NEWBUY

HOME BUILDERS FEDERATION

Guidance for home builders thinking of applying to join NewBuy

23 April 2012

Thank you for your interest in the NewBuy scheme.

Introduced by the Home Builders Federation (HBF) and the Council of Mortgage Lenders (CML), in partnership with HM Government, the scheme has the potential to generate a significant increase in new homes sales, with all the benefits that will bring through increased new housing production, additional jobs and satisfied home owners.

Before you take any further action or incur any costs, it is important that you are made aware of the implications of participating in the scheme.

This starter guide covers a general description of the scheme, how builders provide an insurance indemnity, requirements of builders selling properties under the scheme, legal arrangements, scheme costs and next steps.

GENERAL DESCRIPTION

From a home buyer's perspective, the scheme offers a 90-95% LTV mortgage to buy a new home from a home builder participating in the scheme. This helps buyers who can afford mortgage repayments but do not have a large enough deposit to qualify for a mortgage from lenders' existing product range.

An independent financial advisor will be able to advise borrowers on identifying the most appropriate mortgage product for them, and help them to apply to a lender offering a mortgage product under the scheme in conjunction with the home builder. Some lenders may wish to accept direct applications from borrowers under the scheme.

Lenders will assess mortgages under the scheme in the normal way, and apply their usual affordability and credit criteria.

Borrowers will need to understand that the scheme does not offer any additional protection if they fall into arrears on their mortgage. In the event of a home being repossessed, the borrower will still be responsible for repaying any shortfall between the

Home Builders Federation
1st Floor Byron House, 7-9 St James's Street, London SW1A 1EE
Tel: 0207 960 1600 F: 0207 960 1601
Email: info@hbf.co.uk   Website: www.hbf.co.uk   Twitter: @HomeBuildersFed

sale price of the property and the outstanding mortgage debt. This is the same as it would be for any borrower outside the scheme.

From a home builder's perspective, the scheme offers a way to increase the speed and number of home sales by helping buyers to get a mortgage without a large deposit.

Home builders do this by providing a financial indemnity, along with that provided by the UK Government, to protect the lender in case, at some future stage, the borrower falls behind with their mortgage payments and the lender has to repossess the property and sell it at a loss.

Simply put, lending at higher loans to value is a higher risk for mortgage lenders, and therefore the FSA requires lenders to put aside significantly more capital for such loans. The NewBuy scheme protects mortgage lenders against losses following any repossession, and so enables them to lend at higher loans to value against the new build properties in the scheme. The FSA also provides capital relief for NewBuy mortgages under certain conditions, so that lenders should be able to reflect this in their mortgage rates.

The home builder deposits 3.5% of the sale price for each unit sold under NewBuy into a special indemnity insurance fund which lasts for seven years. Any losses that the lender suffers post-possession will be drawn from the accumulation of these funds. Lenders are able to claim 95% of any loss they suffer. If the fund is exhausted as a result of claims, the UK Government acts as a second-loss provider, with a further guarantee of 5.5% of the total sales price for all properties covered.

PROVIDING THE INSURANCE INDEMNITY

The HBF has set up a special insurance company. This company is designed so that builders can ring fence their 3.5% contributions by putting them into a separate bank account for the lender which has granted the mortgages. This arrangement is called a 'cell', while the umbrella HBF insurance company is a 'protected cell company' (PCC). The company and the builder/lender cells will be administered by insurance broker Jardine Lloyd Thompson (JLT).

Non-HBF members will be welcome to use this company. Their contribution to costs will be calculated on the same basis as for member companies.

The scheme design has been built around an Insurance Company which has been incorporated as a Protected Cell Company. This has many benefits for the scheme overall, but this type of company does not exist under UK law. In light of this HBF Insurance PCC Limited is based in Guernsey and is regulated by the Guernsey Financial Services Commission (GFSC).

The PCC structure and choice of Guernsey is not intended to provide any tax advantages and indeed, as part of the scheme requirements, the builder will be required to sign a tax election for HMRC that will ensure that any dividends the builder receives as a shareholder of a cell in HBF Insurance PCC Limited will be taxed on receipt in the UK. These arrangements will ensure that HMRC will receive the same amount of tax as they would have received had the Insurance Company been established in the UK. Further information is available in KPMG's tax advice which JLT can supply to home builders.

Before a home builder can join the insurance company, they will need to be checked and approved by the GFSC and accepted by a lender(s)..

The size of builder is not limited by the scheme. There are two possible types of arrangement:

- A 'single-user cell' is when a builder just puts their own properties and indemnity contributions into a direct one-to-one arrangement with a lender;
- A 'multi-user cell' combines properties, and indemnity contributions, from a number of different home builders for one lender. Contributions from individual builders will, in the first instance, be used to cover losses on that builder's properties; however, if the losses exceed that builder's contributions, then all builders in the cell will share each other's losses proportionately.

