Devonshires

The Autumn Budget - What you need to know

In this issue

Welcome

Following our initial observations on the Autumn Budget, we've put together this briefing which delves into the detail to bring you further insights into what it means for those operating in the housing industry.

We explore some of the challenges that the proposals raise for housing associations and local authorities as well as the approaches that these organisations can take to help overcome them and boost supply.

Following the Chancellor's measures to prevent land banking, our real estate and property litigation experts discuss the impact of extending compulsory purchase orders.

For those responsible for social housing finance, we provide our views on gearing covenant constraints and the impact on housing supply.

And in our final article, we look at the role of local authorities in meeting the Government's housebuilding targets.

For further information on any of the topics discussed in this briefing, please do not hesitate to contact us.

Jonathan Corris I Partner
020 7880 4305
jonathan.corris@devonshires.co.uk

Doing more with less

Jonathan Corris and Andrew Cowan summarise some of the challenges which follow the Autumn Budget and how housing providers and local authorities can respond.

Although the debate continues on whether it was a homeowners or homebuilders budget, the key message from the Government remains the need to address the housing crisis.

It is clear that the Government is looking for private registered providers (PRPs) and local authorities to plug the gap and take even bigger steps to deliver more housing in a variety of tenures. However, the Chancellor is looking to promote alternative means of delivery and not to provide additional funding through the previous grant regimes.

This lack of grant support raises the question as to how PRPs and local authorities are going to deliver new social rent schemes in those critical areas of the country which are in desperate need of true affordable housing.

The Budget focused on the target of 300,000 homes per year but as reported by Savills, at least a third of this needs to be delivered below market levels. Through our work with a variety of clients across the country on a range of tenure-focused schemes, it is also clear, even to us lawyers, that one solution for the entire country will not address the different needs of local communities.

Barriers for local authorities

On the 16th November 2017, Sajid Javid announced that he was taking action against local authorities which have failed to deliver their local plans and is seeking to put forward regulations that would see these reviewed every five years. This is a significant burden for local authorities and would result in additional costs. Currently, it is proposed that these costs would be covered by the government's commitment to increase planning fees for applicants by 20%.

Balancing local needs with certainty for developers regarding planning requirements will continue to plague the UK's

development landscape for some time. For transactions that were conditional on planning, we used to advise clients to look for conditional periods of 12 - 18 months. Now, we advise to look for a minimum of two to three years to allow time to navigate our cumbersome planning process.

Addressing this issue will require an investment in extra resources within local authorities.

Committing to new approaches

Despite these challenges, PRPs and local authorities have the potential to overcome some of the hurdles if they explore and commit to different approaches to boosting supply.

This includes forming joint ventures, which have been largely embraced by PRPs and sectors of the private development market. These now need to evolve and adapt to new situations and to involve new participants. Stronger commercial ventures and flexible partnering between local authorities and PRPs would not only improve the delivery of homes for market sale but provide different and more sustainable housing solutions in a market downturn.

In addition, the growth of joint ventures and collaborating arrangements between PRPs could increase capacity through shared resources and remove the need for large-scale mergers. Key to the success of these structures is a need to acknowledge the strengths of other parties. Combining the expertise and market knowledge of a dedicated local PRP with the insights from an PRP operating in a different region and which has already delivered new models of housing, could result in cost and delivery efficiencies as well as potential new sources of funding.

Funding for SME builders

The budget message emphasised the Government's focus to work with local SME builders to assist in delivering housing. The exact funding details are due to follow however, we wonder whether there will be opportunities for PRPs to work with SMEs to secure potential funding so that both parties can make those sub twenty unit schemes viable for affordable tenure units in line with local needs.

The challenges raised in the Autumn Budget aren't new but they do underline the need for fresh thinking. PRPs and local authorities will always face hurdles in boosting supply but there are opportunities too. By considering new approaches and ways of working with different partners, housing providers can be a massive part of the solution to our housing crisis.

Jonathan Corris I Partner
020 7880 4305
jonathan.corris@devonshires.co.uk

Andrew Cowan I Partner
020 7880 4350
andrew.cowan@devonshires.co.uk

Closing the Gap

Caroline Mostowfi and Neil Lawlor review the Chancellor's compulsory purchase order proposals.

The Chancellor has announced that he is establishing a review to look at the gap between grants of planning permission and housing construction. This is aimed at addressing and analysing "land banking" ie where land which has deliberately remained undeveloped for commercial reasons such as to keep housing supply low and prices high in areas where demand is high.

