Analysis and advisory work on a potential property bond scheme for property owners affected by plans for HS2

Final report

RefHS2/134

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1. Executive summary

1.1. Background and context

In December 2013, the Department for Transport (DfT) and High Speed Two Limited (HS2 Ltd) commissioned PricewaterhouseCoopers LLP (PwC) to provide analysis and advisory work on a potential property bond scheme for Phase One of the HS2 high speed railway, between London and the West Midlands. The Government consulted on this scheme in the Property Compensation Consultation 2013, which closed on 4 December 2013 (the Consultation Document). Ministers intend to take a decision in the near future on whether to introduce such a property bond scheme for Phase One.

A property bond is a promise to eligible property owners affected by a major, long-term development. It is a promise that, in specific circumstances, they will be given a well-defined financial settlement – an amount of money, referred to as the 'protected value' – in exchange for their property.

The Government is committed to honouring the entitlements of all property owners to compensation under the statutory Compensation Code. The Government also recognises that due to the exceptional scale and duration of the HS2 programme, Compensation Code entitlements may not by themselves fully address the reasonable needs of eligible owners of residential properties affected by the HS2 proposals. DfT and HS2 Ltd are therefore considering the introduction of additional measures to provide support.

The Government consulted the public on additional discretionary compensation schemes for Phase One in the Consultation Document. One of the options is a 'property bond' scheme, of a type described in that paper. The option is based on preliminary analysis and design work, carried out by Deloitte and set out in its September 2013 report on an HS2 property bond option.

Property bond schemes are relatively new and untested, and a Government-backed version would be unprecedented. The idea of a property bond scheme is to provide eligible owners with a means of avoiding financial loss suffered as a result of 'blight'. This term is used to describe the depreciation in property values caused by both direct impacts (e.g. noise and vibration), and indirect impacts such as loss of amenity caused by properties being near major infrastructure projects. It is also claimed that, by protecting property values for sellers and purchasers, bonds support the normal functioning of the property market. This assertion is untested in the market for a project of the scale and duration of Phase One.

The proposed HS2 bond is time-based. It would comprise a legal agreement that commits the promoter (in this case HS2 Ltd) over the life of the scheme to purchase a property if a market sale at an un-blighted value cannot be achieved within a reasonable timescale.

As well as protecting eligible owners, the bond scheme would be intended to maintain public trust and confidence in the property market affected by the scheme.

Our report provides advice on implementing a Government-backed property bond scheme. It highlights a range of commercial, financial, legislative, regulatory, technical and administrative issues that should be addressed if the Government decides to proceed.

In preparing this report, we have sought to take into account views expressed in discussions held as part of our work with professional bodies such as, for example, the Law Society, the Royal Institution of Chartered Surveyors (RICS), the Council of Mortgage Lenders (CML), the National Association of Estate Agents (NAEA) and the Valuation Office Agency (VOA). We have also relied significantly upon the experience, knowledge and input of DfT and HS2 Ltd officials, particularly around agreeing key assumptions and design parameters.

We have not carried out a full business case analysis or considered in any detail the costs or benefits of alternative schemes that could be implemented in the absence of a property bond approach.

1.2. Approach and methodology

We were asked to advise DfT and HS2 Ltd on the practical implementation of a Government-backed property bond scheme, covering a range of commercial, financial, legislative, regulatory, technical and administrative issues. To carry out this work, we have:

Used the design criteria outlined in the Consultation Document

These are:

- fairness
- value for money
- community cohesion
- feasibility, efficiency and comprehensibility
- functioning of the housing market.

The criteria were used to guide the development of individual features of the property bond. However, they were not used to evaluate the property bond scheme against alternative approaches, such as voluntary purchase. This comparison would need to be made by the DfT in considering the best option to pursue following consultation.

Considered precedents and fit with other compensation schemes

There are no direct UK precedents for a property bond scheme of the size and timescale being considered for HS2, and there is limited evidence of what will work effectively in the market. We have looked for precedents for individual elements of the scheme, by assessing features of the design and administration of other compensation schemes, as well as considering proposals in support of property bond type schemes.

Reviewed consultation responses and consulted professional bodies

The consultation process ended on 4 December 2013. HS2 Ltd commissioned Dialogue by Design (DbyD), a company specialising in public consultation, to undertake a fully independent analysis of consultation responses. This report was completed in February 2014. As part of our engagement, in January, we undertook a separate high-level review of consultation responses on the property bond proposal in order to identify views or issues raised in relation to the key design criteria highlighted above.

We have also held informal discussions with the CML, RICS, NAEA, VOA and the Law Society. Acceptance of any scheme by these organisations would be important in gaining wider public and market confidence in its operation.

Reviewed the current scheme proposals

We have reviewed the current proposals as outlined in the Consultation Document, as these would be expected to form the basis of any final scheme. In order to deliver an implementable design, including recommendations on administration, the fundamentals of any scheme would need to be fair and comparable to 'normal' market processes. We worked with DfT and HS2 Ltd to develop and agree detailed design features that would ensure fairness and would support the normal functioning of the housing market.

Created a cost model

We have created a cost model to help the DfT and HS2 Ltd to understand the financial implications of a range of design assumptions, implementation outcomes and property market scenarios. The results of this analysis are set out in our separate Cost Report.

In this report the remainder of the Executive Summary sets out the results of our analysis and our key findings and conclusions. The rest of the report and our Cost Report details supporting analysis and research as well as output from workshops and the financial modelling exercise. The content follows the scope of work requested by the DfT and HS2 Ltd.

1.3. Property bond overview

It is envisaged that a property bond – as a discretionary compensation scheme – would be administered by HS2 Ltd on behalf of the DfT, under the terms of a development agreement between HS2 Ltd and the DfT. Key features of the proposed design of a property bond and scheme are set out below.

Property bond contract

- A property bond would be a binding contract between the DfT and the eligible property owner; it would be registered at the Land Registry. A property bond would grant an eligible owner the contractual right to request HS2 Ltd, acting for the DfT, to purchase the owner's property at an unblighted value, known as the protected value. Eligible owners would be entitled to do this if they are unable to sell the property, at or above, the protected value within a defined marketing period.

- The protected value would be assessed by professional valuers at the time an eligible owner wishes to sell. However, it would take account of an initial baseline value, assessed at the time of application for the scheme and indexed to the point of sale.

- To qualify for payment under any scheme, a property bond owner would need to accept the assessment of protected value, and market their property under the terms of the scheme.

- If a property is sold at protected value, the benefit of a property bond would pass automatically to a purchaser if acquired at, or above, protected value. If a property is purchased at below protected value, the bond attached to it would extinguish. However, in practice it would be expected that property owners would sell to Government in such circumstance.

Eligibility

- Those eligible to apply for, and receive, a property bond would be residential owner-occupiers, small business owners and owner-occupiers of agricultural units (as entitled under a Blight Notice) who have owned a significant interest in land since 10 March 2010, within a fixed geographical distance each side of the central line of the proposed railway. Eligibility criteria mean that not every property within the fixed geographical distance would qualify for a property bond.

Scheme timetable

- Eligible owners would be able to apply for a bond in 2015.[1] On application, the property would be inspected by the scheme administrator to confirm that it is located within the boundary, and to assess its baseline value. The applicant's rights would be confirmed by completion of the property bond.

[1] Implementation dates will be subject to Ministerial approval.

- Property bond agreements would expire one year after Phase One HS2 becomes operational, at which point owners would be able to pursue claims, if appropriate, for direct impacts of the operation of HS2 (e.g. noise) under Part 1 of the Land Compensation Act 1973.

1.4. Legal and regulatory analysis

The legal status of the proposed property bond would differ from private-sector property bond schemes that have operated previously. As this scheme would be backed by the Government, it would involve consideration of the principles of public law, in addition to the principles of contract law that apply to private-sector arrangements.

Government departments have a common law power to enter into contracts with private individuals. Contracts must not conflict with existing statute and cannot restrict the department in exercising its general statutory powers. There appears to be no conflict with existing statute to restrict this general power to contract. It is enhanced by a specific statutory power to incur expenditure in acquiring property in the High Speed Rail (Preparation) Act 2013.

The DfT would need to ensure that the correct internal procedures are followed, so that contracts are signed by someone who has delegated authority to bind the Secretary of State. If a property bond scheme was considered to be within this general power, the usual public law remedies would apply.

We have analysed the regulatory position and we do not believe that a property bond would be considered a novel financial instrument or that the issue of property bonds would constitute a regulated activity in relation to specified instruments falling within regulation under the Financial Services and Markets Act 2000 (as amended).

1.5. Valuation, revaluation and indexation

A number of options were considered to identify a fair and accurate approach to assessing the protected value at which the DfT would acquire an eligible property if it could not be sold within a reasonable marketing period. Consultation responses and further discussions with the VOA and the RICS confirmed the view that valuations at the time of sale, carried out by professional valuers, would be a more accurate and hence fairer method of assessing value than the sole use of an indexed value. However, a baseline value derived from an initial inspection, plus the use of an appropriate index, would give confidence to eligible owners, provide supporting information to the valuation process, and provide the DfT and HS2 Ltd with guidance on any potential liabilities.

The different types of index were reviewed: it was concluded that a combination of Land Registry and Office for National Statistics ('ONS') data would provide the most robust index.

1.6. Eligibility and the application process

A number of key areas of eligibility were considered. These included the nature of the legal interest, the type of property, and the distance from the line. Our work was informed by officials at the DfT and HS2 Ltd on a number of key design features, including:

- The Government's broader discretionary proposals did not include landlords. The DfT and HS2 Ltd could see the case for including landlords – who were once owner-occupiers and are renting their properties for personal reasons – but did not expect other landlords to be eligible to benefit from any scheme.

- The inclusion of rural, town and fringe sites along the line – boundaries would be set within a fixed limit within rural and town and fringe areas[2]. The boundaries of any property bond would not extend into urban areas where the line is predominantly within tunnels or next to existing transport routes.
- Boundaries from the line would be determined by the DfT and HS2 Ltd with reference to a range of factors: precedent from HS1, noise contours (so there will be differences between rural, town and fringe areas), the impact of blight (which will be largely subjective) and costs.

No eligible owner would be compelled to join the scheme. However, a communication and information campaign would be deployed to encourage applications for a property bond. Applications might be phased along the line in order to support early administration over the first year of operation – provision would be made for those who need to apply early. Access to the scheme would mainly be online, but supported with a paper-based process for individuals unable to access online facilities easily.

1.7. Marketing period and bond redemption process

When an eligible owner decides to sell a property secured by a bond, its protected value would be assessed. Once this value is agreed, the property would be marketed for an agreed period (which would depend on its type and location).

If a sale proceeds as normal between buyer and seller at protected value, HS2 Ltd would transfer the bond to the successor in title. If the property is not sold at or above the protected value within the marketing period, the seller can approach HS2 Ltd to acquire the property on behalf of the DfT.

1.8. Bond transfers and status changes

Over the life of a property bond scheme, people's status may change and properties may be transferred. We have considered how transfer and status changes for eligible owners and property could affect their eligibility for the scheme. The key conclusions related to:

- Agreements for lease that were entered into before the qualification date, but where the lease is granted after the qualification date. These are to be included in any scheme, provided that the relevant property would meet other eligibility criteria.
- Divisions of property (e.g. where grounds or part of a dwelling are sold off). The solution proposed is that a bond would only be used on one part, and would only attach to dwellings. If a dwelling itself was divided, only the retained part would benefit from a bond.
- The treatment of shared ownership leases. These would be eligible, although to call on the bond, the leases would have to be offered for sale on the open market. In certain leases, the existence of pre-emption or nomination clauses would mean that the tenant could not make a claim under the scheme.

1.9. Winding down a long-term scheme

The proposed property bond scheme is designed to address the impact of blight. Research and our discussions with RICS, VOA and others reflected a generally held view that once infrastructure is operational, any blight significantly reduces, with property prices progressively recovering, often to normal market levels. It is therefore proposed that any property bond scheme would cease one year after HS2 starts operating (i.e. 2026 for Phase One), after which owners would need to claim compensation under current or future statutory arrangements.

[2] Using the ONS definition.

The ending of the scheme might result in an increase in the number of claims, as a property bond could be of greater value to owners than statutory compensation.

1.10. Administrative design

The processes involved in the administration of a property bond would be relatively straightforward with a number of precedents. For example, it is not considered difficult to design and implement processes such as online applications by the public, registration at the Land Registry or an assessment of un-blighted value.

However, any scheme would need a high-quality design. It would need to be effectively communicated to the public and administered competently if public confidence in a scheme is to be maintained throughout its life.