Deciding whether your company will operate through a single-user cell or multi-user cell

Lenders will only be able to obtain capital relief for mortgages under the scheme once there are 100 units in a cell. It will therefore be important for cells to build up to 100 sales as quickly as possible. Also some lenders will require that a 'single-user cell' builder works with several other lenders (usually two others). So as a rule of thumb, a single-user cell will probably only be suitable for those builders that expect to sell at least 300 properties which qualify for NewBuy loans. Therefore the majority of home builders will need to take part via multi-user cells. In addition, a builder with a single-user cell with one lender may also apply to enter multi-user cells with other lenders. The lender will have the ultimate responsibility for deciding whether a company can form a single-user cell or will need to participate through a multi-user cell. Some lenders may require a builder entering its multi-user cell also to join at least one other lender's multi-user cell.

Lenders currently offering multi-user cells are Nationwide and Halifax. We anticipate that most home builders wishing to join one of these multi-user cells may be required to join the other lender's multi-user cell. Builders in the scheme will receive updates as additional lenders join the scheme and establish multi-user cells.

The scheme will be open to new transactions up to 30 March 2015. Each indemnity will last for seven years. So builders would start to get any unused funding back from the end of year eight onwards, and the scheme will finish seven years after the date of legal completion of the last property.

HOME BUILDER REQUIREMENTS

There are no restrictive requirements on home builders wishing to participate in the scheme. However they must:

- Hold their shares in the cell in a UK tax-resident company;
- Pay the contributions from that company;
- Sign all scheme contracts in the name of that company;
- Make the tax election that will ensure that UK tax is paid on any dividends received from the cell;
- offer a new home warranty on all homes sold under the scheme; and
- Complete a CML Disclosure of Incentives Form (DIF) with all sales. The DIF has been modified to allow home builders to record sales under NewBuy.

The size of home building company participating in the scheme is not restricted under the scheme. The 'multi-user cell' approach will accommodate smaller builders. All costs, except the initial regulator's fee, are proportionate to the number of sales under the scheme. (These costs are set out in some detail later in this paper.)

Home builders should be aware that individual lenders will have their own requirements for the mortgages that they offer under the scheme, and also their own criteria for accepting builders into their multi-user cell. They will consider whether they have experienced past problems with a particular home builder, such as with valuations or incentives. They may also consider other factors, such as whether there is a concentration risk in relation to products (e.g. too high a proportion of apartments) or geographical concentration (e.g. a builder with only one or two sites in a single location).

KEY SELLING REQUIREMENTS

NewBuy is available on **all properties** by participating builders that:

- are sold as residential properties for the first time, or for the first time in the current form – this covers houses, flats, conversions, refurbishments and renovations; also properties previously let by the builder but not previously sold;
- are not shared ownership or shared equity properties; and
- have a sale price of £500,000 or less – however some lenders may set their own price cap at a level less than £500,000.

The definition of a new property in the NewBuy legal documentation is:

New Build Property means a **Residential Dwelling** in England that was built by the **Builder Group** or any joint ventures of the **Builder Group**, and which has not previously been sold or let (other than let by the **Builder Group**) as a **Residential Dwelling** in its current form, and for this purpose a dwelling that has been converted from a single dwelling into flats, or substantially renovated or refurbished shall be regarded as in a form different to that of the original dwelling.

Home builders participating in NewBuy may not restrict the scheme to selected properties or sites. Instead it must be available for all new properties that are priced at £500,000 or less. However we do not expect all of a company's properties to be sold under NewBuy – only those where the customer needs a 90-95% LTV mortgage.

Lenders are particularly concerned that companies offering NewBuy do not artificially push up the price of new properties. Valuers will be very sensitive to this concern, as instructed by the lenders, and will not allow the valuation to incorporate any inflation of the new build premium, other than any general movement in local house prices.

Home builders will only be able to offer a very restricted number of incentives on NewBuy sales. They will be able to offer a straight discount, but the mortgage loan-to-value will then be based on the net price. Free carpets and curtains will be permitted as an incentive. White goods will only be permitted if part of the standard specification, but not as an additional incentive. Part Exchange may be possible if agreed by the lender. Financial incentives, such as deposit paid, legal fees paid or stamp duty paid will <u>not</u> be permitted.

NewBuy is available to **all buyers** meeting the criteria outlined below. Buyer eligibility will be checked as part of the mortgage process:

- buyers are UK citizens and those with a right to remain indefinitely in the country;
- full ownership - NewBuy will not be available for shared ownership or shared equity purchases;
- primary homes – NewBuy will not be available for the purchase of second homes, for investors or for buy-to-let purchases; and
- capital repayment mortgages only – NewBuy will not be available for interest-only mortgages.

The scheme <u>is not restricted to first-time buyers</u>.

