Mortgagee in Possession – Section 106 Standard Clauses

Practice Note January 2019

Introduction

1. Mortgagee in Possession (MiP) clauses within Section 106 agreements (S106 agreement) enable Registered Providers (RP) to provide for circumstances where a Registered Provider defaults on loan payments or other loan/mortgage terms and a mortgagee (or other relevant funding party) takes control of the RP’s interest in affordable housing units as assets against which their loan is secured. The clauses allow for another RP to purchase the affordable housing units within a specified timeframe known as the ‘moratorium period’ under a prescribed procedure. This is set out in the S106 agreement and is a contractual arrangement. Where the units are not purchased within this period, they are released from affordable tenure, enabling the mortgagee to dispose of the units in order to regain some or all of the loan that they have provided.

2. Different approaches to MiP clauses have been applied which has caused delay to S106 negotiations and uncertainty for Local Planning Authorities (LPAs) and the sector. This is relevant to the level of funding that RPs are able to secure against affordable housing units to fund the provision of additional affordable housing as part of their delivery programme.

Standard S106 MiP Clauses

3. The Greater London Authority (GLA) has produced standard S106 MPCs in order to promote a consistent approach across London. These are supported by the National Housing Federation Property Finance Working Group (NHF PFWG). The approach will help to increase the funding available for affordable housing delivery in London, whilst ensuring the role of LPAs in enabling the affordable units to be acquired, in the event of a default by the original RP.

4. The clauses provide for a three month moratorium period and enable the LPA, or an alternative RP nominated by the LPA, to be granted an interest in the land within the initial period of the moratorium period. This increases the likelihood of a transfer of the units to be completed within the moratorium period. The amount payable to the mortgagee should be the greater of the amount due to the mortgagee plus relevant fees and expenses, and the value of the units taking into account the obligations under the S106 agreement. The clauses require that the parties act reasonably when determining a price for the units and undertaking the other obligations as set out in the clauses.

5. The following factors have been taken into account in determining the approach set out in this note:
• The Draft London Plan sets a strategic target that 50% of new homes should be affordable (Policy H5), which is higher than previous levels of affordable housing delivery in London.

• There is known shortfall in funding available to meet the London Plan strategic target and deliver the level of affordable housing necessary to meet London’s housing needs. The approach adopted in the standard clauses has the potential to significantly increase the finance that can be secured for affordable housing delivery in London.

• The Social Housing Regulator monitors the financial viability of RPs and has the ability to intervene in the management of a RP in financial distress.

• There are few examples of RPs falling into financial difficulties and where this has been the case such RPs have to date been taken over by another RP.

• There are no known cases of MiP clauses being triggered in relation to assets owned by RPs.

6. Taking these issues into account it is considered that any risk associated with an RP defaulting on a loan and affordable units not being secured by the LPA or another RP is limited and is outweighed by the factors referred to above.

7. If circumstances change, the GLA reserves the right to revise the standard clauses. There may also be cases where it may not be appropriate to apply the revised clauses, such as where the GLA or an LPA have legitimate concerns regarding the financial position of an RP. The GLA will not accept a reduction in affordable housing or a departure from a policy, target or threshold in any planning application, variation or subsequent or revised application where MiP clauses are relied on but where the prescribed procedure to benefit from mortgagee protection has not been followed.

**Implementation of standard MiP clauses**

8. The GLA will use the standard clauses within S106 agreements for development proposals where the Mayor of London becomes the LPA following ‘call-in’ of the application and will promote their use for other schemes that are referable to the Mayor under the Mayor of London Order 2008, and non-referable applications, subject to the criteria referred to above. The GLA will also apply the standard clauses where an RP seeks a variation to an existing agreement that the Mayor is party to, where relevant.
Standard Mortgagee in Possession Clause

Charge means a mortgage, charge or other security or loan documentation granting a security interest in the Affordable Housing Units and/or the Additional Affordable Housing Units (or any number of them) in favour of the Chargee.

Chargee means any mortgagee or chargee of the Registered Provider\(^1\) of the Affordable Housing Units\(^2\) or the Additional Affordable Housing Units\(^3\) (or any number of them) and any receiver (including an administrative receiver) and manager appointed by such mortgagee or chargee or any other person appointed under any security documentation to enable such mortgagee or chargee to realise its security or any administrator (howsoever appointed) including a housing administrator.