Core processes could be carried out by HS2 Ltd, by an outsourced provider within the Government, or by a third-party private sector provider. There are advantages and disadvantages to each of these options. Operating costs, however, should not be materially different. A decision whether to outsource administration is most likely to be influenced by timing, with a projected implementation of any property bond scheme by mid-2015 at the latest. (It is unlikely, given the need to perform further detailed process and system design, and carry out a range of tasks including recruitment and procurement, that the infrastructure supporting the administration of a property bond could be in place more quickly than this).

One of the difficulties in planning the management of any scheme lies in forecasting volume – how many bonds would be registered, how many properties could come to market and how many would be acquired by HS2 Ltd? Fluctuations in demand on any scheme are likely to generate extra cost; therefore, an important consideration in choosing an organisational solution would be flexibility and the ability to cope with variations in demand and administrative tasks.

The management of assets acquired would be a key part of any scheme. HS2 Ltd might need to acquire a significant number of properties and would need to manage these until it is appropriate to sell. Ultimately, this is a decision for HS2 Ltd as scheme administrator for the DfT. However, it is assumed that properties would be held and rented out until the property market within the bond boundary recovers. Selling properties acquired at blighted values would undermine the effectiveness of any scheme.

Holding properties for rent would require administrative and operational resources and appropriate budgets. We envisage that HS2 Ltd could seek to transfer assets and/or the associated management of properties purchased to private sector investors or asset managers. However, any transfer would need to be conducted carefully, particularly in terms of the purchase and disposal of assets, to ensure value for money.

Should the Government decide to implement a property bond scheme for Phase Two of HS2, it would still be possible to implement in early to mid-2015, but clearly this would require a significantly larger resource requirement. This has not been assessed as part of this report.

1.11. Capturing the performance of a property bond

The performance of any property bond scheme represents a key opportunity for the Government to gather data on blight and the ability of property bond arrangements to support confidence in local housing markets, together with the associated costs. This data could be used to inform future developments in compensation schemes relating to major infrastructure projects.

A property bond scheme implemented for Phase One of HS2 could be considered a 'pilot' approach for large infrastructure projects. As such it should not be viewed as setting a precedent to be implemented on all infrastructure or related projects. However, it would be a large and geographically dispersed 'pilot', given the scale of the HS2 project. Performance measures have been suggested to test all property bond processes and the assumptions made around their design.

The performance measures have also been designed to ensure that processes are continually monitored to address any issues that could affect public confidence in a property bond (for example, due to errors in administration or failure to communicate the features of a property bond scheme effectively).

1.12. Costs analysis

A series of financial scenarios have been modelled in order to estimate the potential costs of a property bond scheme (if implemented as proposed in this report). Further detail on the cost analysis can be found in the Cost Report.

Approach

The cost analysis used a series of differing assumptions, designed to reflect scenarios across a range of operating outcomes.

Given the unprecedented nature of the proposed property bond, there is a lack of direct empirical evidence and supporting historical data on which to base assumptions. The assumptions used were arrived at in consultation with officials at the DfT and HS2 Ltd, and were informed by discussions with industry bodies. As a result we have had to rely on professional judgement and experience in developing input assumptions.

It is possible that the actual outcomes would deviate materially from the assumptions that have been made in developing the cost model. Any such deviation has the potential to have a significant impact on the cost and financial resources needed to implement and operate the scheme. The results of our analysis should therefore be viewed as illustrative only; nonetheless, they are helpful in providing a broad estimate of the potential costs and capital requirement of any property bond scheme.

The Government will need to make a judgement on the risks it is prepared to assume around the cost of any property bond scheme.

Assumptions

Given the uncertainties that exist in relation to many aspects of a property bond scheme, the cost modelling has been developed on the basis of two scenarios:

Given the uncertainties that exist in relation to many aspects of a property bond scheme, the cost modelling has been developed on the basis of two scenarios:

- **'Optimistic' scenario** – where it is assumed that a property bond achieves many of its objectives and a relatively viable property market is maintained.

  A number of different assumptions have been made and some of the assumptions vary depending on the width of the boundary that is assumed for a property bond. Some of the key assumptions for an 'optimistic' scenario are included in the table below:

Assumption	120m	300m	500m
Proportion of properties that come to market that Government is required to buy between 2015 and 2023	60%-80%	25% – 50%	20-40%
Percentage of owners looking to sell within 12 months of introducing a property bond	15%	10%	8%
Level of ongoing blight at expiry of property bond scheme	5%	2.5%	2%

- **'Pessimistic' scenario** – where it is assumed that a property bond does not function as hoped and the impact of a bond in providing market stability and encouraging purchasers is limited.

  Some of the key assumptions for a 'pessimistic' scenario are included in the table below:

Assumption	120m	300m	500m
Proportion of properties that come to market that Government is required to buy between 2015 and 2023	90% – 100%	60-80%	40-65%
Percentage of owners looking to sell within 12 months of introducing a property bond	20%	15%	12%
Level of ongoing blight at expiry of property bond scheme	10%	7.5%	7%

For both scenarios, we have assumed that house price inflation will be 4% per annum.

Sensitivity analysis has been undertaken to illustrate the impact of changing these assumptions on the projected costs of a property bond scheme.

We would emphasise that the 'pessimistic' scenario is not necessarily a worst case scenario. The Government may wish to consider the implications of a worst case scenario in any decision on whether to introduce a property bond scheme.

The cost model has been developed to generate different illustrative cost and capital requirement outcomes, depending on the boundary adopted for any property bond scheme.

The cost model outcomes are highly sensitive to changes in key assumptions, particularly those related to:

- the level of blight
- the number of owners who decide to sell their property
- the presence of purchasers in the market who would be willing to acquire properties at the protected or un-blighted value.

The strategy chosen in managing the acquired properties would be critical to the overall cash flows to the DfT and HS2 Ltd. The current cost-model base case assumes that the vast majority of properties purchased by HS2 Ltd would be held and rented out until, following the completion of the HS2 project, the underlying housing market returns to something close to normality. At this point it is assumed that HS2 Ltd would sell the properties it has acquired. If this assumption does not hold, net present costs would increase materially.

In addition, the cost model assumes that underlying un-blighted property values would rise over the period covered by the property bond scheme. This inflation, alongside a policy of holding the majority of properties acquired until blight has reduced, would provide an opportunity for the DfT and HS2 Ltd to realise gains, over the long term, on the properties acquired. This holding gain would reduce the total net present cost of any scheme over the long term. Clearly, if property prices in the vicinity of the line do not recover or if values in the overall housing market decline, then a holding strategy could result in losses and higher net present costs.

Model outputs

A summary of the results of the financial analysis across a number of boundary scenarios and assumptions is set out below. The table firstly highlights the total current value of un-blighted properties within a number of potential property bond boundaries. It then presents the results of our analysis as to the potential net present costs and peak annual and cumulative cash requirements to implement a scheme under a range of scenarios and assumptions relating to uptake, properties acquired, blight levels and both rental income and receipts on ultimate disposal of properties.

Scenario	Value of un-blighted properties eligible for a property bond (nominal)	Projected peak annual cash requirement (nominal)	Projected year of peak annual cash requirement	Projected maximum cumulative cash requirement (nominal)	Projected net present value/(cost) of scheme in base case (3.5% real discount rate)
120m optimistic	£242.7m	£32.9m	2015/16	£104.1m	(£13.1m)
120m pessimistic		£54.5m	2015/16	£169.3m	(£38.5m)
300m optimistic	£1,066m	£61.0m	2015/16	£235.0m	(£17.7m)
300m pessimistic		£143.3m	2015/16	£509.4m	(£85.0m)
500m optimistic	£2,905m	£101.7m	2015/16	£468.0m	(£30.5m)
500m pessimistic		£255.3m	2015/16	£1,072.2m	(£158.1m)

In the table above values have been assessed by CBRE as at July 2013, no costs of purchase or sale are included within these numbers. The total number of properties within each boundary have been provided by HS2 Ltd and do not include any properties that are; within the safeguarded area, already in the ownership of HS2/DfT, or outside property bond eligibility criteria.

The results of this analysis are illustrative only. However, they indicate that if a property bond scheme achieves its intended function, the overall costs could be viewed as low. However, if purchasers are not prepared to pay the market value for eligible properties, the implementation of a property bond scheme would be likely to require a substantial investment of resources, and HS2 Ltd, as the administrator, could incur significant costs. The analysis also illustrates a wide range of potential outcomes over the short to long term.

In particular, we highlight the relationship between the overall potential costs of any scheme and the high capital or cash requirement. The more properties that are potentially acquired and held, allowing the possibility of a holding gain to be realised, the greater the projected potential long-term income of the project. However, the more properties acquired would also mean more capital would be required to implement the scheme. This capital would be 'at risk' as the amount of gain would be dependent on the property market and capital release at a favourable point in a property market cycle. The DfT and HS2 Ltd would need to ensure that any capital allocation allotted to the HS2 project included sufficient resources and flexibility to meet the potential requirements of any scheme.

A number of sensitivities have been run to illustrate the impact on projected costs in the event of changes in input assumptions. This analysis, which is set out in the Cost Report, highlights the high sensitivity of those costs to small changes in key assumptions.

Accounting implications

We have not been instructed to analyse the detailed accounting implications of a property bond scheme. Our initial view is that the DfT and HS2 Ltd would need to account for the potential liabilities generated by any property bond scheme from the outset. To illustrate, this is likely to include:

- marking down the value of any properties purchased to fair value on acquisition

- as a property bond could be viewed as an insurance scheme, there may be a requirement to make provision for the projected overall losses and costs of the scheme over its lifetime, discounted to the date of introduction
- even before a bond is signed, once the DfT makes an offer to eligible homeowners, a constructive and possibly legal obligation may arise which may need to be accounted for as a provision.

Accounting for any scheme is likely to be complex and annual deficits or gains booked may be materially different from the cost and cash-flow analysis presented above.

Government accounting and budgeting approaches would pose challenges in planning and accounting for a property bond. Annual predictions would be needed for the potential deficits and cash and capital requirements, so that the DfT (and hence HS2 Ltd) can achieve a budget settlement with HM Treasury (HMT). The uncertainty around the projected operation of a scheme and the assumptions that underpin projections of deficits, costs and capital requirements will require a prudent approach to budget forecasting.

Accurately predicting the overall costs, cash and capital requirements of a property bond scheme, as well as the complexity in accounting, provisioning for potential future losses and budgeting suitable resources to meet the requirements of the scheme, would present a challenge and a risk in deciding whether to proceed. These financial risks are for the DfT and HS2 Ltd to consider as part of their overall policy appraisal. We have set out below a number of other risks to be taken into consideration.

1.13. Key risks

We have identified a series of risks associated with a property bond scheme. We have examined in particular, risks that are concerned with assumptions relating to the market and the potential behaviour of owners and purchasers, together with risks to the administration of a scheme and its implementation. We highlight a number of these key risk areas below.

Owner behaviour

A property bond would support property owners through a 'purchaser of last resort', which would acquire their property if they wish to sell and cannot find a buyer at protected value in the market. However, the assurance offered by a bond may actually induce some people to move, and could enable more owners to move than if no such scheme existed. The risk is that a scheme's existence could generate additional 'churn' in the market, with more moves taking place than in a normal market. Higher numbers of properties on the market might result in HS2 Ltd acquiring more than predicted and could increase the overall costs of the scheme.

Prospective purchasers

If there is a greater supply of properties to the market, increased demand would be required from purchasers willing to buy at protected values, otherwise HS2 Ltd would have to acquire them. A property bond would appear to satisfy mortgage lenders, so finance should be available to purchasers to underpin that demand.

However, when we consulted property professionals, their general view was that even with a bond, purchasers could require some level of discount from a protected value and that those properties nearest to the line (most blighted) may not receive suitable offers and therefore would need to be acquired by HS2 Ltd. This would result in HS2 Ltd taking on full acquisition, management and disposal costs in due course.

However, some properties might sell with the assurance provided by a bond. Predicting purchaser behaviour and the likely impact on the costs of any property bond scheme is problematic and represents a risk.

Administration of the scheme

There are risks around the administration of any scheme. The public interface needs to be robust and processes need to be in place to manage acquisitions and sales along the length of the railway line. The design also needs to allow for flexibility as forecasts of the volume of applications and transactions are uncertain.

Adjacent markets

Owners of properties just outside any property bond scheme boundary may still feel a degree of unfairness and there may be some market distortion around these boundaries, to the disadvantage of those owners not covered by the scheme. This is inevitable given a requirement for a boundary, and a similar impact would be likely whatever form of compensation scheme was introduced.

Precedent

Any scheme put in place for Phase One of HS2 would be likely to form a precedent for Phase Two. Certain elements of a property bond scheme, such as the difference in approach adopted between urban and rural areas, are likely to be even more important for Phase Two.