Most lenders offering NewBuy mortgages will accept referrals from an IFA. However some may only accept direct applications by home buyers.

LEGAL REQUIREMENTS

Builders will need to complete a detailed application form for the Guernsey Financial Services Commission (GFSC) which will carry out its own checks.

Following GFSC regulatory approval and an agreed link-up with a lender or lenders, home builders will need to sign the following documents which will be legally binding:

- **Framework Agreement (per cell)** – this sets out the obligations on all participating parties. For builders, this will mainly be around transferring 3.5% of sales proceeds into the scheme and sharing risk with other builders if participating in a 'multi-user cell'. This document also requires the redemption and return of any unused funding to builders;
- **Insurance Policy (per cell)** – this is issued on behalf of each cell and allows the lender to use the 3.5% financial contribution to cover up to 95% of any losses;
- **Services Agreement (per builder)** – this sets out the obligations on Jardine Lloyd Thompson to administer the scheme, in return for which builders will pay a separate fee for each of their properties sold under the scheme;
- **Cell User Agreement (per cell)** – this allows a cell to be established, cell shares to be subscribed for by the builder and how the cell will be administrated, including all regulatory arrangements;
- **HBF Cost Recovery Agreement** – this allows HBF to recover at the outset estimated up-front and ongoing legal, auditing and regulatory costs for the life of the scheme from home builders operating through single or multi-user cells;
- **Tax Election Letter** that will be provided for completion to cell shares being allotted.

A more detailed summary of the legal documents can be downloaded from our website.

SCHEME COSTS

HBF has incurred significant NewBuy set-up costs and it will be responsible for ongoing regulatory, audit and legal costs for the HBF insurance company and most of the cell costs throughout the 10-year life of the scheme. HBF's approach is merely to cover these costs. It will not attempt to make a profit, nor will the cost of staff time be recovered.

To ensure there are sufficient funds to cover these costs, HBF will be charging an initial levy from each participating home builder as the company enters the scheme. As these costs can be reasonably accurately estimated, the actual levy per home builder will depend on the number of homes that home builders expect to sell under NewBuy. HBF will review the levy annually in the light of experience. In the event that your company is likely to exceed the anticipated sales volume initially indicated to HBF, you may be required to make a further contribution. At the end of the scheme, any surplus funds will be returned to participating home builders on a fair and equitable basis. HBF members and non-members will be charged on the same basis. As the levy will be based on your expected sales, the levy each company pays will reflect its size. In other words, larger and smaller companies will make a fair and proportionate contribution.

So the upfront costs are:

- A one-off application fee of **£1,420** per builder charged by the Guernsey Financial Services Commission; and £1,420 per cell if using more than one single-user Cell; but for a home builder entering multi-user cells, no further GFSC fee is payable for entering a second or subsequent multi-user cell; and
- An HBF levy per home builder, based on the number of sales the builder expects to make during the life of the scheme (see above for an explanation). The levy has been initially set on an expectation of 25,000 sales. Based on our predicted costs the initial levy will be **£90** per property.

All other costs are ongoing and charged per sale except specific cell costs:

- **3.5%** of each home sale value is payable 10 days prior to legal completion of the home. This is then held for seven years, after which the funds will be returned minus any claims by lenders; during the period that this money is held, it will earn interest from the lender for the benefit of the cell and thus the builder;
- **0.35%** plus VAT of each home sale is payable to Jardine Lloyd Thompson to cover the cost of administering the scheme; and
- **Insurance Premium Tax** (currently levied at 6.0%) on the premium element of the 3.5%. (To meet the regulatory requirements for running an insurance company, the 3.5% is split into 1.47% premium and 2.03% capital.) This is to be paid when the 3.5% contribution is paid;
- **Guernsey regulatory fees**, currently **£1,660** per cell per year.

Worked Example

For example, if a builder sells 25 homes at £200,000 each through one cell over 3 years, the cost would be:

GFSC one-off application fee per builder £1,420
+ HBF levy (£90 x 25) £2,250
*+ Indemnity deposit (3.5% of 25 x £200k) £175,000**
+ JLT fees (0.35% of 25 x £200k) £17,500
+ IPT £4410

= £200,580

In addition, there is an annual per cell Guernsey regulatory cost, currently £1660, which in the case of multi-user cells will have to be divided between shareholders in the cell.

** Any interest accrued would be paid to the builder, and any remaining funding, after lender losses, returned at the end of the scheme.*

In all, the 3.5% deposit plus the JLT fee, the HBF levy and IPT are equivalent to approximately 4% of the sale price. Depending on any lender claims for losses, at least some of the 3.5% deposit should be returnable after 7 years, and of course this money will earn interest over this period.

