What do lenders need to know about the Building Safety Act 2022?

The Building Safety Act 2022 aims to create a new system of regulation and accountability in the construction and operation of high-rise residential buildings in England. The demand for a fairer, safer and more modern regulatory framework for the building industry was driven by devastating incidents which exposed major flaws in the previous system. However, the Act comes with its own complexities and controversies.

Some of the changes to be brought about under the Act are not yet in force. We also await detail on some of the measures that will be set out in secondary legislation.

In this briefing, we consider the impact of the Act on financing tall buildings with a residential element (in England only) and some of the issues that lenders will need to consider in structuring, investigating and documenting the debt financing of such buildings.

Higher-risk residential buildings

Both existing and new higher-risk residential buildings (HRRB) will come under the remit of a new regulator, the Building Safety Regulator (BSR), and will need to comply with new rules relating to fire safety, design, construction and occupation.

HRRB are buildings which are or are intended to be at least 18 metres high (or seven storeys) with two or more residential units (with exclusions applying to certain types of building in particular circumstances).

Gateways

New HRRBs require BSR approval at three 'gateway' stages during the design and construction process to ensure that safety has been a genuine and key consideration in that process.

The three gateways at which the BSR's approval is needed are:

- **Gateway One: Planning** – this came into force in August 2021 and requires a fire statement to be submitted to the planning authority as part of any planning application. The BSR can advise the planning authority of any concerns with a proposed building's fire safety plans and request more information from applicants.

- **Gateway Two: Design and construction** – this is anticipated to come into force by October 2023. The BSR will need to confirm that the plans relating to the design and construction of the building meet the Building Regulation requirements before a developer can begin any construction or refurbishment works.

- **Gateway Three: Pre-occupation** – this is also anticipated to be in force by October 2023 (although there will be a transitional regime for HRRBs currently under construction) and requires a developer to submit as-built information to the BSR. The BSR will need to assess whether the building complies with the Building Regulations and issue its own completion certificate. In order for the certification to be given, the building must be completed and systems fully commissioned – with documentation to evidence the build is compliant.

Given the nascent nature of the gateway regime and the processes that need to be implemented in conjunction with each gateway, it remains to be seen how timely sign-off by the BSR at each of the gateways will be – although the BSR will have a 12-week determination period from the date of receipt of both the Gateway Two and Three applications.

Registration of new developments

A failure or a delay in the receipt of an approval from the BSR may have timing (and, consequentially, cost) implications that may be significant for the relevant development (and any lender funding it). Significantly, most new

HRRBs cannot be physically occupied until they are registered with the BSR (and such registration can only take place once the completion certificate has been issued by the BSR at Gateway Three).

On that basis, it is expected, in new agreements for lease for HRRBs, that tenants will seek to ensure that registration with the BSR is a condition precedent to the rent becoming payable by the tenant under such leases – as they cannot legally occupy until registration.

The requirement for this additional certification from a third party (the BSR) at Gateway Three and registration, therefore, raises further considerations for lenders – especially where the relevant deal is underwritten on the basis of an income stream materialising at a specific point in time and/or the building being ready for occupancy before a specific point in the year.

Registration of existing developments

The gateway regime only applies to new developments of HRRBs. Existing HRRBs must be registered with the BSR by 30 September 2023 (certain buildings which are subject to their own safety regimes, such as hospitals, care homes and hotels are excluded).

The process for registration of an existing HRRB is not necessarily straightforward. It may, for example, be necessary to obtain professional advice to determine whether the building is an HRRB, there may be complexity in establishing who is responsible for submitting the application and/or it may be necessary to compile key building information that needs to be submitted following registration.

Failure to register an HRRB by the statutory deadline is a criminal offence punishable by up to two years imprisonment for officers of offending corporate bodies and daily fines until the building is registered.

The Act does not oblige the BSR to make the register public – although it is thought that it will be made public at some future point in time. Accordingly, lenders against HRRBs will need to request evidence of registration (in the form of the registration certificate issued by the BSR) from the borrower to evidence compliance with this aspect of the Act.

Accountable Persons

Every existing HRRB must have an identified Principal Accountable Person (PAP) by 30 September 2023. It is not entirely clear from the Act but it would appear that new HRRBs must have an identified PAP prior to occupation. This is the person or organisation that owns or has a legal obligation to repair the structure and exterior parts of the building.

The PAP is responsible for registering the building with the BSR and must carry out ongoing mandatory reporting to the BSR, assess safety risks and establish a residents' engagement strategy and complaints procedure.

In some circumstances, there may be others with legal responsibility for different parts of a building's common parts, in which case they will be Accountable Persons (AP) with duties to co-ordinate and co-operate with the PAP. The information provided as part of the on-going mandatory reporting regime forms part of the "Golden Thread" (see below).

Failure by a PAP/AP to comply with the duties imposed on it may result in criminal prosecution. Additionally, the BSR has the power to appoint a special measures manager to take over building safety duties from all PAP/APs where failure to discharge duties puts residents at risk.

Managing agents

Government guidance indicates that a managing agent appointed under a contract (as opposed to a management company who is party to a lease) cannot take on the role of PAP (or AP).

The PAP or AP may employ a managing agent to perform its duties under the Act but, ultimately, responsibility for compliance with it rests with the PAP and/or the AP (as the case may be).