In addition, evaluating the success or otherwise of any scheme, particularly through building evidence of numbers of applications for a property bond and ease of use, will be vital for any successful implementation in Phase Two (and potentially for other large infrastructure projects).

Clearly, a risk exists that a property bond scheme that is largely unprecedented and untested could become a precedent and be applied to Phase Two, yet not deliver the desired outcomes in Phase One. Conversely, a successful scheme would be valuable in helping the Government to manage the impact of major infrastructure projects on property owners.

Programme implementation

There is a risk that any scheme implementation could be delayed. Adequate time would be required between scheme announcement and implementation to ensure that risks of delay are minimised and public confidence in a property bond is not undermined. Late implementation of any scheme would limit its ability to address the blight caused by both planning and construction.

Theoretically, early implementation of a property bond scheme, on announcement of the HS2 project, may have provided an up-front boost to market confidence with a consequent reduction in potential blight. Currently, any property bond scheme would be introduced into a market already suffering from a degree of unmanaged blight. While this may affect the overall success of a property bond scheme, its implementation and the consequent demonstration of the Government's commitment to stabilising the market could assist in managing blight related to HS2.

1.14. Conclusions

The main objective of our work was to assist the DfT and HS2 Ltd in designing an effective and implementable time-based property bond scheme. In carrying out our work, we have made reference to the HS2 Property Compensation Consultation 2013 Document and the criteria set out within it. The Government will evaluate the relative merits of the different compensation schemes under consideration against these criteria. Our conclusions are set out under each of the criteria, which are Fairness, Functioning of the housing market, Community cohesion, Feasibility, efficiency and comprehensibility and Value for money.

The brief for this report did not include work to analyse or assess the relative merits of a property bond scheme compared to alternative policy options, such as a voluntary purchase scheme, which is the key comparator in the Consultation Document for providing support to owners of blighted properties in the rural support zone. The DfT and HS2 Ltd should consider carrying out a full and detailed comparative analysis of these and any other relevant policy options before reaching a final decision on a preferred policy approach.

Fairness

A property bond guarantee – a purchase of a property at full, un-blighted value – would clearly protect eligible owners of properties from a diminution in property value within any agreed boundaries to the scheme. We anticipate that this would likely have a positive impact on public perceptions of the HS2 project, provided the scheme boundary is wide enough to include the majority of properties that are substantially affected. A narrowly drawn boundary – for any potential scheme – that may exclude a significant proportion of substantially affected properties could be seen as unfair.

We are unable to comment on whether a property bond scheme would be fairer than other means of compensation. Determining an appropriate boundary for the scheme is a design issue and a decision for the Government. However, our analysis demonstrates that a wider boundary would mean more home owners would benefit from the protection that a property bond would offer.

Our analysis indicates that a wider boundary could better support a level of normal housing market activity than a boundary that is drawn close to the line. Where a compensation scheme boundary is close to the railway line, it is more likely to create a market anomaly, potentially creating a disparity between those owners with blighted properties who could call on a scheme's support and those who cannot.

As our financial modelling illustrates, the wider the boundary, the higher the potential costs to the Government of implementing a property bond scheme. However, any compensation scheme that the DfT and HS2 Ltd decide to implement will carry costs – similarly, these are likely to increase as the boundary widens.

To properly decide on the trade-off between cost and benefit, we recommend that the DfT and HS2 Ltd consider carrying out further work to better understand the costs of alternatives to a property bond.

For those owners within the agreed boundary for any property bond scheme, the compensation and reassurance provided by a property bond would be seen as fair. A property bond would likely be viewed as the Government providing additional protection for those affected by HS2; consequently, it could be viewed as a fair response to addressing blight. However, the degree to which fairness is perceived by owners is likely to depend on a boundary wide enough to include the majority of properties that are substantially affected by blight.

Functioning of the housing market

To support the market adequately, a property bond would need to underpin, to a reasonable extent, the operation of the housing market. It could do so by providing prospective purchasers with the confidence and incentive to purchase properties at a full, un-blighted market value. This will depend on purchasers' confidence in the Government as full-market-value purchaser of last resort, in the event of a subsequent sale. Without a precedent, it is not possible to judge reliably whether a property bond scheme would achieve the objective of maintaining the housing market, as purchaser behaviour in this instance is extremely difficult to predict.

Implementing a property bond scheme a number of years after the announcement of the HS2 project may reduce its effectiveness in supporting or restoring confidence in the housing market, since blight is already a factor in the market along the route.

What is clear, however, is that a property bond scheme – and its announcement – would offer at least the potential to support some level of normal market activity (during the life of the property bond's existence), and could move the market some way towards pre-blight levels. However, it is impossible to predict how large a positive move this would be.

Despite the uncertainty as to the impact of a property bond scheme, the potential to induce a positive response in the market is a key differentiator from other schemes that do not provide purchasers with any value guarantee to rely on. Depending on whatever scheme the Government decides to introduce, the lack of a similar guarantee could encourage crystallisation of blight in the market.

The success of any property bond scheme would depend on the confidence of owners and purchasers in the Government as a purchaser of last resort and the extent to which buyers value this 'insurance' and the extent to which purchasers would be willing to pay the full market value unaffected by the railway line. The level of this confidence cannot be predicted. Effective communication and implementation of a scheme would be important to engender and support this confidence. A property bond scheme could therefore offer the potential to support, to some degree, the maintenance of a functioning housing market, either by stabilising prices or reducing blight. However, risk would remain around the stability of the property market on cessation of a scheme. At this time, careful management of the disposal of properties acquired for rent by HS2 Ltd would be required to ensure minimal disruption to local markets.

Community cohesion

Effectively communicating the potential market stabilisation effect of a property bond scheme, and any resulting increase in market confidence, could persuade existing residents to remain *in situ*, thereby supporting local communities.

In addition, the emphasis placed on supporting the conditions necessary for a 'normal' housing market suggest that a property bond approach, should it function as intended, is more likely to aid community cohesion than approaches that focus merely on fair compensation. This should address the lessons from HS1, where a scheme with similarities to a voluntary purchase scheme resulted in significant long-term change to some communities along the route.

Any scheme operator would need to manage acquired properties effectively by working with local communities to ensure that housing is occupied and community facilities continue to be viable. There is a risk that if a property bond is implemented with a wide boundary, that a large number of households could decide to move, potentially generating a greater change in communities along the HS2 route.

A property bond scheme may support community cohesion if it succeeds because of the potential it offers to stabilise the market in proximity to HS2 and help persuade residents not to move.

Feasibility, efficiency and comprehensibility

Our work has demonstrated that it is possible to design a process and organisational model that should provide a firm foundation for the efficient operation of a property bond scheme. The processes around application, valuation, acquisitions, rental and property disposals are well understood. The Government also has a track record in creating on-line application systems, and HS2 Ltd should draw on this experience. A property bond approach may be new, but the processes that underpin its implementation are tried and tested.

The efficiency of a property bond scheme and the ultimate take-up by the market would depend on a full and focused communication campaign to ensure that eligible owners are fully aware of their rights and fully appraised in terms of the application process and how to use the protection a bond would offer in any subsequent sale of their property. An equally focused campaign on educating prospective purchasers on the merits of the scheme including disturbance mitigation measures, would also be important to the prospects of generating any 'normal' market behaviour. This would help to ensure that the process is seen to be efficient and effective.

Risks and questions remain around the time required to build any supporting administrative infrastructure and the issue of whether a scheme is operated in-house by HS2 Ltd or outsourced to a third-party provider. If a property bond scheme is to be implemented successfully, it would be important to decide quickly whether to outsource or build in-house, in order to facilitate its early introduction and to ensure that the requirements for an effective design are fully identified to avoid operational error.

Implementing and administering a property bond scheme is feasible and its efficiency would depend upon effective implementation. Again, any alternative scheme designed to address and manage property blight would require administrative and operational resource and will carry implementation risks that would need to be considered.

Value for Money

The financial and cost analysis of a property bond approach has enabled a view to be taken on the extent of any potential costs and liabilities.

Over the long term, renting properties and selling them once values have recovered, offers the potential to generate revenue and gains to offset up-front costs depending on market conditions on renting and disposal. Adopting a policy of holding properties for rent would also avoid the creation of a two-tier market caused by disposing of properties at blighted values, which would undermine the effectiveness of any scheme.

However, operating a property bond scheme would require a significant cash outlay in order to purchase properties that do not sell at protected value. The cash or capital requirements are difficult to predict, but could be considerable, year-on-year, as properties are acquired. This uncertainty represents a key risk in terms of ensuring that the overall funding envelope for the HS2 project is flexible enough to accommodate variations in capital spend over the life of the scheme. The Government would need to make suitable provision for any gain or loss on acquisition prices, given the generally lengthy pay-back period before acquired properties are released back into the property market.

We consider that the announcement of any scheme may give rise to a number of early applications (the result of pent-up demand in anticipation of an announcement). This may come at a point where the overall budget for HS2 implementation is still relatively restricted before construction starts.

The announcement of a property bond scheme could help stabilise the market, but the volume of early applications and the potential impact on HS2 Ltd's cash flow may be difficult to manage. Therefore, the DfT and HS2 Ltd may wish to consider a variant that permits eligible owners to claim under a scheme, but only once construction starts. This should provide more time to plan and confirm a realistic budget. Those with a real need to move (prior to construction commencement) could continue to be accommodated through the long-term hardship scheme, but under eligibility criteria associated with a bond e.g. location within a boundary. This is suggested as it would be undesirable for members of the public to have to wait longer than necessary for the Government to purchase properties where that is the only satisfactory solution.

Our analysis demonstrates a wide range of potential cost outcomes, depending on assumptions applied around blight levels, as well as seller and purchaser behaviour. The costs and capital requirements of any scheme are sensitive to relatively small changes in assumptions and illustrate the uncertainty involved in implementing a scheme.

Risks and uncertainty would need to be managed through effective communication and administration of any scheme. Some risks, such as purchaser and seller behaviour, plus overall market conditions, are much more difficult to predict and manage. For a price, it may be possible to share or transfer some of the risks of a property bond scheme to a third party in a commercial arrangement aimed at capping liabilities and providing more certainty as to the overall amount and timing of costs and capital requirements. The DfT and HS2 Ltd may wish to explore this option before implementing any scheme.

Cost is a key consideration and risk factor in assessing the attractiveness of a property bond as a policy instrument. A property bond scheme would need to represent value for money as well as being affordable to the public purse. Our analysis demonstrates that while a bond would offer a number of attractive features when compared to the evaluation criteria, it would also bring a significant level of uncertainty and risk. This is to be expected, since it is a new approach to addressing the impact of blight. Any other policy alternatives under consideration would also involve a level of cost, risk and uncertainty, and any assessment of the value for money offered by a property bond scheme should be judged in comparative terms, not in isolation. It would be important to manage this risk to provide effective value for money to the Government.

Summary

Our analysis of a property bond approach demonstrates that, if it functions as intended, such a scheme could help the Government to meet a number of the policy evaluation criteria set out in the Consultation Document. In particular, it would assist in fairly compensating eligible owners who have suffered a reduction in the value of their property, and its potential to build confidence in the market could assist in managing or reducing blight in communities along the route of the HS2.

However, a property bond scheme could require significant resources to implement and operate in order to meet the potential obligations of acquiring properties. There is significant uncertainty as to its likely success in influencing market behaviour. This makes it difficult to accurately predict the timing and sum of cash resources needed to support a scheme – a risk which is difficult to manage. It may be possible to manage and reduce the DfT and HS2 Ltd's cash-flow, risk and uncertainty by entering into some form of partnership with a third party willing to share risk and potential gains on any acquired property portfolio. This option would need to be tested in the market to ensure it presented good value for money.

A key consideration for the DfT and HS2 Ltd is value for money and affordability. In this regard, it is clear that alternative policy approaches, including a decision on a boundary, will also carry cost, risks and uncertainties. Setting a boundary for any scheme involves trade-offs between:

- the potential offered by a wider boundary to better support homeowners and the market
- the potential for greater costs and uncertainty.

Without a full evaluation of alternative schemes and boundaries in the context of the resources and budgets available to the DfT and HS2 Ltd, it is difficult to reach a fully evidenced view on a preferred option.

Whatever the potential merits of a property bond scheme, its ability to meet the Government's stated evaluation criteria would depend on both the effective communication and implementation of the scheme and the level of resource – operationally and financially – that the Government makes available to support its operation. Long-term support and commitment to the scheme by the DfT and the promoter, HS2 Ltd, would therefore be an important factor in its overall performance and the extent to which it achieves its objectives.

On balance, we would conclude that it is possible to make a considered argument in support of a property bond scheme but it is difficult to make a firm recommendation.