NEXT STEPS

If after reading the information above you are interested in participating in NewBuy, there are three key initial steps (further details below):

Initial Step 1: Advise HBF of your intention to enter the scheme, because HBF owns the insurance company through which the scheme is operated; at the same time, you may wish directly to contact any lender with whom you have an existing corporate relationship;

Initial Step 2: Obtain approval from the Guernsey Financial Services Commission (GFSC);

Initial Step 3: JLT will then advise your chosen lenders on your behalf that you have approval and put forward your request to work with them.

The GFSC approval process covers some of the information required by the lenders and doing this step first will enable lenders to cut down the length of time it takes them to conduct their own due diligence processes.

Initial Step 1

You first need to inform HBF that your company wishes to participate in the scheme via the HBF insurance company. HBF requires the following essential information from you:

- Your company name and contact details plus the key contact at your company for the NewBuy scheme, with job title and contact details;
- An estimate of the total number of homes you anticipate selling under the NewBuy scheme from the approximate date your company joins the scheme until 30 March 2015. This is needed so that HBF can calculate your company's initial up-front contribution to the legal, regulatory and auditing costs of setting up and running the HBF insurance company and the cells your company operates through;
- Whether you wish to participate via a single-user cell; multi-user cell; or both (see above for an explanation); and if appropriate, the name of any lender(s) you wish to form a single-user cell with;

To provide this information, please complete the Pro Forma on HBF's web site: www.hbf.co.uk. It is essential that you provide this information or your company will not be able to progress to full participation in NewBuy and you will not receive future HBF Briefings on NewBuy.

If you have an existing corporate relationship with a lender, then you may wish to get in touch directly.

Initial Step 2

To obtain approval from the GSFC, you will first need to contact JLT who will send you an application pack: Adam_Buckholt@JLTGROUP.COM. You can, if you wish, do this as soon as you have read HBF's Guidance and completed the HBF Pro Forma in Step 1..

You will need to be mindful that the £1,420 fee paid to the GFSC is not refundable should your company not be accepted by any lenders, and therefore not be able to participate in the scheme.

JLT will confirm whether you have successfully completed the GSFC registration process.

Initial Step 3

JLT will confirm with you which lenders that you want to work with and will help by putting forward your request to lenders. Whilst JLT will manage the initial contact with the lenders, the lenders will then contact you directly to inform you of the outcome.

The lender(s) may also contact you earlier in the process to collect additional information. This may include:

1. What is your total build/sales plan for each of the following 3 years (split for England and Scotland)?
2. How many properties are you likely to build/sell in years 1, 2 & 3 that will attract this profile of buyer?
3. What is the split in 2 above by property type i.e. apartment and house (split for England and Scotland)?
4. What is your range/average selling price for properties in 3 above?
5. How many sites will you be selling on?
6. What is the geographical spread of sites in 5 above?

Once you have completed these three initial steps, and have agreed lender relationships, you will need to sign the scheme contracts and pay your upfront levy for ongoing regulatory and audit costs. JLT will send you the necessary legal documents. If you have any questions about the legal documents, you would be wise to seek independent legal advice. Neither HBF nor JLT can provide advice on these contracts, although HBF has retained Clyde & Co and their advice to HBF will be made available to scheme participants.

Some home builders may wish to see the legal documents at an early stage to help them decide whether they wish to participate in NewBuy. As long as you have completed the HBF Pro Forma, you may request a set of pro forma legal documents, Clyde & Co's advice and KPMG's tax advice from JLT. To obtain these please contact:

Adam_Buckholt@JLTGROUP.COM

Jardine Lloyd Thompson will then be able to make the final cell arrangements.

Once the cell(s) is open for your use, you will be able to start using NewBuy branding as part of your marketing, and start selling homes under the scheme. A copy of the NewBuy logo, and guidance on use of the logo, is available to scheme participants on the HBF web site: www.hbf.co.uk.

We will be putting other information on our web site for home builders and IFAs as the scheme develops: www.hbf.co.uk.

There is also a consumer web site for NewBuy; www.newbuy.org.uk.

How to become a NewBuy builder

Complete HBF Pro Forma at www.hbf.co.uk

↓

You apply for GFSC regulatory approval, via Jardine Lloyd Thompson (JLT)

↓

Approval notified to you via JLT

↓

JLT to confirm with you which lender(s) and submit your details to lender(s)

↓

Lender(s) to notify builder whether or not accept in cell(s)

↓ *If approved*

You pay your remaining upfront fees and sign the scheme contracts

↓

JLT sets up and confirms your cell arrangements

↓

APPENDIX 1

Note on the Contractual Structure of the NewBuy Scheme

Background and Introduction

This note is a summary of the documentation and commercial terms which form the NewBuy Scheme (**the Scheme**). This note is not in any way a substitute to reading the contractual documentation.