It will be important for lenders to understand who will be performing the actions required of the PAP and/or the AP and to consider the documentary and structural ramifications of this on a deal-by-deal basis. Where an HRRB is owned by a special purpose vehicle (SPV), it would seem likely that a third party will be employed by the SPV-owner to perform the PAP/AP duties – and the extension of the services provided by the managing agent to the SPV could be a natural home for these.

Whether managing agents will be willing to take on this role, however, is another question. Where they do undertake to perform services related to these duties, how this is reflected in the terms of their appointment and any related duty of care in favour of a lender will need to be considered.

The 'Golden Thread'

One of the criticisms of the previous regime was a lack of information – meaning that refurbishments of a building often took place without critical details about the original design. The Act therefore introduces the concept of a "Golden Thread" of prescribed information held digitally and maintained throughout the lifecycle of an HRRB which aims to improve transparency and accountability for building design.

The details of this information are yet to be finalised, but it is anticipated that this will include the building's construction and maintenance history and any defects that have been identified, together with remediation works carried out. Secondary legislation is expected in autumn 2023.

Everyone involved with the build (including the developer, designers and contractors) will be obliged to feed into the Golden Thread, with compliance monitored by the BSR at each of the gateways discussed above. Post-registration, the PAP and any APs will maintain the Golden Thread, again subject to the oversight of the BSR.

Failure to maintain the Golden Thread will have ramifications for any sale of an HRRB in connection with any lender enforcement action or otherwise given the new PAP and/or AP will then assume responsibility for compliance with the Act following a sale. Accordingly, lenders funding the development of an HRRB (or any investment in an HRRB) will be keen to obtain comfort on the completeness of the Golden Thread at the point that they become involved with an HRRB and the subsequent upkeep of that information.

It will be interesting to see how the market seeks to address these issues – whether it be through an enhanced package of representations and/or reporting by an independent third party.

Additional regime compliance costs

Specific provision is made in the Act to allow some of the additional costs that will be incurred for the owners of HRRBs in discharging the ongoing PAP duties (ongoing mandatory reporting, managing a residents' engagement strategy, etc.) to be recovered from the leaseholders via the service charge.

Lenders will be keen to establish the quantum of such costs and any amounts that are not recoverable, via the service charge, from tenants.

Relevant Buildings

Remediation costs for Relevant Buildings

The Act also creates a further class of buildings: Relevant Buildings. Their definition is different to an HRRB and a Relevant Building may also be an HRRB. Relevant Buildings are defined in the Act as self-contained buildings (or parts of buildings) that contain at least two dwellings and are at least 11 metres high or have at least five storeys.

The Act requires building owners to undertake building safety remediation works to Relevant Buildings and applies caps and exclusions to limit or prevent the recovery of the cost of remediation works from the leaseholders through their service charges.

Not all leases in Relevant Buildings benefit from the same caps and exclusions and, in certain circumstances, the protection can even extend to commercial leases within a mixed-use building that qualifies as a Relevant Building. The provisions are complex and different levels of protection apply depending on a variety of factors including:

- the cost of the work, the type of work and who bears responsibility for the issue that has necessitated remediation;
- whether the landlord has pursued all viable avenues of recovery before seeking to recharge costs through the service charge;
- whether the current landlord (and its predecessors in title) supplied prescribed documentation to the leaseholders when it was required to do so;
- the net worth of the party which was the landlord on 14 February 2022 and its group;

- how many other properties were owned by the party who was the tenant on 14 February 2022; and
- what each leaseholder's property was worth on 14 February 2022.

Additional due diligence

On any debt financing of a Relevant Building, it is important that lenders carry out due diligence to ascertain whether any remediation will be required and how the costs of that remediation will be apportioned between the leaseholders (via the service charge) and the owner of the Relevant Building – and the impact this may have on the cashflows of the borrower.

The apportionment of remediation works will be determined on the basis of some of the factors mentioned above. Evidence will need to be obtained from the previous owner(s) to establish the position of the Relevant Building's owner/leaseholders as at 14 February 2022.

Remediation Orders and Remediation Contribution Orders

Interested parties may seek orders from the First-Tier Tribunal for determination that a party (usually the landlord) must carry out remediation works to a Relevant Building, or to require that another party (perhaps the original developer) makes a contribution to the costs of remediation works that need to be or have already been carried out.

The contribution option means that a developer that has constructed and sold on a building with a defect which causes a risk to the safety of residents could later be subject to a Remediation Contribution Order requiring it to refund sums incurred in remedying that defect. The lookback period is considerable, with a 30 year retrospective period for claims where the cause of action accrued before 28 June 2022.

The Act makes provision to pierce the corporate veil in relation to Remediation Contribution Orders. These can be made "*where just and equitable*" and can be issued against specified landlords and developers but also against a person "*associated*" with either of them.

Building Liability Orders

The Act also makes provision to pierce the corporate veil in relation to Building Liability Orders, preventing those responsible for safety defects escaping liability through the practice of carrying out projects using an SPV which is then wound-up once the build is complete. Where *"just and equitable*", the court can impose liability on an associate entity (broadly a parent, subsidiary or sister company).

Impact on lenders

There are still a number of "known unknowns" in respect of which further legislative action is pending. For example, the detail of how Gateway Two and Gateway Three will operate has yet to be set out in legislation and the format and exact content of the Golden Thread has yet to be settled. These matters aside, the Act will necessitate new considerations by lenders funding tall buildings with a residential element.

How these new considerations manifest themselves in the market's approach to documentary and structural requirements remains to be seen, but there will inevitably be some flux and uncertainty until that point is reached.

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