In a scenario comparing the worst case of any compensation approach with the same boundary and offer to compensate householders for the full protected value of their property – where the DfT and HS2 Ltd are required to purchase the majority of properties – costs would probably be comparable.

A property bond scheme, if successful, would, however, have the merit of offering the potential to underpin market confidence and support some level of normal market functioning. This potential, as illustrated in our cost analysis, could result in a lower cost solution to fairly addressing the compensation of homeowners with properties affected by blight.

However, the range of risks identified would need to be successfully managed and mitigated in order to retain market confidence and hence give any scheme the best chance of success. In making a decision the Government should weigh up the merits and risks of a property bond scheme against those of alternative approaches to compensation in order to determine the preferred way forward.

2. Introduction

2.1. Background and context

In December 2013, the DfT and HS2 Ltd commissioned PwC to provide analysis and advisory work on a potential property bond scheme for homeowners affected by plans for HS2.

The potential implementation of a property bond for HS2 has arisen as a response to the Government's recognition that due to the exceptional scale and duration of the HS2 programme, the Compensation Code entitlements may not by themselves fully address the reasonable needs of owner-occupiers of residential properties affected by the HS2 proposals. The DfT and HS2 Ltd are therefore considering the introduction of an additional package of compensation measures.

The Government consulted public opinion on its proposed schemes for Phase One of HS2 in the Property Compensation Consultation 2013[3] which closed on 4 December 2013 (the 'Consultation Document'). One of the options presented in that consultation paper is the option to introduce a 'property bond' scheme of a type described in that paper.

Ministers intend to take a decision in spring 2014 on which of the discretionary compensation options to take forward for Phase One of HS2. In making that decision, they would take into account the information and analysis in the compensation paper, previous consultancy advice on property bond scheme design options, and comments received through the current consultation process.

A property bond is a promise to eligible property owners affected by a major long-term development programme such as HS2, to give a well-defined financial settlement in exchange for their property. This settlement can be redeemed under specific circumstances.

Property bond schemes remain new and are relatively untested, and a Government-backed property bond scheme would be unprecedented. However, if ministers should decide to introduce a property bond scheme, broadly as described, they would then wish to be in a position to be able to take further decisions in order to introduce such a scheme without undue delay.

This work is intended to inform those practical decisions on implementation to be made by the DfT and HS2 Ltd, and to provide advice on the implementation of a Government-backed property bond scheme, covering a range of commercial, financial, legislative, regulatory, technical and administrative issues, and taking account of the risks and opportunities a scheme could present. The details of the work commissioned are contained in the Invitation to Tender HS2/134, dated 4 December 2013. The work commissioned did not require a review of or comparison to alternative compensation schemes.

2.2. Approach

We were asked to address the following three main requirements within the overall scope of the commission:

1. a report detailing the legal and operational mechanisms by which a property bond would be operated, underpinned by an analysis of the legal and regulatory requirements and risks
2. a cost-analysis report illustrating a range of potential costs of implementation
3. consultancy support to the DfT and Hs2 Ltd to build readiness and understanding of a property bond scheme and its design, and to prepare for potential implementation in terms of operational and financial requirements.

[3] https://www.gov.uk/government/consultations/hs2-property-compensation-consultation-2013.

In this Final Report, we are addressing our response to the above requirements in the following sections, which follow the requirements as set out in the Invitation to Tender (HS2/134):

- Section 3 provides a short summary of the 2013 consultation on a property bond proposal.
- Section 4 presents an overview of proposals for a property bond scheme.
- Section 5 outlines the design of a property bond agreement and legal status.
- Sections 6 to 9 set out further details of a property bond scheme design.
- Section 10 presents a proposed approach for administering any scheme.
- Section 11 suggests appropriate performance measurement of the scheme.
- Section 12 presents an analysis of risks and opportunities.

The sections are supported by appendices covering details on legal advice, and detailed process maps.

As part of our work, we have undertaken a series of workshops and meetings with the DfT and HS2 Ltd to present progress, jointly assess and analyse design issues and gather additional information and assumptions to support our work.

For reasons of brevity, this report does not contain a description of the HS2 rail project or the details and principles of compensation and related schemes. These are covered in the Consultation Document.

The report refers to a property bond or 'bond' and property bond scheme.

2.3. *Methodology*

We have been tasked to provide recommendations on the practicalities and design of a property bond scheme supported by analysis and informed by wide-ranging professional expertise and experience. In developing our proposals in conjunction with the DfT and HS2 Ltd team we have taken into account the proposed property bond scheme design outlined in the Consultation Document and undertaken our own independent analysis to challenge key design assumptions that we have elaborated on where necessary. Throughout our study we have sought input from industry, including professional associations, in order to build on available experience and provide relevant evidence where available.

Consideration of the design criteria

We have taken into consideration the criteria as outlined in the Consultation Document by which decisions on the introduction and design of any potential property bond scheme have been, and would be, guided. These criteria are:[4]

- **Fairness**
- **Value for money**
- **Community cohesion**
- **Feasibility, efficiency and comprehensibility**
- **Maintenance of the functioning of the housing market**, that is a particular driver for a property bond approach.

[4] All criteria carry equal weight as set out in the Consultation Document.

It is important that all decisions on the design of a property bond and any property bond scheme are taken with reference to these criteria to create a coherent approach. In considering and developing the design we have placed particular emphasis on:

- **Fairness** – Our assumption is that fairness would underpin trust in a property bond that would enable its adoption and acceptance by buyers and sellers and hence confidence in its operation in the market. By inference, if a property bond is not fair it could be challenged, it would not be trusted and its market support function would fail.

- **Maintaining a functioning property market** – The aim of a property bond is to maintain a functioning property market with buyers and sellers present, as far as is possible, in comparable quantities to similar un-blighted markets in order to minimise any diminution in value due to planning and construction blight[5]. To achieve this, a property bond scheme should be, preferably, of a simple design, clearly understood by buyers and sellers and should track, as far as possible, normal market processes.

Reviewed the current scheme proposals

We have reviewed the current proposals as outlined in the Consultation Document as these basic principles would form the basis of a robust scheme. The initial proposed design of a property bond left some questions to be answered, particularly as there is no direct comparator for the suggested scheme in its entirety.

To build on the initial proposed design we have used our own professional expertise (legal, economic and property), reviewed consultation evidence and undertaken further exploration of key issues with interested professional bodies and other representative organisations.

In particular, we have consulted further with:

- CML (Council of Mortgage Lenders)
- RICS (Royal Institute of Chartered Surveyors)
- Law Society
- Land Registry
- NAEA (National Association of Estate Agents)
- VOA (Valuation Office Agency)
- ONS (Office of National Statistics)

The specific form of interaction has been phone interviews and meetings, with discussions taking place in an informal and exploratory manner. We have drawn on the information obtained during the preparation of this report, including in relation to a property bond design, administrative arrangements and costing assumptions. During these discussions we have been fully independent of the DfT and HS2 Ltd.

We would emphasise the importance to the DfT and HS2 Ltd of, from these bodies and other key stakeholder groups, the endorsement of any final proposed property bond scheme. This would form an important element in securing acceptance of any implemented scheme and securing wider public and market confidence in its operation.

[5] The construction and operation of major projects or the planned acquisition of land can have negative effects on nearby properties. This negative effect is commonly known as blight.

Detailed work

In building on the features of the proposed property bond scheme outlined in the Consultation Document, we have undertaken additional detailed work on:

- the legal form of a property bond
- the impact of a property bond on different forms of interest in land
- applicability to transfers in interests in land
- process development covering the setup and administration of a property bond scheme
- consideration of risks around a property bond scheme processes and mitigation measures
- outline assessment of strengths and weaknesses of internal or external administration of a property bond scheme
- developed a cost model, with supporting assumptions, to illustrate a range of potential scheme costs under different scenarios and eligibility criteria (see separate Cost Report).

As part of this work we have identified a list of issues pertaining to a property bond design to which solutions would need to be identified. As the level of design for any scheme becomes more detailed, the process gives rise to more questions. These have been logged and the design has progressed by looking at the range of solutions for each issue using professional and market expertise and previous comparators (should they exist) to come to recommendations for consideration by the DfT and HS2 Ltd.

3. Consultation on property bond proposals

3.1. Background on consultation

As a result of the High Court ruling in March 2013, the Government launched a new consultation on the HS2 Phase One property compensation schemes during September to December 2013. The timing of our engagement enabled the team to consider the initial results of this consultation. A core part of the consultation was around a property bond option and an example of how a property bond might work. This example was based on a study commissioned by the DfT from Deloitte[6].

The Deloitte study reviewed earlier examples of property bond type mechanisms and developed a high-level proposal that outlined how a property bond scheme might be designed. Specific focus was given to highlighting the key features and operational practicalities of such a scheme.

Key recommendations that emerged from the study included the need for the bond to be time-based and structured around a clearly defined boundary in order to define eligibility. A 'time-based' bond scheme operates on the basis that a property not sold in the open market within a defined time period would be acquired by the scheme operator at the pre-agreed bond value. This value is essentially the un-blighted value of a property assuming the HS2 project had not been proposed. On the other hand, a 'value-based' bond scheme operates on the basis that the scheme operator would, if necessary, offer to pay a 'top up', i.e. the incremental difference between a pre-agreed bond value and the un-blighted value. We have not considered a value-based bond scheme as part of this work as it was not consulted on.

The Consultation Document described the key design features of a property bond and asked respondents to provide their views. The key features can be summarised as follows:

- **Eligibility**
  - owner occupiers who acquired dwelling before 10 March 2010.
- **Applications**
  - open throughout the life of the scheme.
- **Valuation**
  - a 'base bond price', based on either a sale price in the 12 months to March 2010 or an independent assessment providing an un-blighted valuation
  - the 'base bond price', regularly updated according to a price index to take account of future changes in the average property values in the relevant areas
  - final current bond price subject to assessment of property.
- **Modifications**
  - any property modifications to be included in the guaranteed price.

[6] HS2 Property Bond Option, September 2013. http://assets.hs2.org.uk/sites/default/files/inserts/Deloitte%20report_HS2%20property%20bond%20option.pdf

Transfer

- contract is transferable to successor in title.

- **Expiry**
  - to expire one year after operation of railway begins, i.e. when Statutory Compensation becomes available.

- **Redemption**
  - inform a property bond operator of the intention to sell
  - a property bond operator verifies the house value and agrees the sale price
  - owner has six- month marketing term to sell at or above agreed price
  - if the owner is unsuccessful, the operator acquires the property at the agreed sales' price.

- **Boundary**
  - straight geographic line up to 120m each side of the centre line of the proposed railway
  - exceptional Hardship Scheme (or any replacement scheme) applies outside of the boundary
  - rural only.

3.2. How consultation responses have been considered

In the recent Consultation Document, HS2 Ltd asked: "What are your views on the option to introduce a 'time-based' property bond scheme within a 'rural support zone' as an alternative to the voluntary purchase scheme?"

The consultation process closed on 4 December 2013. HS2 Ltd commissioned DbyD to undertake a complete – and fully independent – analysis of consultation responses.

As part of our engagement, we have undertaken a separate high-level review of consultation responses. The purpose has been to gather key information, with particular focus on identifying views or issues raised in relation to the key design features of a property bond highlighted above.

Information provided by DbyD shows that in total, 17,097 responses were received. Of these, 1,050 respondents made explicit reference to a property bond proposal. It was not feasible, however, for us to review this number of responses during our engagement.

We therefore undertook a review of responses that was selective and focused on obtaining views from a small number of representative bodies, and respondents who addressed particular issues. We focused on obtaining relevant information from their submission to inform subsequent discussions we have had with those particular bodies and other stakeholders. This information-gathering therefore focused on issues that concerned the eligibility criteria, boundary and any proposed approaches for indexation of property values.

We used an objective approach to identify key points where respondents were suggesting changes to a property bond scheme proposed in the Deloitte report. This approach provided valuable information to inform our review and subsequent further development of the initial design of a property bond scheme. The results of this review are reflected in the proposals set out in this report.

Our review has not identified or responded to all suggested changes or challenges to a property bond scheme proposed in the Consultation Document. The final report by DbyD would provide a complete view. Our focus has been on providing a summary of key points of difference or agreement and these are set out below.

Overall, our review identified a broad support for the proposed (time-based) property bond scheme. It would also appear that consultation respondents believe that a property bond would help to bring confidence back to the property market along the route. However, several of the proposed key design features were challenged. Challenges centred in particular on those features of the property bond proposal that constrained owners' eligibility to apply for a bond, e.g. due to distance from the rail line and exclusion based on geography or type of ownership.