The Scheme has involved establishing a Guernsey protected cell company by HBF which will be regulated by the Guernsey Financial Services Commission (**GFSC**). The following Agreements form the documents which need to be entered into to take part in this Scheme:

- Cell User Agreement between the Builder and HBF Insurance PCC Ltd (the **Cell Company**);
- Cost Recovery Agreement between the Builder and the Cell Company;
- Management Agreement between the Cell Company and Jardine Lloyd Thompson (Guernsey) Ltd (**JLT Guernsey**);
- Framework Agreement between the Cell Company acting on behalf of the Cell, JLT, a Lender and the Builder(s);
- Insurance Policy (**the Policy**) between the Cell Company acting on behalf of the relevant Cell and the Lender and the Builder;
- Government Guarantee between the Secretary of State and the Cell Company; and
- Services Agreement between JLT Speciality Ltd (**JLTS**) and the Builder.

Attached at Appendix 2 is a structure diagram of the legal framework. A further high level explanation as to each of the contractual elements and commercial terms of the NewBuy Scheme is set out below.

Set out below is a summary of the issues arising from the documents. This note does not deal with unexceptional matters, nor does it summarise all the provisions of the agreement.

The Framework Agreement

Overriding all the Agreements is the Framework Agreement.

There will be one Framework Agreement per cell. The parties to this Agreement will be the relevant Builder, the relevant Lender, the Cell Company contracting on behalf of the relevant Cell, HBF and JLTS. This Agreement is governed by English law.

This Agreement sets out the relevant parties' obligations and liabilities under the Scheme. These are set out in broad terms below.

The Cell Company, the Cell and JLTS give a series of warranties and undertakings about the establishment and set up of the Cell Company and the Cell, and the issuing of the Policy: this will create a potential liability for these parties. In summary these are:

- that the Cell Company has been set up in accordance with the law, and has the capacity to execute and deliver the Framework Agreement
- that the Cell Company and Cell has obtained all legal requirements to comply with the Agreement and that the insurance business under the Policy is compliant with all applicable regulations
- the Cell Company alone has given warranties and undertakings to the Lender that the Cell Company will comply with applicable regulations, that cell payments will be held in an account of the Cell which is charged to the Lender (**Nominated Account**), in accordance with the Framework Agreement and charge, and that Insurance Premium Tax (**IPT**) will be paid to HMRC promptly when it becomes due
- the Cell Company must ensure that the Policy remains in force for the term of the Agreement and that it provides the Lender with copies of the regulatory returns and accounts and that it notifies the Lender of any material and persistent breach of applicable regulations
- HBF is not permitted to dispose of its shares without the consent of the Lender and the GFSC

The Lender must consent to any change to JLT Guernsey acting as management company to the Cell Company. In addition the Memorandum and Articles of the Cell Company cannot be amended without the consent of the Lender.

JLTS must perform the Cell Company's obligations under the various Agreements and will carry out weekly and monthly reconciliations of the money and information provided to the Cell Company.

Each Cell will have a Nominated Account into which the 3.5% Builder contribution will be paid which is charged to the Lender. The interest on the Nominated Account is for the account of the Cell and the Lender must transfer this out of the Nominated Account (the timing and mechanics are to be agreed when the Nominated Account is opened). The Lender must pay the commercial fee in accordance with the Commercial Fee Agreement.

The Builder must pay 3.5% of the Sale Price of the properties to the Cell (1.47% premium and 2.03% capital) plus IPT, and could be pursued by any party to the Agreement if they fail to do so. A breach by the Builder is incapable of being compensated adequately by damages and as such the Lender can seek a decree of literal enforcement – i.e. specific performance. The Builder must notify JLTS when it makes the payment.

A Builder must make all eligible properties built available for the Scheme and, again, a failure to do so could result in any party to the Agreement taking action against them.

The Framework Agreement states that a Lender shall make mortgages available under the Scheme for an initial period of three years but it will be under no obligation to accept any mortgage application or make a mortgage offer.

A Builder cannot provide other financial incentives to home buyers alongside the Scheme including paying legal fees and stamp duty. Part exchange is permitted provided that the Lender has not notified the Builder that it is not (this is at the sole discretion of the Lender).

The Framework Agreement sets out how funds will be released to Builders in the event that funds are not used for claims during the first eight years of an insured loan (i.e. once the initial loans are no longer insured). This will take place at the 8th and 9th year from inception and also at termination.

If a Builder fails to pay the fees due to JLTS under the Services Agreement, JLTS can serve notice to suspend the provision of services to that Builder. This will effectively suspend the Scheme for that Builder but will not affect those insured loans already included under the Policy (i.e. it will not have retrospective effect).

Data flows and data protection are provided for in the Agreement dealing with the circumstances where parties are data processers or data controllers. Builders will be providers and receivers of data. The Cell will be receiving data and passing it on to other parties, for example, under the Government Guarantee and the Policy. An indemnity is given by all parties to the Agreement in respect of data save that the indemnity given by the Lenders and the Builder is capped at £5 million. The indemnity of the JLT Group is capped at £100 million as further described below.

