Housing association insolvency: legal options in the absence of bail-out or rescue

As we approach the fourth anniversary of the credit crunch most registered providers (RPs) remain in good financial shape, but there is renewed chatter that some may find themselves in difficulty during the next 12-24 months.

The most common causes of corporate insolvency are fraud/criminal activity and poor management. For RPs, non-fraud problems usually arise from diversified activities including property development, market sales and extra-care, rather than core social renting.

The commonly-held view is that 'the government will step in' and the tenanted properties will be transferred to another RP together with a grant dowry.

In this situation lenders have previously been happy to go with the flow, provided that their loan position remains intact. Only one failure has been highly public – Ujima in 2007; all other troubles have been resolved quietly. But this may not be the case in future.

> "Commonly-held view that the government will step in and rescue problem cases, with consent from lenders, may not be the case in future"

Workout

A successful workout or solvent re-organisation is more likely where problems are identified early. A workout is an agreed plan to put the organisation on a better footing so it can keep going – like fixing a slow puncture on a tyre. This could include:

- Suspension or re-structuring of debt or debt payments;
- Disposing of bad development or other contracts, or selling bad assets;
- A transfer of some businesses within the group.

It would be usual for management to stay in post during the workout. If problems are not resolved early on, the situation may deteriorate to formal enforcement or insolvency action, and to the provisions of 2008 Housing & Regeneration Act. Incumbent management are unlikely to survive formal enforcement action.

Moratorium

The moratorium is contained in sections 144 to 159 of the Act.

In simple terms, the moratorium is triggered on the first serious step required to start insolvency proceedings or the enforcement of security over land. The moratorium applies to non-profit and profit-making RPs which are registered companies or industrial & provident societies.

The moratorium does not affect all types of creditors and security.

Disposals which do not include land and rents are excluded from its remit. Unsecured lending is also excluded. A liquidator can disclaim onerous contracts in land. The moratorium prevents the disposal of land and rents.

While enforcement of security over land and rents is therefore not possible during the moratorium, calling default and drawstop (stopping a loan advance being made because the conditions for payment are not met) may be possible and all contractual rights and opportunities should be actively considered by creditors during the moratorium period.

The moratorium lasts for a period of 28 working days, but may be extended with the consent of the secured creditors.

As well as commercial lenders, secured creditors may include the grant regulator (the HCA) where it holds security, other RPs which have made loans on secured terms and local authorities or developers which have financial interests, including financial assistance or deferred consideration, secured on specific property interests.

An important power under the Act is the ability of the regulator to appoint an interim manager with broad powers to run the business during the moratorium.

The regulator can appoint the interim manager without the consent or involvement of secured creditors, employees, tenants or the RP board.

In practice it is anticipated that this power would be exercised by the regulator only to preserve the RP's operations and to protect tenants' services and employees.

It is expected that the interim manager would be another RP rather than, for example, an insolvency professional.

The regulator is not required to pay the interim manager, so remuneration would be an additional, and probably priority, cost on the business.

The exit plan

During the moratorium there is no obligation on the regulator to make proposals and there is a power for the regulator to cancel the moratorium early, in consultation with the person who originally triggered the moratorium event.

This allows the possibility of creditors or others putting forward and negotiating a workout plan, not just waiting for the regulator to design a rescue.

The secured creditors will need to give unanimous consent to any proposals, which may include the appointment of a manager to run the business or organise the sale of assets. At this stage of the process it is possible, but unlikely, that a workout situation would be achievable. It is therefore anticipated that this manager would be an insolvency professional rather than another RP. Proposals at this stage of insolvency are likely to facilitate running the business for a period to allow the orderly sale and break up of the property portfolio, or the disposal of the business by sale, which may be achieved through transfer or amalgamation.

Rescue

The 2008 Act changed the legal responsibilities of the regulators.

Additionally, the regulator has less money to splash around.

Many would-be rescuer RPs are fairly fully committed on their own expenditure. Many lenders are lending at a loss. The unrewarded co-operation of lenders and commonality of their interest in an RP insolvency should not be presumed.

Lenders might expect to re-price loans or charge fees to reflect a higher risk and higher costs necessarily incurred during a rescue situation. Some lenders might want to be re-paid, refusing to co-operate as a secured creditor and forcing a re-payment as part of the overall rescue arrangement. Some lenders might want to re-schedule, perhaps shorten, loan terms. Some lenders might not be able to agree a rescue because the combined loans of the existing and rescuing RPs exceed their credit limit for the combined entity. Lenders might want to exit shared security arrangements or improve their security position as part of any rescue agreement.

Sector analysis to date has tended to presume a failure of a medium-sized or small RP.

In the case of a larger RP, it is likely the business would need to run on until the property can be geographically separated for disposal. Some RPs are considered too big to fail, with asset values of several billion pounds. In the case of the largest RPs perhaps the regulators should require them to create a 'living will' arrangement, as is proposed for the banks.