Key observations that we would highlight include:

- **Eligibility** – where specific comments are made, they are focused on a widening of the bond eligibility criteria to include, for example:
  - landlords, social housing, businesses
  - second homes
  - properties purchased after March 2010
  - properties above tunnels.
- **Valuation** – Comments are made in relation to the proposed approach for determining the future 'un-blighted' value, i.e. indexation of a 'base bond price' based on a pre-HS2 valuation, e.g.:
  - indexation is a blunt instrument
  - valuation at the time of sale should be used instead of the indexation approach.
- **Redemption**
  - shorter marketing period before rights can be exercised under the bond.
- **Boundary**
  - inclusion of urban areas, in particular London
  - a wider boundary in excess of 120m from the centre of the rail line.

As part of our work in developing a design for a property bond scheme, we have considered each of these issues further and discussed their implications with the DfT and HS2 Ltd which gave input, and guidance to the decisions on the design proposals set out in this report.

4. Overview of design proposals for a property bond scheme

The following section sets out the current status of design proposals for a property bond incorporating work carried out by PwC in conjunction with the DfT and Hs2 Ltd officials reflecting their input on design parameters and operating and market assumptions.

4.1. Administration

A 'property bond', as a discretionary compensation scheme, would be administered by HS2 Ltd on behalf of the DfT under the terms of a development agreement between HS2 Ltd and the DfT. It is intended that any scheme would be accessed on-line by potential applicants and that owners of property bonds would be able to carry-out any related processes, securely, also on-line. The on-line site would be supported by the ability to seek advice over the telephone and paper-based applications would also be accepted for those without internet access.

4.2. Legal form of a property bond

Property bonds would be issued by the administrator to eligible owners in the form of a contract that would be registered at the Land Registry.

4.3. Eligibility

Those eligible to apply for, and receive, a property bond would be residential owner occupiers, small business owners and owner-occupiers of agricultural units (as entitled to serve a blight notice) that have owned a significant interest in land since 10 March 2010, within a boundaries to be set by the DfT each side of the central line of the proposed railway in rural and town and fringe areas (as defined by the ONS).

Eligible owners would be expected to be able to apply for a property bond on-line in 2015. On application the property would be valued and inspected on behalf of the scheme administrator to confirm location (within the boundary).

A property bond would transfer to successors in title in the event of a sale at a 'protected value'. The protected value is the value that a property (in its then current condition) would have if a development (in this case HS2) were not planned and implemented.

4.4. Rights confirmed by a property bond

Any property bond issued would grant to an eligible owner the contractual right to call upon HS2 Ltd (acting for the DfT) to purchase their property at the 'protected value' if they have not been able to sell their property over a reasonable period of marketing on the open market. Protected value and a reasonable period of marketing would be determined at the point of application to sell with reference to an appropriate house price index and two market valuations.

4.5. Applying for, and redeeming, a bond

In order to take advantage of the scheme an eligible owner would need to have a property bond in place – registered at the Land Registry – and apply on-line to market their property under the terms of the scheme, for an agreed market period at an agreed price. Further, under the proposed terms of a scheme, an eligible owner would undertake to accept a reasonable offer at or above the protected value within the marketing period. If a property is successfully sold on the open market at or above the protected value, the owner would be liable for all normal marketing and conveyancing fees.

Eligible owners would not be able to market their properties outside the scheme with the benefit of a property bond.

If no reasonable offers are received during the defined marketing period under a property bond scheme HS2 Ltd would make arrangements, on behalf of the DfT, to purchase the property at the protected value. No other payments would be made to the property bond holder.

4.6. Expiry of the scheme

Property bond contracts would expire one year after Phase One of HS2 becomes operational, at which point owners would be able to continue to pursue claims under Part 1 of the Land Compensation Act 1973.

4.7. Structure of the report

The remainder of this report is structured to provide further detail on a proposed design for a property bond scheme and reflects the scope of work and areas we were asked to examine by the DfT and HS2 Ltd in our engagement.

Sections 5 to 8 consider key aspects of the design of the scheme:

- **Section 5: Overview of a property bond agreement** including legal and regulatory analysis. This section includes a draft of a property bond agreement supported by the legal and regulatory analysis that have informed its design.

- **Section 6: Valuations, revaluations and indexation**. Establishing value is a key aspect of the design of a property bond scheme. In this section we examine options for providing robust and effective valuations to support a property bond application process and subsequent sale or redemption under a property bond scheme.

- **Section 7: Long-term wind down and closure**. This section considers options for a practical wind-down of a property bond scheme taking into account the property market and ownership scenarios.

- **Section 8: Setting boundaries for a property bond scheme.** Setting the boundary for a property bond scheme each side of the line is a key decision for the DfT and Hs2 Ltd. This section of the report looks at the options for setting a boundary and the issues to be considered.

Sections 9, 10 and 11 consider the design of a property bond scheme administration

- **Section 9: Process Design for a property bond scheme**. The section details end-to-end processes to be used in the administration of a property bond scheme from establishing initial eligibility, application for a property bond, managing the marketing of property through to eventual claim on a property bond if a sale of a property has not been achieved.

- **Section 10: Administration of a property bond scheme**. Based on the processes outlined in Section 9 this section considers the design of an organisation required to administer a property bond scheme and the resources required – people, IT and finance.

- **Section 11: Performance measurement.** To monitor the success of the implementation of a property bond scheme the administrator would need a robust performance management process, both to check on the efficiency and effectiveness of its operation and outcomes as well as record learning should a property bond be considered a workable solution for future infrastructure schemes.

- **Section 12:** Identifies a series of potential risks and opportunities in the design, operation and implementation of a property bond scheme.

A separate Cost Report was also produced as part of our work which sets out an illustrative financial analysis of the potential costs of implementing a property bond scheme. The key finding from this analysis has been incorporated in the Executive Summary to this main report.

5. A property bond agreement

5.1. Introduction

This section provides advice on the legal and regulatory status of a property bond highlighting detailed design implications and how a property bond would operate alongside the Compensation Code and existing statutory compensation provisions. At the end of this section a draft model bond document has been provided as an example of what might be issued to successful applicants.

5.2. Legal status

The Consultation identified the defining characteristics of property bond schemes as follows:

- Eligible property owners, at an early stage of the project's development, are given a specific and binding promise under a property bond of a well-defined, individual settlement – the protected value – which the property owner would be entitled to redeem in specified circumstances.
- If a property bond recipient transfers the property to a third party, the bond would also be transferred to the same third party.
- Settlements would be defined with reference to independent professional property valuations.

The property bond scheme designed as part of this work aims to comply with all these characteristics as follows:

- A property bond would be a binding contract between the DfT and the eligible property owner under which the scheme operator would purchase the property at the protected value if the owner is unable to sell the property at, or above, the protected value within a defined marketing period.
- Under the terms set out, the benefit of a property bond would pass automatically to successors in title of the owner (including mortgagees in possession) by virtue of the express application of the Third Party Contracts Act to a property bond contract.
- The protected value of a property would be determined by reference to valuations carried out by independent professionals.

In addition, a property bond would be registered against the title of the property at the Land Registry to ensure that the arrangements are transparent and open to search online by the general public for a small fee (currently £6 for a copy of the register and title plan for one title number).

Also, the scheme administrator, HS2 Ltd, would require notice of the sale of properties with the benefit of a property bond so that its records are maintained in addition to those at the Land Registry.

Feedback on the proposed legal status of a property bond contract

We have discussed the legal form of the property bond contract with representatives from both the Law Society and the CML.

The Law Society wished to have further details of the proposals in order to consider a property bond scheme and any guidance to the profession in relation to it.

The CML has collated anonymised responses from members regarding the proposed property bond design, the registration of a property bond at the Land Registry and the application to a property bond contract of the Third Party Rights Act. The responses received were broadly supportive of the registration of a property bond at the Land Registry and the use of the Third Party Rights Act to pass on the benefits of a property bond contract to mortgagees in possession but in the case of the application of the Third Party Rights Act, the respondents were clear that this was subject to reviewing the actual provisions of any scheme.

Operation alongside the Compensation Code

A property bond as designed could not require an owner to contract out of statutory rights to claim Compensation and, accordingly, consideration would need to be given to the extent of such potential claims and how to address them under any property bond scheme. We have considered methods for dealing with this situation within the bond documentation. If there has been a successful claim under Section 10 – other than for physical damage – prior to a trigger notice under a property bond being served, then either (a) the successful Section 10 claim could be a termination event under a property bond or (b) the amount of the Section 10 damages could be deducted from the amount of the protected value; if there is an ongoing Section 10 claim (again, other than for physical damage), then the bond could provide that a trigger notice would not be served under the property bond until the resolution of that claim.

It is suggested that claims for physical damage under Section 10 should not result in a loss of protection under a bond. This is due to the fact that, to the extent that there is physical damage that reduces the value of a property, it may result in a lower protected value on a sale, as the property would be valued in its current state at that time.

Model documentation

An outline draft of a model document for a property bond agreement has been prepared and is intended to be clear and easily understood so as to comply with the design criterion in the Consultation Document as regards comprehensibility.

It should be understood that the draft documentation presented is an initial draft based on the current design of a property bond scheme and it would need to be refined and developed further to reflect any changing requirements if the scheme is taken forward.

Registration at the Land Registry

A property bond agreement would be registerable on the basis that there would be a provision in an agreement obliging the owner/occupier to notify HS2 Ltd as scheme administrator in the event they wish to sell the property and make a claim on the property bond agreement. This obligation would be treated as a burden affecting the property and would be registerable as a restriction against the title to the property at the Land Registry.

The Land Registry requires consent from the registered proprietor before it can register a restriction against title. Under a property bond agreement, the owner/occupier would provide consent to HS2 Ltd as scheme administrator to apply to enter this restriction on the register. The Land Registry would not require mortgagee consent to enter such a restriction on title. In any event, mortgagees would already have a restriction entered against the title and would rank in priority on the register.

The wording of the restriction would be agreed and included within a property bond agreement and derives from a standard Land Registry restriction. The restriction requires the prospective buyer of any property (whether it be the DfT or a third party) to obtain a certificate from a conveyancer confirming that the obligation to notify HS2 Ltd, as per the property bond agreement, has been complied with. Without this certificate, the prospective buyer would be unable to register the purchase of the property (unless the requirement to notify is waived by the DfT).

The fact that a property bond agreement is registered would mean that properties with the benefit of a property bond agreement may be transferred in the ordinary way (e.g. as part of an inheritance) without any real need for participation by HS2 Ltd (the onus would be on the owner/occupier to notify HS2 Ltd and the certificate could be provided by any conveyancer, including the conveyancer of the owner/occupier). It is anticipated that this would be done as part of the normal post-completion activities that follow a property purchase. Analysis of transmission situations and their relationship to bond ownership is contained within Appendix A4.

Communications' strategy for the general public

The development of the legal documentation and the processes set out in Sections 7 and 8 would also need to be backed up by a comprehensive communications exercise to ensure that all those property owners affected or potentially affected are clear about how any property bond scheme would operate and what they would need to do to take advantage of its provision.

In addition, given the potential length of the construction period, there would need to be a level of flexibility in all elements of the scheme to adapt to changes in the law and best practice, the need to incorporate administrative changes, significant changes to the route, and to cope with developments in the technology used in the operation of any scheme.

Liaison and guidance for the legal profession, lenders and the Land Registry

In addition to a communications strategy for the general public referred to above, for any property bond scheme to be successful there would need to be regular liaison with and training for professional bodies representing those involved in the legal aspects of a scheme, such as lawyers and secured lenders as well as the Land Registry. This approach has been clearly expressed in our discussions with the Law Society, the CML and the Land Registry and a continuous dialogue and exchange of information would be helpful as part of the process of gaining support for a scheme.

5.3. Legal and regulatory analysis

We have undertaken an analysis of the legal and regulatory status and implications of a property bond and our findings are set out more extensively in Appendix A.

Our analysis is based on the premise that any property bond scheme has the following legal characteristics:

- It would consist of an agreement between the DfT and the eligible property owner which would be registered at Land Registry as a restriction on the property owner's title and would continue to be in place until one year after operation of HS2 Phase One commences (when the part 1 statutory compensation scheme becomes available).

- An eligible property owner could trigger a sales process at any time during the term of a property bond agreement. This would require the property to be marketed in accordance with the marketing and sale conditions for a minimum period with a view to obtaining a sale of the property to a third party at or above the protected value. If such sale to a third party is completed, the property would transfer to the new eligible property owner with the benefit of a property bond in place.

- If a sale of the property to a third party at or above the protected value is not completed within the marketing period, then HS2 Ltd on behalf of the DfT would enter into a property contract to purchase the property at the protected value. The DfT would have discretion as to whether a property bond agreement would terminate or continue in favour of a subsequent owner.