Date of Deemed Service means, in each instance where a Chargee has served a Default Notice under paragraph 1.1.1:

(a) in the case of service by delivery by hand of the Default Notice to the LPA’s offices at [insert address] during [specify the LPA’s office hours], the date on which the Default Notice is so delivered; or

(b) in the case of service by using first class registered post to the LPA’s offices at [insert address], the second Working Day\(^4\) after the date on which the Default Notice is posted (by being placed in a post box or being collected by or delivered to Royal Mail) PROVIDED THAT the Chargee is able to evidence that the Default Notice was actually delivered to the LPA (by Royal Mail proof of delivery or otherwise).

Default Notice means a notice in writing served on the LPA by the Chargee under paragraph 1.1.1 of the Chargee’s intention to enforce its security over the relevant Affordable Housing Units and/or Additional Affordable Housing Units.

Intention Notice means a notice in writing served on the Chargee by the LPA under paragraph 1.2 that the LPA is minded to purchase the relevant Affordable Housing Units and/or Additional Affordable Housing Units.

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1 This term will be defined in the agreement.
2 This term will be defined in the agreement representing the base level of affordable housing as determined in the planning application.
3 This term will be defined in the agreement relating to the additional affordable housing units that may be required as a result of an Early or Late Viability Review under the Draft London Plan and the Mayor’s Affordable Housing and Viability SPG (as relevant).
4 This term will be defined in the agreement.
Moratorium Period means, in each instance where a Chargee has served a Default Notice under paragraph 1.1.1, the period from (and including) the Date of Deemed Service on the LPA of the Default Notice to (and including) the date falling three months after such Date of Deemed Service (or such longer period as may be agreed between the Chargee and the LPA).

Option means the option to be granted to the LPA (and/or its nominated substitute Registered Provider) in accordance with paragraph 1.3 for the purchase of the Affordable Housing Units and/or the Additional Affordable Housing Units.

Sums Due means all sums due to a Chargee of the Affordable Housing Units and/or the Additional Affordable Housing Units pursuant to the terms of its Charge including (without limitation) all interest and reasonable legal and administrative fees costs and expenses.

1.1 In order to benefit from the protection granted by paragraph [ ], a Chargee must:

1.1.1 serve a Default Notice on the LPA by delivery by hand to the LPA’s offices at [insert address] during [specify the LPA’s office hours] or using first class registered post to the LPA’s offices at [insert address] in either case addressed to [the Head of Planning and Head of Legal Services] of the LPA prior to seeking to dispose of the relevant Affordable Housing Units and/or Additional Affordable Housing Units;

1.1.2 when serving the Default Notice, provide to the LPA official copies of the title registers for the relevant Affordable Housing Units and/or Additional Affordable Housing Units; and

1.1.3 subject to paragraph 1.6 below, not exercise its power of sale over or otherwise dispose of the relevant Affordable Housing Units and/or Additional Affordable Housing Units before the expiry of the Moratorium Period except in accordance with paragraph 1.3 below.

1.2 From the first day of the Moratorium Period to (but excluding) the date falling one calendar month later, the LPA may serve an Intention Notice on the Chargee.

1.3 Not later than 15 Working Days after service of the Intention Notice (or such later date during the Moratorium Period as may be agreed in writing between the LPA and the Chargee), the Chargee will grant the LPA (and/or the LPA’s nominated substitute Registered Provider) an exclusive option to purchase the relevant Affordable Housing Units and/or Additional Affordable Housing Units which shall contain the following terms:

1.3.1 the sale and purchase will be governed by [the Standard Commercial Property Conditions (Third Edition – 2018 Revision)] (with any variations

5 The LPA may amend as appropriate.
that may be agreed between the parties to the Option (acting reasonably));

1.3.2 the price for the sale and purchase will be agreed in accordance with paragraph 1.4.2 below or determined in accordance with paragraph 1.5 below;

1.3.3 provided that the purchase price has been agreed in accordance with paragraph 1.4.2 below or determined in accordance with paragraph 1.5 below, but subject to paragraph 1.3.4 below, the LPA (or its nominated substitute Registered Provider) may (but is not obliged to) exercise the Option and complete the purchase of the relevant Affordable Housing Units and/or Additional Affordable Housing Units at any time prior to the expiry of the Moratorium Period;

1.3.4 the Option will expire upon the earlier of (i) notification in writing by the LPA (or its nominated substitute Registered Provider) that it no longer intends to exercise the Option and (ii) the expiry of the Moratorium Period; and

1.3.5 any other terms agreed between the parties to the Option (acting reasonably).