It was announced that if these practices were found to exist, that they could be subject to government intervention, including using compulsory purchase powers to ensure the land was developed. An interim report from the review is expected in time for the Spring Statement 2018.

The Chancellor also revealed that to increase development and housebuilding, the Homes and Communities Agency will expand to become "Homes England". This will then bring together "money, expertise, and planning & compulsory purchase powers".

Controversial but not surprising

Extending compulsory purchase powers would be a controversial move and the proposal has already seen some housebuilders' share prices tumble. Many developers would argue that their land holdings would be developed if it were viable to do so and some will continue to deny that they land bank in the first place.

However, the potential introduction of compulsory purchase powers should not come as a surprise to housebuilders. It follows a number of other reviews on this matter as well as calls from various quarters over the last few years to force developers to end land banking.

Unanswered questions

Nonetheless there are some key questions which will need to be clarified: What exactly qualifies as 'land banking'? and Who exactly would the powers affect?

The main aim is to bring forward housing on land which has planning permission but remains undeveloped, although arguably land banking isn't the whole story. There are numerous external factors which can, and will, determine whether a development goes ahead - for example, going forward this could include a shortage of construction workers because of Brexit.

Ultimately the Government and its agencies will need to tread carefully to strike the right balance between private property rights and the need to intervene. And let's not forget that the compulsory purchase process is rarely straightforward and could prove to be an expensive task for the new Homes England agency.

We will need to wait until the Spring Statement to know the full extent of these compulsory powers and their impact. However, the mere threat of introducing compulsory purchase powers for land banking is likely to lead to many developers and investors re-thinking their strategies.

Neil Lawlor I Partner
020 7880 4273
neil.lawlor@devonshires.co.uk

Caroline Mostowfi I Partner
020 7065 1855
caroline.mostowfi@devonshires.co.uk

Gearing cuts against the grain

Gary Grigor discusses the gearing covenant constraints and the impact on housing supply.

In light of recent initiatives in the 2017 Budget to stimulate housing supply, there is an ever-growing argument that gearing covenants constrain Registered Providers (RPs) and Registered Social Landlords (collectively, Associations) from reaching their true potential.

Most mature Associations on corporate covenants are expected to demonstrate their perceived financial health via annual interest cover compliance (sometimes on a three-year rolling basis) and gearing compliance at all times. Net rental income tests are also infrequently requested by some funders in the sector.

Gearing covenant frustrations

Whilst no Association would take issue with demonstrating its ability to generate enough income to satisfy interest cover over a rolling periodic basis, it is the gearing covenant, in its various subtle iterations, that continues to cause frustration.

In essence gearing assesses the amount of debt in an Association as a proportion or percentage of that Association's underlying assets. The greater amount of debt to the cost/value/number of those assets (however the test happens to be prescribed), the more turbulent the financial health of that Association is perceived to be.

But in a sector where the debt capital markets (private and public) have successfully funded without a gearing covenant, why does it continue to persist in new and restated legacy bank funding documentation and some private placements that go to market?

Banks will point to compliance of the gearing covenant as a demonstration of stability and financial health within

predefined parameters, all with the aim of ensuring that the Association is not financially overstretching itself over the short-medium term.

Hindering supply

In the debt capital markets, there is recognition that by the very nature of the long-term funding of those particular deals, the relevant Association needs to put its cash to work in order to realise the long term financial gains to which it aspires.

So, at a time when the Chancellor is calling all Associations to arms and to equip themselves with every possible trowel and spade within sight to deliver the extra capacity, do the constraints of a gearing covenant cut against the grain of the call to increase supply?

In short, yes. With an already limited supply of housing available to be acquired, Associations are naturally looking to development activities to try and meet demand. Such development activities require large up-front cash commitments, but this results an intrinsic lag between that upfront cash investment and when the tangible assets emerge that can readily be identified for covenant testing purposes. There is therefore limited scope for Associations to be able to increase debt and show immediate equivalent assets gains.

Debt

With £15.3bn of new financial measures announced by the Chancellor, it is too early to say if those financial initiatives will ultimately disseminate down to the pockets of the Associations. If they do, then that raises the question if such funds will constitute component parts of "debt" for the purposes of gearing?