The Agreement provides that the liabilities of the Cell are limited to the assets of the Cell from time to time. However, the majority of the assets of the Cell are held in the account administered by the Lender (or nominee) under charge to pay Lender claims (this is the Nominated Account). Fees paid to the Cell Company are made on an advance basis and the intention is that they belong to the Cell Company as opposed to the Cell.

The aggregate limit of liability for the JLT Group under the whole Scheme is £100 million.

No parties are liable for consequential damages under this Scheme.

Establishing the Cell

There are a number of Agreements required to establish and administer the Cells.

Cell User Agreements

The Cell Company will set up a Cell for a Builder through the issue of non-voting preference shares in the Cell. This relationship will be governed by the Cell User Agreements.

The Cell User Agreement

This is the Agreement for the subscription of the non-voting preference shares in the Cell. Shares are issued to the Builder upon paying the 3.5% fee for the payments under the policy (2.03% of which is consideration for the shares). Transfers of shares in Cells are prohibited without the prior written consent of the Cell Company, the GFSC and the Lender. Various warranties and undertakings are given by the shareholders of the Cell, which are the Builders, to the Cell Company. Also detailed are the contractual relations of the Cell Company, the Cell and the Builder and the relationship between them and these include that the Cell shareholder:

- has had the opportunity to investigate the terms of the Scheme and seek such advice as required;
- has the legal capacity and authority to deliver and execute the Agreement;

- has provided verification of its identity and that the subscription for shares won't breach any money laundering regulations; and
- acknowledges that the Cell Company can appoint a manager.

The Cell User Agreement also sets out details of how the redemption of shares will work.

The Cost Recovery Agreement

Like the Cell User Agreement this Agreement governs the relationships between the Cell Company, the Cell and the Builder who is the shareholder of the Cell. This Agreement is the mechanism by which the Cell Company can receive contribution to its expenses (audit, legal, regulatory, etc) from the Builders.

Management Agreement

The Cell Company will enter into a Management Agreement with JLT Guernsey. This will provide for JLT Guernsey to manage the Cell Company in accordance with the relevant legal and regulatory requirements of Guernsey law. The Agreement also provides for JLT Guernsey to carry out the various tasks required of the Cell Company under the other Scheme contracts.

The Services to be provided under this Agreement include, but are not limited to:

- establishing the Cell Company and complete and submit all applications to the GFSC;
- various services relating to the running of a protected cell company in Guernsey;
- establishing Cells on behalf of the Cell Company under the Scheme;
- carrying out all such acts and services as required in order for the Cell Company to comply with its obligations under the Policy, Framework Agreement, Government Guarantee and any other document relating to the Scheme;
- collecting premium due under each Policy;
- paying claims and monitoring the bank accounts which have been charged to the Lender. Reconcile claims under each Policy, verifying that claims are valid and challenging such claims which have been miscalculated or which are illegible loans under the Policy;
- carrying out audits in accordance with the terms of each Policy and producing audit reports of the same;
- reviewing and verifying information provided under each Policy including but not limited to accounts, remittances and declarations;
- procuring payments to the Cell Company and its Cells under the Government Guarantee when payment under the Government Guarantee has been triggered;
- monitoring the use of the Government Guarantee to ensure all parties know how much of the limit under the Government Guarantee has been utilised under the

Scheme. Notifying the Cell Company, and any other relevant parties, of any notifications received under the Government Guarantee; and

- administering Multi-User Cell Agreements on behalf of the Cell Company including, but not limited to, administering any bank accounts, notional accounts and reconciliations.

This Agreement can only be terminated in very extreme circumstances which include where the Builder is in breach of its undertakings, warranties and obligations.

Only nominal consideration will be paid under this contract, as the main consideration for services will be provided by the Builders under the Service Agreement (as described below).

The Services Agreement

This is an Agreement by which JLTS, a London based company, provides certain services to Builders. The services are mainly a duplication of those provided to the Cell Company and the Cell, rather than something actually required by the Builder as a shareholder in the Cell. Having said this, some of the information provided to Builders may be useful. The services to be provided under this Agreement include, but are not limited to:

- acting as insurance intermediary in the arranging and placing of the Policy with the Cell Company;
- assisting in and processing and advising on the application of the Builder to the GFSC;
- administering the Scheme for the benefit of the Builder Group (as defined in the Framework Agreement);
- providing the services required to establish and manage the company as set out in Schedule 1 of the Management Agreement;
- complying with the obligations contained in the Framework Agreement;
- monitoring market movements to ensure the Scheme remains competitive and advising on the strategic development of the Scheme (e.g. widening the potential pool of Lenders willing to provide mortgages pursuant to the Scheme);
- monitoring and reviewing any claims made under the Policy;
- auditing the Lender's compliance with the agreed criteria as required under the Policy; and
- assisting the Builder in the appointment of any replacement insurance manager to the Company in the event that a member of the JLT Group is unable or unwilling to continue to act in this capacity or in circumstances where the Management Agreement has been terminated.

