a case-by-case basis (by issuing a side letter to reinstate the previous policy wording), where this is not given, what other methods could RPs use to secure repayment of deposits if the developer becomes insolvent?

- Parent company guarantee – depending on the corporate group structure of the developer, a guarantee from the main trading vehicle or ultimate parent company might provide sufficient covenant strength.
- On-demand advance payment bond – usually given by a recognised financial institution, this will provide arguably better cover than NHBC once did, but may be prohibitively expensive for SME developers.
- Legal charge over the whole or part of the site – if the affordable homes are being delivered relatively early compared to the remainder of the site, that land could be used as security for the deposit as long as it is independently deliverable and bears sufficient residual value.
- Taking the land transfer at Golden Brick stage – although this may already be envisaged in a large number of transactions, until recently lower value deals were often simpler to structure on a turnkey basis with a released deposit. These could instead be restructured as Golden Brick deals to offset the cash flow disadvantage of not releasing the deposit.
- Taking the land transfer up front – this could release the whole of the land price to the developer (not just the deposit) in return for a lower construction package price, but would be dependent on the VAT treatment of the land sale.

Whilst each of these alternative options would require some degree of additional complexity, that may become a worthwhile trade off in the absence of the more straight-forward solution of using NHBC pre-completion contractor insolvency cover.

But in all cases, RPs will likely be scrutinising developers' financial health with increasing rigour and may adopt more conservative payment profiles in light of the growing concerns over the risk of insolvencies in the housebuilder sector.

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