Conventional wisdom would say that the Government will require its money back in some form and for that reason the financial assistance will constitute "debt", therefore scuppering the intention of those Associations constrained by gearing covenants. Irrespective of whether the debt is accrued from government or private finance arrangements the Associations will still be constrained from putting that money to work because of the lag of achieving tangible housing properties by which to counter-balance the debt ratio for gearing purposes.

This often has the added complication that the treatment of an Association's assets for calculating gearing is not uniform. It is not untypical for gearing covenants to attribute a lower value to shared equity assets such as shared ownership properties and right to buy properties. This places an additional hardship on Associations to meet prescribed gearing thresholds where their asset base is diverse.

So whilst the Chancellor will continue to call on Associations to do as much as they can for the greater social purpose upon which they are founded, just don't expect too much because it will be to their ultimate peril if they do!

Gary Grigor I Partner
0113 357 1144
gary.grigor@devonshires.co.uk

The role of local authorities in hitting the 300,000 new homes target

Jonathan Jarvis explores what needs to change to help local authorities play a bigger role in boosting housing supply.

The Autumn Budget confirmed the Government's commitment to fixing the broken housing market. A key tenet of that commitment is its aim for the country to be building, on average, 300,000 new homes per annum by the middle of the next decade.

For that aim to be met, all housing providers will need to pull together and maximise their capacity.

Stepping up to the plate

Local authorities, for their part, have been "champing at the bit" for some time to play a bigger role. Many have established their own local housing companies, financed through on-lent Public Works Loan Board (PWLB) funds, to supplement the development carried out within their housing revenue account (HRA).

The HRA debt cap, introduced by Government when it dismantled the HRA subsidy system in 2012, has been subject to much criticism for artificially constraining local authorities' financial capacity and their ability to develop more homes.

The Chancellor gave muted support for local authorities' aspirations to do more in the Autumn Budget. This took the form of up to £1billion of additional debt capacity for those local authorities operating in areas that face "high affordability pressure". It is for local authorities to submit bids for a slice of the additional debt capacity.

The Local Government Association has been quick to call for Government to offer up more significant debt freedoms than those offered up in the Autumn Budget. But what else could the Government do to encourage local authorities to increase their outputs and help deliver on the 300,000 new homes per annum target?

Support for local housing companies

A willingness to support local housing companies that are ambitious about increasing local supply and joint ventures with other local housing providers (whether private registered providers (PRPs) or other housebuilders) could play a key role in boosting supply. Removing the spectre of the high value voids levy would also undoubtedly help.

At present, the General Consents regimes (under Section 32 Housing Act 1985 and Section 25 Local Government Act 1988) discourage the growth of local housing companies. Certain consents are not available where the disposal, or financial assistance, is to an entity in which the local authority has an interest or where the local authority is seeking to provide the housing management services.

The same is true of arrangements relating to the application of RTB receipts where the local authority is, in effect, penalised for passing those proceeds to an entity in which the local authority has a controlling interest. If the Government is serious about achieving its 300,000 new homes target, isn't it incumbent on it to support all avenues available to create new supply?

Joint ventures

PRPs and national housebuilders have forged successful joint ventures in recent times. Local authorities have too, but not on the same scale, at least in terms of frequency. Lessons need to be learnt from PRPs increased joint venture activity and whether these structures are replicable for local authorities.

The development of "conventional" structures and terms has helped to speed up joint venture activity within the PRP sector. Housebuilders willingness to share in the risk and reward of a development and access supply chain efficiencies in consideration for funding made available from their joint venture partners has also been instrumental. Local authorities are capable of offering up comparable funding terms, so there's no reason why the same models can't be replicated.

Fresh thinking

The rebrand announced for the Homes and Communities Agency in the Autumn Budget (Homes England going forward) brought back memories of English Partnerships. One of the last initiatives driven forward by English Partnerships, before it was merged with the Housing Corporation to create the HCA, was a pilot scheme for local housing companies. This envisaged a three-way joint venture model involving a local authority, a national housebuilder and English Partnerships. The Department for Communities and Local Government's (DCLG) demonstrable lack of enthusiasm for the model meant the initiative never progressed.

It is understandable that the DCLG took that view as the proposal was for large scale, competitively procured joint venture projects. But a new pilot initiative, endorsed by DCLG, aimed at offering up a template for a simple joint venture model which builds on the experiences of PRPs and national housebuilders, may be very timely indeed.

Jonathan Jarvis I Partner
020 7065 1810
jonathan.jarvis@devonshires.co.uk