Regulatory analysis

Regarding the regulatory analysis of a property bond agreement, we have focused on whether the issue of property bonds would constitute a regulated activity or a financial promotion under the Financial Services and Markets Act 2000 as amended ('FSMA') as any breach of the FSMA requirements in this respect would be a criminal offence.

In order for there to be regulated activity or a financial promotion, a property bond would need to constitute a specified investment under the Financial Services and Market Act 2000 (Regulated Activities) Order 2001 as amended ('RAO').

There are two categories of specified investment that might apply to a property bond – (a) government and public securities and (b) options. In relation to government and public securities, a property bond would not come within the category of conventional loan stock or bonds. However, there is also a general category of 'other instruments creating or acknowledging indebtedness'.

There is no definition of 'indebtedness' in the RAO but commentary in relevant case law and other UK legislation suggests that a three-element test should be applied to establish whether a debt exists: the debt must be for an identifiable sum, it must be payable at an ascertainable date, and the liability to pay should be certain.

Under this test a property bond agreement does not appear to be an 'instrument creating or acknowledging indebtedness'. Arguably a debt would not arise until an eligible property owner has exercised their right to require the DfT to purchase their property, and the DfT has entered into a property contract with the purchaser, which would confirm the amount owed (the purchase price) and when such indebtedness would be due and payable. That property contract would not be considered to be a financial instrument regulated under FSMA because it is a contract for the purchase of real property. Therefore, property bond agreements would not constitute government and public securities under the RAO. The RAO also provides that options to acquire or dispose of certain financial instruments amount to specified investments for the purposes of FSMA. An eligible property owner would have the option to require the DfT to purchase their property. Options to acquire real property do not fall within types of options covered under the RAO. Therefore, property bond agreements would not amount to the option type of specified investment under the RAO.

On the basis of the above analysis, property bond agreements would not be 'specified investments' for the purposes of FSMA and, accordingly, the activities by the DfT and/or HS2 Ltd relating to the promotion, issuance, sale and execution of any property bond agreements would not be regulated under FSMA and the RAO.

However, this issue should be kept under review if the proposed design of a property bond scheme changes.

Legal analysis – Comparison with other property bond schemes

As set out in a more detailed analysis in Appendix A, previous property bond scheme proposals developed by the private sector have been promoted, particularly in relation to potential airport developments and also in relation to the proposed Central Railways development.

From the information publicly available, these schemes have operated on a similar contractual basis but appear to have included 'put' options in favour of property owners. These options would enable an owner to require the bond issuer to purchase the property at a pre-determined price (base valuation plus index linking and certain agreed costs and allowances).

The scheme details we have seen refer to options lasting 21 years. This would be due to those schemes having been proposed prior to 6 April 2010, when the law required options in respect of land to be exercised within 21 years of the grant of the option. However, this requirement has been repealed by the Perpetuities and Accumulations Act 2009.

With any property bond agreement we are not proposing a formal grant of an option in favour of the property owner, but rather a contractual undertaking to act as purchaser of last resort if the owner is unable to sell the property at, or above, the protected value with the benefit of a property bond.

The potential property bond for Phase One of HS2 would similarly be on a contractual basis but without incorporating an option for the property owner to require the acquisition of the property (so as to maintain the normal functioning of the property market).

Legal analysis – The status of a government backed property bond

However, the legal status of any HS2 property bond is likely to be different as a result of the involvement of the Government in any scheme that would involve the consideration of the principles of public law in addition to the principles of contract law applying to private sector arrangements.

The two main areas for review are:

1. whether the entry by the DfT (or HS2 Ltd on its behalf) would be considered ultra vires
2. whether the obligations of the DfT (or HS2 Ltd) would be considered to be governed by private contract law or public law – the main distinction being that under private contract law, any dispute would be governed by ordinary contractual principles whereas under public law, any dispute would be governed by the law surrounding judicial review.

Government departments have a common law power to enter into contracts with private individuals. Contracts must not conflict with existing statute and cannot restrict the exercise by the department of its general statutory powers. There appears to be no conflict with existing statute to restrict this general power to contract. It is enhanced by a specific statutory power to incur expenditure on acquiring property in the High Speed Rail (Preparation) Act 2013.

The DfT would still need to ensure that the correct internal procedures are followed to ensure that contracts are signed by someone with delegated authority to bind the Minister of State. If a property bond scheme were considered to be within this general power, most of the usual contract law remedies would apply and decision- making could also be subject to challenge under judicial review procedures.

If HS2 Ltd was the contracting party, the position would not be dissimilar. The power to contract would be included within its constitution and as a public body its decisions could still be subject to judicial review.

Internal governance

We would also highlight the potential internal governance implications of any proposed bond scheme. The DfT is currently subject to the requirement to report on an annual basis to Parliament on the expenditure incurred in relation to the HS2 rail project. This requirement includes reporting on actual expenditure and the creation of any liabilities such as a property bonds. The DfT should clearly satisfy itself, in discussion with HMT and/or other stakeholders, on the type of information to be included within departmental reports. Given the fact that there would be some uncertainty as to when payment would be made under the terms of any bond, it may be necessary to provide separate information on aggregate contingent liabilities arising and those crystallising in any report period. We also provide some high-level views on accounting for a property bond scheme in Section 10.

Outline draft of the Property Bond Agreement

As requested in the Invitation to Tender we have drafted a model bond document consistent with the preceding advice on contractual status, regulation and administration of the scheme.

Outline draft

Property Bond Agreement

Date:	
DfT	[Department for Transport]
Original Owner	[name(s) and postal address of registered proprietor(s) of the relevant Property]
Property	[Property address and any other relevant details, including whether it is leasehold or freehold and Title Number(s)]
Baseline Value	[To be established as part of the application for the Property Bond Agreement]
Scheme Administrator	[High Speed Two (HS 2) Limited]

Main Agreed Terms

1. The Original Owner has applied for the Property to benefit from the property bond scheme and the DfT has agreed that the Original Owner and the Property meet the Eligibility Criteria for the property bond scheme and that the Property with its current Baseline Value shall benefit from the property bond scheme on the terms of this agreement.

2. An Owner may at any time before the Expiry Date deliver a Trigger Notice to the Scheme Operator to start marketing the whole of the Property on the terms of the Marketing and Sale Conditions. If the Owner does not exchange contracts for the sale of the whole of the Property for an aggregate consideration at, or above, the Protected Value to a third party within the Marketing Period and in accordance with the Marketing and Sale Conditions, then the DfT would purchase the Property from the Owner at the Protected Value on the terms of a Standard Purchase Contract.

3. In consideration of the offer of the DfT to purchase the Property as a buyer of last resort under 2. above, the Owner agrees that a Restriction giving details of this agreement would be registered against the Property at the Land Registry by the Scheme Administrator.

4. Any Change of Ownership during the operation of this agreement shall be registered by the Successor Owner with the Land Registry and with the Scheme Administrator as set out in the property bond Standard Terms.

5. Successors to the Owner in respect of the Property would have the right under the Contract (Rights of Third Parties) Act 1999 to enforce this agreement so long as the Successors and the Property continue to meet the Eligibility Criteria.

6. This agreement shall be interpreted in accordance with the Definitions and is subject to the property bond Standard Terms.

Definitions	
Agricultural Unit	An agricultural unit as defined in the Town and Country Planning Act 1990 (as amended) which is occupied by the Owner for the purpose of farming the land comprised in the Property or (if not occupied) last occupied or intended to be occupied by the Owner as an agricultural unit
Attorney(s)	Any attorney(s) appointed by an Eligible Owner under a valid enduring power of attorney or lasting power of attorney in each case enabling such attorney(s) to deal with the Property
Baseline Valuation	The Valuation of the Property as at the date of this agreement to establish its Baseline Value as determined in accordance with the property bond Standard Terms and the PBS Documentation
Business Premises	A building or buildings on the Property providing self-contained business premises for a business carried on by the Owner with a rateable value that did not exceed RV £34,800 as at the Qualifying Date
[Change of Occupation]	[Any changes to the occupation of the Property by the Owner as their only or main residence or place of business]
Change of Ownership	Any changes of ownership of the Property during this agreement including any changes in the nature of the legal interest of the Owner in the Property
Change to the Property	Any change to the external structure or extent of the Dwelling or the Business Premises on the Property which requires planning permission or any change to the use of the Property or the destruction of or damage to all or a material part of the Dwelling or the Business Premises on the Property
Cut-Off Date	The date falling [●] months before the Expiry Date
Designated Area	The geographical area to which the property bond scheme would apply as set out in publications issued by the DfT and/or the Scheme Administrator from time to time
Disposal	Includes a sale, transfer, assignment, lease or other disposal of the Property, whether voluntary or involuntary and whether for valuable consideration or by way of gift or a combination of the two
Dwelling	A building or part of a building on the Property which is either occupied by the Owner or (if not occupied) last occupied or intended to be occupied by the Owner as a private dwelling and their only or main residence
Eligible Mortgagee	A mortgagee who has made a loan to the Owner or any Successor in each case as an Eligible Owner which is secured on the Property
Eligible Owner	The Original Owner of an Eligible Property who owned it, on or before, the Qualifying Date and any Successors of the Original Owner
Eligible Property	A property which: • is located wholly or partly within the Designated Area at the time of the application for this agreement; and • is an Agricultural Unit or includes a Dwelling and/or Business Premises; and • has title registered at the Land Registry; and • is a freehold; or • is a leasehold property held under a lease granted on or before the Qualifying Date with a term of at least 7 years; or • is a leasehold property held under a lease granted after the Qualifying Date pursuant to an agreement for lease entered into on or before the Qualifying Date with a term of at least 7 years (but excluding any lease granted following the variation of an agreement for lease after the Qualifying Date which would have the effect of making the lease as granted an Eligible Property); or

Definitions	
	• is a freehold property created after the Qualifying Date following enlargement of a long lease under section 153 of the Law of Property Act 1925 or a merger of a leasehold interest with the relevant freehold title where the long lease has the benefit of a property bond Agreement already registered against its title (provided that the Baseline Value and the Protected Value of such freehold shall be limited to the value of the original lease); • is a commonhold property occupied by an Eligible Owner; • is not an Excluded Property; • but excluding any new leasehold property resulting from a surrender and re-grant of an existing leasehold property with the benefit of a property bond Agreement already registered against its title whether as a result of an express surrender or re-grant or a deemed surrender and re-grant on an extension of the term of or demise under the existing leasehold title and any reversionary lease taking effect after the Expiry Date.
Eligible Transfer	A disposal by one Eligible Owner to another Eligible Owner of an Eligible Property
Eligibility Criteria	The criteria for Eligible Owners, Eligible Properties, Eligible Mortgagees and Successors pursuant to Eligible Transfers to benefit from the property bond Scheme as set out in the Definitions
Excluded Property	Any property which has been designated as being within a protected area for shared ownership homes pursuant to the amendments to schedule 4A of the Leasehold Reform Act 1967 made by sections 301 and 302 of the Housing and Regeneration Act 2008 and any other property which may be excluded by the DfT from time to time pursuant to the property bond Standard Terms
Expiry Date	The date falling on the expiration of 12 months from the date of commencement of operation of the HS2 Line for use by the general public in the area adjacent to the Property
HS2 Line	Phase One of the proposed high speed railway line between London and the West Midlands as set out in the revised line of route maps published by the DfT and the Scheme Operator on 12 January 2012 (as amended from time to time)
Marketing Period	The period for marketing of the Property as determined by the Sale Valuation
Marketing and Sale Conditions	The conditions which would apply when an Owner has delivered a Trigger Notice and cover obtaining a Sale Valuation, determining the Marketing Period and the Protected Value, the appointment of estate agents and the control of the sales process by the Scheme Operator
Owner	The Original Owner or any Successors from time to time
PBS Documentation	All documentation relating to the Property Bond Scheme including the application form, the Valuations, the property bond Agreement, the property bond Standard Terms, the Trigger Notice, the Marketing and Sale Conditions, agreements with estate agents and valuers, the Standard Purchase Contract and any amendments to such documentation during the period of the operation of the property bond scheme which are in line with changes in applicable law and/or best practice or are required to improve the administrative efficiency of the property bond scheme from time to time
Property Bond Scheme	The voluntary scheme set up by the DfT and administered by the scheme Administrator with a view to protecting the value of Eligible Properties within the Designated Area owned by Eligible Owners from blight associated with the construction of Phase One of the HS2 Line
Property Bond Standard Terms	The standard terms applying to this agreement
Protected Value	The price as determined by the Sale Valuation at which the DfT would be purchaser of last resort in respect of the Property