It should be noted that under the Agreement, JLTS is not responsible for advising on the suitability of the Scheme for any taxation, legal, regulatory or accounting advice in relation to the Scheme.

One of the reasons for the Agreement is that this is where the fees of JLT are due and payable for the operation of the Scheme (and not under the Management Agreement). To ensure that JLT's fees are paid, JLTS reserves the right to ask the Lender not to accept any further properties by a defaulting Builder.

The fees are 0.35% of the sale proceeds for each property sold under the Scheme for the first 60,000 units, decreasing to 0.2% after this. This will become due upon the paying of the insurance premium and will be invoiced monthly in arrears. Interest can be charged on late payment.

The Insurance Documentation

This structure of the Policy is designed to provide capital relief (in respect of the Lenders' FSA capital requirements) to Lenders allowing them to lend at a higher LTV. The premium and capital due from the Builder under the Policy is to be paid into an account charged to the Lender to be held on trust to meet claims under the Policy (the **Nominated Account**). To the extent that there is insufficient money in the Nominated Account there is a Government Guarantee supporting the Cell to pay claims up to 9 percent of the Sale Price of all properties insured under the Policy (3.5% Builder contribution and 5.5% Government Guarantee).

Insurance Policy

There will be one Policy per Cell. The parties to this Agreement are the relevant Lender, the relevant Builders and the Company contracting on behalf of the relevant Cell.

The key features of the Policy are:

- for a loan to qualify it must be an Eligible Loan, as defined in the Policy, made prior to 12 March 2015;
- the eligibility criteria for the Scheme is as follows: it is a repayment mortgage, is not a publicly-assisted mortgage, is the first mortgage on a new build residential dwelling with a sale price of up to £500,000, the LTV is 90-95% (including set up costs charged by the Lender to the borrower) and at least one of the individuals is a UK citizen or has indefinite leave to remain and purchased the dwelling as their sole or principal residence and it is not part of a shared equity or ownership Scheme;
- the Policy will cease to write new business where the Government Guarantee is suspended or terminated (see below Government Guarantees) under the Scheme or in certain other circumstances including the non-payment of premium and capital by a Builder under the Policy;
- the Policy does not cover loans where the Lender has made a further advance, the loan is off-risk or the Government Guarantee has been suspended or closed;
- losses which can normally be claimed under building insurance are also not covered;
- loans are covered even though no premium, capital or IPT has been paid;
- where an Eligible Loan, as defined in the Policy, or a loan becomes off risk then there is no refund or reduction in premium or capital, these monies remain in the Nominated Account;

- the Builder must pay the insurance premium and capital (which is 1.47% / 2.03% respectively) plus IPT ten days prior to the date of completion of the sale of the property. These amounts are paid into the Nominated Account. If these amounts are not paid the loan will still be insured under the Policy;
- in respect of a loss under the Policy, the Cell is liable for 95% of the loss (up to 95% of the sale price) and the Lender will bear 5% of the loss. The liability of the Cell (**the Insurer**) is limited to the amounts in the Nominated Account (including monies payable under the Government Guarantee);
- the Policy responds to claims under a property for up to 7 years after the date of completion of a sale;
- losses arising as a result of damage to a property which is subject to an Insured Loan, as defined in the Policy, which would ordinarily be covered by a buildings insurance Policy is not recoverable under the Policy;
- a loss paid under a claim is for the Delinquent Balance, Eligible Costs (there is a list of eligible costs in the Policy) and Interest, as defined in the Policy, less the proceeds of sale;
- there is an Aggregate Limit of Liability which is 9% of the total of all Sale Prices of the properties. The Aggregate Limit of Liability will be reduced if a Builder does not pay the 3.5% Builder Contribution;
- it is a pay and dispute Policy. The Lender will debit the claim amount from the Nominated Account. If there are insufficient funds in the Nominated Account the Insurer must call on the Government Guarantee. Claims can only be disputed after payment where there is a miscalculation in the claim amount or is excluded (including if the loan was eligible at the date it was taken out). Claims must be disputed within four months of receipt of the claim. Lenders have agreed to provide evidence of eligibility at the point they make a claim i.e. with the claim file submission to enable eligibility to be reviewed after the claim has been paid. The Policy contains a process for disputing claims which include resort to an Independent Expert;
- the Insurer has waived subrogation rights. Where the Lender recovers monies owed under the Insured Loan after a claim has been made, this will be allocated firstly to discharge the costs of recovery, then the Lender's loss which was not covered by the Policy, and then any remaining money will be paid to the Insurer. There is no obligation on the Lender to pursue a recovery and neither the Builder nor the Insurer can require the Lender to do so. Money received will be paid back into the Nominated Account; and
- audits can take place on the Lender's records up to four times a year at 15 business days notice. The audit will review a random sample of Insured Loans which will never be less than:

    (i) 20 or 20% of the number of insured loans, where the total number of loans under the Policy is less than 100;

    (ii) 20 or 10% of the total number of insured loans whichever is greater, where the total number of loans under the Policy is greater than 100 but less than 500;

(iii) 50 or 2% of the total number of insured loans, whichever is greater, where the total number of loans under the Policy is greater than 500;

- following an audit, the auditor must prepare an audit report which must be provided to the Lender within 10 business days of the audit. A JLT company will be undertaking this. Follow-up audits can take place to check if remedial action has been undertaken. However, ultimately, if remedial action is not undertaken or cannot be agreed, then the Insurer can terminate the Policy. This has no impact on the loans already insured which are affected by these issues, unless it falls within one of the grounds to dispute a claim, meaning the only remedy is nuclear in nature;
- the Lender will submit an account setting out claims 10 business days after the end of each month. The Insurer is bound by all adjustments, settlements and compromises made by the Insured under the mortgage and on the date of the repossessed property; and
- securitisation of the Policy is permitted.

Charge

This is the document which grants a fixed charge over the Nominated Account to the Lender and makes them sole signatory of the account. This enables the Lender to withdraw the claims monies in accordance with the Policy. The Insurer and Builder will have no control over this account or access to it. However, interest due on the account will accrue and may be paid into a separate bank account so it is not subject to the charge. Interest will be for the benefit of the Cell. Certain of these accounts may not be with the Lender where, for example the Lender cannot offer a suitable account.

Government Guarantee

If there is no money in the Nominated Account to pay claims (excluding Interest) then the Government Guarantee is triggered and will provide an additional 5.5% of the aggregate of the Sale Prices of the properties relating to the Insured Loans under the policy to pay claims. The Government Guarantee will pay out quarterly in arrears. There is a limit of £1 billion on the Government Guarantee.

When the total liability of the Secretary of State, incurred under the Government Guarantee, has reached or is approaching or has exceeded £1 billion, the Secretary of State will issue a closure notice.

Broadly, the Government Guarantee tracks much of the Policy to enable them to operate back to back. The Secretary of State can also exercise any right, power or discretion under the Policy where the Cell Company is unable or unwilling to comply with a direction given by the Secretary of State.

The Cell Company must provide written statements containing the conclusions of any audits to the Secretary of State, to allow the Secretary of State to communicate any concerns he may have to the Lender and Cell Company.

There are various rights for the Secretary of State to suspend the Government Guarantee in respect of a particular Cell by issuing a Cell Suspension Notice. The Cell Suspension Notice takes effect after 58 days. These are:

- the Policy issued has been amended without the Secretary of State's prior written consent

- the Framework Agreement has been amended without the prior written consent of the Secretary of State
- the commercial fee is outstanding after three months of it becoming payable
- Builder(s) have not paid the 3.5% contribution after three months of it becoming due
- material information has not been provided to the Secretary of State
- an audit has not been carried out in accordance with the Policy
- the benefit to home buyers has been minimal, due to the volume in the Cell or for any other reason
- there has been a material breach of the Framework Agreement

The Government Guarantee can be suspended for all Cells in certain limited circumstances once the Secretary of State has given notice. The suspension takes effect 20 business days after the Cell Company has forwarded the Notice to Lenders and Builders (which must be done within 5 business days of receipt). The circumstances in which this can be exercised are:

- insolvency of JLT
- JLT Guernsey has been replaced as manager of the Cell Company without the Secretary of State's consent
- state aid proceedings are issued
- it is necessary to comply with, to avoid, settle or secure a favourable outcome in respect of proceedings in the European Commission, ECJ or a UK court
- it is necessary to safeguard public money, the Government Department's budgetary position or for the proper functioning of the mortgage market or competition in the market for the construction of residential dwellings

After the termination date, reconciliation will take place to ensure that the Secretary of State's liability has not exceeded the 5.5% of Sale Prices. Where it has this will be repaid from the funds remaining in the Cells (to the extent there is any money available). Where a Lender recovers monies from the mortgagor, the Cell Company must repay the Secretary of State where the Government Guarantee has been called on to pay the claim.

It should be noted that the Secretary of State can amend the form of the Government Guarantee in his absolute discretion by giving written notice to the parties. There is a requirement to consult the parties, CML and HBF, before doing so. Any amendment to the Government Guarantee should be automatically reflected in the Policy.

Appendix 2: Contractual Structure

Home Builders Federation
1st Floor Byron House, 7-9 St James's Street, London SW1A 1EE
Tel: 0207 960 1600 F: 0207 960 1601
Email: info@hbf.co.uk Website: www.hbf.co.uk Twitter: @HomeBuildersFed