1.4 Following the service of the Intention Notice:

1.4.1 the Chargee shall use reasonable endeavours to reply to enquiries raised by the LPA (or its nominated substitute Registered Provider) in relation to the Affordable Housing Units and/or the Additional Affordable Housing Units as expeditiously as possible having regard to the length of the Moratorium Period; and

1.4.2 the LPA (or its nominated substitute Registered Provider) and the Chargee shall use reasonable endeavours to agree the purchase price for the relevant Affordable Housing Units and/or Additional Affordable Housing Units, which shall be the higher of:

(a) the price reasonably obtainable in the circumstances having regard to the restrictions as to the use of the relevant Affordable Housing Units and/or Additional Affordable Housing Units contained in this Schedule [ ]; and

(b) (unless otherwise agreed in writing between the LPA (or its nominated substitute Registered Provider) and the Chargee) the Sums Due.

1.5 On the date falling 10 Working Days after service of the Intention Notice, if the LPA (or its nominated substitute Registered Provider) and the Chargee have not agreed the price pursuant to paragraph 1.4.2(a) above:

1.5.1 the LPA (or its nominated substitute Registered Provider) and the Chargee shall use reasonable endeavours to agree the identity of an independent surveyor having at least 10 years’ experience in the valuation of affordable/social housing within the London area to determine the dispute and, if the identity is agreed, shall appoint such independent surveyor to determine the dispute;

1.5.2 if, on the date falling 15 Working Days after service of the Intention Notice, the LPA (or its nominated substitute Registered Provider) and
the Chargee have not been able to agree the identity of an independent
surveyor, either party may apply to the President for the time being of
the Royal Institution of Chartered Surveyors or his deputy to appoint an
independent surveyor having at least 10 years’ experience in the
valuation of affordable/social housing within the London area to
determine the dispute;

1.5.3 the independent surveyor shall determine the price reasonably
obtainable referred to at paragraph 1.4.2(a) above, due regard being
had to all the restrictions imposed upon the relevant Affordable Housing
Units and/or Additional Affordable Housing Units by this Agreement;

1.5.4 the independent surveyor shall act as an expert and not as an arbitrator;

1.5.5 the fees and expenses of the independent surveyor are to be borne
equally by the parties;

1.5.6 the independent surveyor shall make his/her decision and notify the
LPA, the LPA’s nominated substitute Registered Provider (if any) and
the Chargee of that decision no later than 14 days after his/her
appointment and in any event within the Moratorium Period; and

1.5.7 the independent surveyor’s decision will be final and binding (save in the
case of manifest error or fraud).

1.6 The Chargee may dispose of the relevant Affordable Housing Units and/or
Additional Affordable Housing Units free from the obligations and restrictions
contained in paragraphs [ ] to [ ] of this Schedule which shall determine
absolutely in respect of those Affordable Housing Units and/or Additional
Affordable Housing Units (but subject to any existing tenancies) if:

1.6.1 the LPA has not served an Intention Notice before the date falling one
calendar month after the first day of the Moratorium Period;

1.6.2 the LPA (or its nominated substitute Registered Provider) has not
exercised the Option and completed the purchase of the relevant
Affordable Housing Units and/or Additional Affordable Housing Units
on or before the date on which the Moratorium Period expires; or

1.6.3 the LPA (or its nominated substitute Registered Provider) has notified
the Chargee in writing pursuant to the Option that it no longer intends
to exercise the Option.

1.7 The LPA (and its nominated substitute Registered Provider, if any) and the
Chargee shall act reasonably in fulfilling their respective obligations under
paragraphs 1.1 to 1.6 above (inclusive).