Definitions	
Qualifying Date	10 March 2010
Restriction	A restriction to be registered against the title to the Property at the Land Registry in the following terms: “No transfer of the registered estate by the proprietor of the registered estate or by the proprietor of any registered charge, not being a charge registered before the entry of this restriction, is to be registered without a certificate signed by a conveyancer that the provisions of [Standard Term 4] of the property bond Agreement dated [●] and made between the Department for Transport and [●] have been complied with."
Sale Valuation	The value of the Property as determined by a valuation following the delivery of a Trigger Notice by the Owner and in accordance with the Marketing and Sale Conditions and the property bond scheme documentation
Standard Purchase Contract	The standard form of contract used by the DfT for the purchase of property subject to a property bond agreement
Successors	All successors in title to the Owner pursuant to Eligible Transfers and successors in title to the DfT (following a purchase of the property pursuant to this agreement where it has decided in its discretion not to terminate this agreement before the Expiry Date) in each case in respect of the Property and including Eligible Mortgagees, personal representatives of any deceased Owner or any Attorney(s) provided that such successors and the Property continue to meet the Eligibility Criteria and that there has not been a Termination Event
Trigger Notice	The notice under which the Owner starts the marketing process in respect of the whole of the Property in accordance with the Marketing and Sale Conditions
Termination Event	Any event which might bring a property bond Agreement to an end before the Expiry Date, including: • a decision by the Government of the United Kingdom not to proceed with the construction of the HS2 Line; • the service of a notice of termination by the Owner; • a Disposal of part of the Property by the Owner shall result in the termination of the property bond Agreement as regards that part of the property which does not include the Dwelling or the Business Premises; • a Disposal of part of the Property by the Owner including part of the Dwelling or Business Premises shall result in the termination of the property bond Agreement in respect of the part of the Property not retained by the Owner; • if the Property becomes *bona vacantia* or subject to escheat; • if the Property is subject to a successful application for a party claiming adverse possession to be registered as proprietor of the Property; • if the Property becomes subject to a compulsory purchase order; • if the relevant leasehold interest in respect of the Property expires without renewal or extension or is otherwise terminated.
Valuation	The Baseline Valuation and any Sale Valuation(s)

Property bond standard terms

1. Eligibility

1.1 The property bond scheme is available to Eligible Owners of Eligible Properties as at the Qualifying Date.

1.2 Applicants to the property bond scheme must provide evidence of their status as an Eligible Owner of an Eligible Property to the reasonable satisfaction of the Scheme Administrator.

2. Application process

2.1 Applications to the property bond scheme must be made no later than the Cut-Off Date.

2.2 Full details of the application process and form(s) can be obtained online at [●] or by telephoning [●] or writing to [●].

2.3 On completion of the property bond Agreement, the Scheme Administrator would arrange for the Restriction to be registered against the title to the Property.

2.4 The Owner would continue to be responsible for all obligations arising in relation to the Property after completion of the property bond Agreement, including, for example, the maintenance and repair of the Property, all payments for council tax or business rates and utilities, all obligations in respect of any mortgage or charging order over the Property and the provision of property and public liability insurance in respect of the Property. Any failure by the Owner to be responsible for these obligations may adversely affect the Protected Value of the Property in the future.

3. Baseline Valuation process

3.1 As part of the application to the property bond scheme, a Valuation of the relevant property must be undertaken which would establish a Baseline Value for information purposes only. The Protected Value established following delivery of a Trigger Notice may be more or less than this.

3.2 Full details of the Baseline Valuation process can be obtained online at [●] or by telephoning [●] or writing to [●].

4. Changes to be notified by the Owner

4.1 The Owner must notify the Scheme Administrator of any [Change of Occupation,] Change of Ownership or Change to the Property by completing the relevant form(s) for the notification.

4.2 The Owner must provide sufficient details of any [Change of Occupation,] Change of Ownership or Change to the Property as may be reasonably requested by the Scheme Administrator to enable the Scheme Administrator to determine whether the relevant change constitutes a Termination Event.

5. Ability to sell without giving a Trigger Notice

5.1 The Owner may choose to effect a Disposal of the Property without first delivering a Trigger Notice to the Scheme Administrator. In these circumstances, the Change of Ownership must be notified to the Scheme Administrator so that the benefit of the property bond Agreement may pass to any Successor.

5.2 If a Trigger Notice has not been delivered to the Scheme Administrator, the DfT would not be obliged to buy the Property as no Protected Value would have been determined and there would not have been a Disposal of the Property in accordance with the Marketing and Sale Conditions.

6. Giving a Trigger Notice

6.1 If the Owner wishes to effect a Disposal of the Property with the benefit of the offer by the DfT under the property bond Agreement to purchase the Property as a buyer of last resort, then the Owner must deliver a Trigger Notice to the Scheme Administrator and the Disposal of the Property must proceed in accordance with the Marketing and Sale Conditions on the basis of an open market sale with vacant possession on completion.

6.2 Full details of the process for delivering a Trigger Notice, the form and the Marketing and Sale Conditions can be obtained online at [●] or by telephoning [●] or writing to [●].

6.3 The Owner may at any time withdraw from a disposal of the Property following delivery of a Trigger Notice subject to payment of any applicable fees.

Property bond standard terms

7. Termination before the Expiry Date

7.1 The property bond Agreement may come to an end before the Expiry Date if a Termination Event occurs. In particular: if the construction of the HS2 Line does not proceed, then the property bond scheme shall come to an end and all property bond Agreements shall terminate and all Restrictions shall be removed from the Land Registry; or if there is a significant change to the route.

7.2 The Owner shall notify the Scheme Administrator of any Change of Ownership or Change to the Property or any other circumstance giving rise to the Termination Event and would provide evidence of the Termination Event to the reasonable satisfaction of the Scheme Administrator.

7.3 Full details of the process for giving notice of a Termination Event can be obtained online at [●] or by telephoning [●] or writing to [●].

7.4 If the DfT purchases the Property pursuant to a property bond Agreement, then it may in its discretion terminate the property bond Agreement before the Expiry Date.

8. Expiry Date

8.1 The property bond Agreement and all liability of the DfT to the Owner under the PBS Documentation shall come to an end on the Expiry Date other than in respect of any Disposal of the Property pursuant to a Trigger Notice delivered by the Owner to the Scheme Administrator on or before the Cut-Off Date.

8.2 After the Expiry Date, the Owner shall be free to apply for any compensation for which they might be eligible in respect of the Property under Part I of the Land Compensation Act 1973.

[Legal Boilerplate – Insert standard 'boilerplate' provisions for a legal agreement including the ability to amend these terms in line with changes in applicable law and/or best practice or to the extent required to improve the administrative efficiency of the property bond scheme from time to time and PBS Documentation to take precedence over any general information etc. published by the DfT and/or HS2 Ltd to promote and explain the scheme.]

[Warning to be included to advise the Owner to read all the PBS Documentation in full and to take independent advice before agreeing to enter into this agreement]

Insert signature blocks

Name	Signature	Printed
[Mr XXX]		

6. Valuations, revaluations and indexation

6.1. Introduction

In this section we provide advice on how valuations, indexations and adjustments could be efficiently and effectively achieved through the anticipated lifetime of a property bond scheme.

The determination of the protected value, at which HS2 Ltd would acquire an eligible property if it fails to sell on the open market, is a key element of a property bond scheme. Ideally, such a value should reflect the value that an owner-occupier might reasonably expect to receive if the HS2 project had not gone ahead.

In the September 2013 Consultation the proposal consulted on was as follows:

- "The bond issued to state a base bond price, reflecting either an actual price paid for the property within the 12 months before 10 March 2010, or an independent professional assessment of the property's value at that date."
- "The price set by a property bond would be kept adjusted, through indexation to reflect subsequent changes in average property value in the relevant area. Bond prices would also be adjusted to reflect any significant changes in the size, configuration or condition of the property".

Our approach to this work, as outlined earlier in this report was to examine the fundamental elements of the scheme described in the 2013 Consultation Document against the key criteria of fairness and compatibility with market processes in order to deliver an implementable design. We have concluded that an approach to valuation based on indexation from a base date, is less likely to be viewed as fair than the use of valuation at the point of sale. Indexation has the potential to create significant winners (properties that beat the index) or significant losers. This also reflects feedback in response to Consultation that 'indexation' is a blunt instrument, which does not always provide an adequate reflection of value of the unique features of a property (which only a good quality valuation can do). This view was supported by further consultation with the CML and their members, and the RICS and VOA.

In addition, there are a number of challenges to producing reliable house price indices, due to the unique nature of individual properties and multiple approaches to estimating average house prices. The Consultation Document suggested the use of Land Registry data, which has some significant disadvantages including the absence of data on new properties not previously traded and limited data on type of property.

6.2. Options

Given the drawbacks of committing to a 'protected value' based upon a baseline value and indexation three other options were considered:

- valuations at the time of sale only
- valuations at the base date (time of application for a property bond) and at time of sale but without any form of indexation,
- valuation at the base date (time of application for a property bond) indexed as a reference point for protected value, but protected value predominantly assessed through valuation at the time of sale.

The choice of option for determining protected value was determined with reference to the following considerations:

- early valuation of those properties (potentially) eligible for a property bond, offers benefits to sellers (and, possibly, buyers) in the form of reduced uncertainty
- using indexation alone to determine value at the time of sale has significant disadvantages because indices are not capable of reflecting any unique features of individual properties: this creates the risk of significant winners and losers, and does not score well in terms of fairness, potentially giving rise to frequent challenge. Valuation at the time of sale can help to overcome this
- professional valuers are already skilled at assessing antecedent values and values without blight as part of other compensation schemes and the process is understood
- the more times a property needs to be valued, the higher the administrative costs of a property bond. These costs are, however, small relative to the potential costs of a bond (i.e. the difference between the actual market value and the underwritten value)
- the existence of baseline values and indexation would provide HS2 Ltd with a means to assess potential future liabilities.

The decision was taken to recommend an approach that uses both a baseline valuation with indexation and valuations at the time of sale to assess protected value, on the basis that it would be robust and fair and the cost is likely to be reasonable compared to other potential costs of the scheme. In addition use of this approach would assist Government in the continual assessment of likely liabilities.

6.3. The recommended valuation process

A description of the valuation process is also contained within Sections 7 and 8 of this report.

On application for a property bond

- On application by any eligible owner, two valuers selected from an HS2 Ltd framework would be commissioned by HS2 Ltd to inspect and value the property. An owner could commission a third valuation at their own cost and provided it is undertaken on the same basis as the HS2 Ltd valuations, would be taken into account in the assessment of value. An upfront inspection would also provide an element of due diligence over the asset that the Government may acquire and a more reliable assessment of liability for accounting purposes.
- The valuations would provide a Red Book assessment of the value of the property at March 2010.
- The average of the valuations would form the basis of the baseline value.
- If an eligible owner does not agree with the baseline value an independent expert would be commissioned to assess the value.
- The agreed baseline value would be contained within a property bond contract.
- The description of the application process in Section 7 contains more information on valuations, selection and payment of valuers, and any dispute processes.

Marketing and the property bond redemption process

Owners would be able to apply for a property bond at any time. If an owner intends to move straight into a sale process only one set of valuations would be carried out according to the following process:

- On application for sale (or property bond followed by immediate sale) one valuer appointed by HS2 Ltd and one valuer appointed by the owner (from HS2 Ltd's valuer framework) would be commissioned to inspect and value the property. An owner would be free to leave HS2 Ltd to select both valuers if they prefer. In addition an owner could commission, at their own expense, a third valuation, which, provided it is prepared on the same basis as valuations prepared by valuers selected from HS2 Ltd's framework, would be considered as part of the assessment of protected value.

- The valuations would take account of qualifying improvements and the indexed baseline value and would provide a Red Book assessment of the value of the property at that date had HS2 not been planned or constructed, i.e. an un-blighted value.

- The average of the valuations would form the basis of the protected value that would be offered by HS2 Ltd to an eligible owner at the start of the sales process.

- If an eligible owner still does not agree with the assessment of protected value the matter would be referred to an independent expert. The independent expert may have regard to an indexed baseline value in coming to a determination.

- An owner must agree to the protected value before HS2 Ltd would commit to purchasing the property if it does not sell at that value or above. If an owner does not agree a protected value then that owner would be free to market the property, but would not be able to do so with the property bond in place and HS2 Ltd would not be compelled to purchase.

The description of the redemption process in Section 8 contains more information on valuations, selection and payment of valuers, and any dispute processes.

6.4. Indexation

There are challenges to developing a suitable house price index to support a property bond valuation process. These challenges reflect the nature of housing compared to other goods:

- **Properties are unique.** Each house is different (for example, due to its size and the features or its location) and properties are traded less frequently than other items making successive pricings much less likely.

- **Sales volumes, prices and the composition of the sold stock vary between periods.** House price indices should reflect the change in price of comparable properties, but this is not straightforward when the types of properties and the volumes sold change between periods.

- **Multiple approaches are available for estimating average house prices (with and without HS2).** Average house prices can be estimated using several different sources and methods, but each choice may produce slightly different results.

- **Some house prices may be excluded.** Typically, published average house prices represent the price of traded properties – they do not necessarily reflect the value of untraded properties (because some types of property are traded less frequently).

The options for creating an appropriate index reflect two issues:

1. How to calculate the index?
2. Which properties should be covered by the index?

How should the index be calculated?

There are four primary methods for calculating indices.[7]

Two are currently used in the UK:

1. Hedonic regression which is used by the ONS, and
2. Repeat sales method which is used by the Land Registry.

Two others exist:

3. Mix – adjustment with a stratification matrix,
4. Sale price appraisal ratio, which is used in several countries.

In practice, we believe that any index should, if possible, be based closely on the 'official' indices already available from the ONS and Land Registry. An advantage of both these sets of indices is that they are well understood in the market and are trusted. The key features of both methods are compared below.

Key features of the ONS and LR house price indices

	ONS (previously DCLG)	LR
Data source	Based on CML mortgage data – initially sample based, now census based although only lenders covering 75-80% of lending provide data	• Based on transaction data • Based on properties where more than two transactions (repeat sales' method) – uses only some of data (6m out of 16m sales) • Limited data on characteristics
Properties covered	Excludes cash purchases Excludes buy to let/remortgages	Excludes new properties (because no previous sales)
Calculation method	Uses mix adjustment method – now using hedonic regression (rather than stratification) Outliers removed	• Uses geometric mean • Adjusted for change in quality of properties
Results	Currently modelling 100,000 cells (indices) – but not all published	Calculates fewer indices

Which categories of properties should be covered by an index?

Geography

If an index is to be valuable to home owners and buyers, any index needs to be as specific as it can be to the local area. This implies that indices that reflect local authority boundaries might be the best option recognising that, at present, only the Land Registry publishes such indices (although the ONS calculates them).

[7] Based on ONS: Official House Price Statistics Explained, April 2013.

Type of property

The analysis undertaken by the ONS potentially provides a basis for estimating the underlying value of different types of property with the most important parameters being related to the size of property. Analysis of trends in the price of different types of property at national level in the period since March 2010 shows that price and type are highly correlated.

The Land Registry does not hold data on a property's size, which means that it is not possible to use this source to track (any) differences in prices over time. Ultimately, a risk exists that too many indices based on house price type or size may be generated, which could mitigate any enhancements in terms of transparency.

Time period and frequency

Ideally, the base date used for any indexation should be immediately before the effects of any potential blight from HS2 manifest themselves in the local housing markets. The option proposed in the Deloitte report is March 2010, but more recent options have also been suggested. House prices have increased in the intervening period. Which date is most appropriate requires a careful and detailed analysis of the local housing markets to assess when, if at all, there have been changes in house prices (and/or the volume of transactions) which can be linked to the proposed development of HS2. We note that an earlier report by CBRE in December 2010 found little evidence of any impact, although arguably this may have been too soon.

House price indices are currently prepared by both the ONS and the Land Registry on a monthly basis (as well as a quarterly and annual basis). This would seem to provide the best basis for applying indexation. The only potential issue may be the time lag that exists before indices are released. In practice, this seems unlikely to be a significant issue: the Land Registry usually releases its house price indices within one month while the ONS releases its indices within about six weeks.

6.5. Conclusions and implications

The key points from our assessment can be summarised as follows:

- We have concluded that an approach to valuation based on indexation from a base date is less likely to be fair than a valuation at the point of sale. We have therefore recommended that valuations would be carried out twice: once on application for a bond and again on application to sell a property in order to establish the protected value that would be offered to an eligible owner by HS2 Ltd (on behalf of the DfT) should the property fail to sell during a reasonable marketing period.

- It is suggested that the first valuation and inspection is included in the process in order to enable HS2Ltd to carry out due diligence over a property that may be purchased which would, together with indexation, enable the DfT and HS2 Ltd to continually assess liabilities.

- There are a number of challenges to selecting a reliable house price index to assist in assessing liabilities. We have concluded that a set of house price indices based on a combination of Land Registry and the ONS house price indices is likely to be preferable to alternative approaches. This needs to be explored further with both the ONS and the Land Registry.

- House price indices should be developed for areas that best represent local housing markets: in the absence of the data required to define (and calculate) more tailored indices, local authority areas are likely to be pragmatic and adequate, and a monthly index is preferable to a quarterly or national index and can be produced quickly (within 4-6 weeks). It is envisaged that HS2 Ltd would work with the ONS and the Land Registry to put in place processes for developing and maintaining indices through the life of any property bond scheme.

7. Long-term wind down and closure

7.1. Introduction

This section considers what, if any, time limit should be applied to define eligibility for a property bond scheme.

The Government's Consultation Document proposed that a property bond scheme should only be available until one year after the commencement of services on Phase One of HS2. Thereafter, owners, if they qualify, would be able to claim statutory compensation under the 1973 Act. Such claims could be made for a period of up to six years. There is, however, an issue about whether this is the most appropriate period given the potential impacts of Phase One of HS2 during both the construction and operating phases, and the time the housing market takes to adjust for the expected impacts. In particular, consideration needs to be given to the possibility of a 'cliff edge' (a sudden change) emerging between house prices during the operating period of a property bond scheme and the period following its cessation. This depends in large part on the extent to which HS2 would have a lasting impact on property prices when operational.

7.2. Options

The three options we have considered are:

- Option 1: Limit a property bond scheme to one year after the commencement of services (with an assumption that Part 1 compensation would be available beyond this period).
- Option 2: Extend a property bond scheme to the end of the period for statutory compensation (i.e. six years after services commence).
- Option 3: Use some intermediate time limit and/or introduce a gradual tapering over the period from one to six years after services commence.[8]

7.3. Options analysis

We have considered each option against the Government's evaluation criteria, the key issue being the potential behavioural effects of different 'cut-off' points for a property bond scheme. This depends, in part, on what compensation might be available once a property bond scheme ends.

We assume that affected home-owners would be able to claim compensation under Part 1 of the Land Compensation Act (LCA) 1973 for depreciation in the value of their interest in land that is attributable to HS2. This compensation would be limited to depreciation in the market value of the qualifying interest caused by the use of the land or works, but only in so far as that depreciation is attributable to 'physical factors'[9]. This statutory compensation is assumed to be less generous than that associated with a property bond.

This difference in the value of compensation creates a residual risk, linked to a potential 'cliff edge' at the cut-off point for the property bond scheme (depending on how values are determined). This risk is exacerbated if, as seems likely, the operation of HS2 would have a downward impact on house prices within an area close to the line. Moreover, it would be difficult for potential house purchasers and sellers to assess this risk, since it would depend on their being able to assess with confidence how the market would develop once HS2 is

[8] This could be considered as two separate options but we consider them as a single option for simplicity.
[9] These are defined in s.1 of the LCA as noise, vibration, smell, fumes, smoke, artificial lighting, and the discharge on to the land in respect of which the claim is made of any solid or liquid substance.

operational. For example, if a property bond is successful in stabilising house prices (at their 'without HS2' level) **and** if no long-term effect on underlying house prices is expected once HS2 is operational, the impact could be minimal.

On the other hand, if the without HS2 valuation is determined at the base date and then indexed, this could result in a significant exposure for the DfT at the end of a property bond scheme period, especially if purchasers anticipated the need for a downward adjustment in prices. This could lead to many owners seeking to sell their properties, but a lack of willingness among purchasers to acquire them. In this instance, Hs2 Ltd (on behalf of the DfT) may be required to purchase a substantial number of properties.

7.4. **Option 1:** *One year after services commence*

The attractiveness of terminating a property bond scheme one year after services commence on HS2 depends on how quickly market participants (both purchasers and sellers) are able to gauge with sufficient confidence, the likely long-term effect of HS2, once it is operational.

If Phase One of HS2 is expected to have a sustained negative impact on house values, home-owners might be incentivised to sell their properties ahead of a property bond scheme ending. Similarly, if there is any uncertainty about the long-term effect of HS2 on property prices once it is operational, this could have a similar effect.

The issue therefore, is that the length of time that market participants have to understand the long-term impact of HS2 would affect the risk of a 'cliff edge' arising. If they only have one year (plus the two years of testing the line, which may also provide valuable information), this may not be long enough for them to be fully informed of the implications, for the effects to be felt in housing market fundamentals. This creates the further risk that uncertainty would lead to increased supply/reduced demand for housing leading to lower prices and fewer transactions. This would mean a higher cost for any property bond scheme. If the time is lengthened for operation of the property bond, beyond one year after operation, this could create a negative perception that HS2 is having a long-term effect on property values which may undermine the normal recovery of the market. However, a potential advantage of an earlier end to a property bond scheme is that it sets clear expectations, is phased out as Statutory Compensation under the 1973 Act operates and reduces the administrative costs of running any scheme.

7.5. **Option 2:** *Six years after services commence*

At the other end of the spectrum, if a property bond scheme runs until six years after services commence, this would allow the market more time to adjust. This would help to reduce the effects of uncertainty, but would not address the risks (and costs) that would arise if the operation of HS2 has a long-term (downward) impact on local house prices. It would, however, potentially defer the time when the costs of the scheme to HS2 Ltd and the Government are crystallised.

In contrast to Option 1, the longer operating period of a property bond scheme would mean higher administrative costs because the scheme would require administration needs to be operated for a longer period of time – with associated costs.

7.6. **Option 3:** *Intermediate period after services commence (or taper)*

Whether an intermediate period would offer a better approach is ultimately an empirical matter, which involves balancing the benefits that a longer period could have in terms of reducing the effect (or risk of an effect) of a 'cliff edge' against the higher costs of resource requirements of administering a property bond scheme over a longer period.

The other potentially significant consideration would be if a tapered scheme were seen as more complex and, therefore, harder for affected home-owners to understand. We have not considered this in detail.

7.7. Conclusions

Ultimately, it is the DfT and HS2 Ltd's decision as to the choice of time limit for a property bond scheme. Any choice would be influenced by:

- The relative generosity of the Part 1 compensation scheme, which would affect the value of properties after closure of a property bond scheme and, hence, the nature and scale of any potential 'cliff edge'. This, in turn, would affect sellers' enthusiasm to take advantage of a property bond scheme.

- The signalling effect of the time limit selected: it is possible that a short period would tend to add to the risk of a 'cliff edge' because it could heighten the probability that uncertainties would remain over the long-term effect of HS2 and this would encourage more sellers to take advantage of a property bond scheme at a higher cost (because market values of properties close to HS2 would be depressed). However, a longer time limit may be interpreted by both sellers and purchasers as indicating that the (negative) effect of HS2 on house prices would be likely to be sustained for a longer period of time and this may further delay the efficient functioning of the market.

- How likely the operation of HS2 is to have a (negative) long-term impact on house prices which would influence the nature and scale of any 'cliff edge'.

- How many properties would take advantage of a property bond scheme: arguably, a longer period of time means that more home owners would apply to a property bond scheme in respect of their properties and this would increase its cost although the costs would potentially arise later in time (thereby reducing the expected net present cost).

Professionals consulted from the VOA and the RICS were of differing views as to whether a period longer than the one year after operation would be better for the market. Ultimately, no evidence could be produced to ascertain what that length of time might be, with any time boundary likely to influence market behaviours. In general, it was thought that historic evidence points to markets recovering from blight quite quickly after operation of an infrastructure scheme and that to extend a period beyond one year might set an unhelpful precedent. In consultation with the DFT and Hs2 Ltd it has therefore been decided to follow the original time limit put forward at consultation. HS2 Ltd may wish to consider an extension close to the end of the scheme, depending upon market conditions at the time and when a more accurate analysis can be made of market impact, and costs and benefits to both eligible owners and HS2 Ltd.

7.8. Administrative implications

The closure of the scheme would need to be clearly communicated in the property bond documentation and on the on-line site, together with a clear announcement to all remaining property bond holders on the date of operation of the scheme of the final date for the end of the property bond. Applications for bonds would also cease from this date.

The operation of any scheme would be managed down, probably over the preceding years, allowing for a small increase in sales prior to the closure of the scheme. A potential issue may be the need to extend or cut short any contracts with suppliers of services to a property bond scheme: if the railway is operational earlier or later than forecast, this should be relatively easy to do.

8. Setting boundaries for a property bond scheme

8.1. Issue

This Section considers what, if any, geographical boundary should be drawn to define eligibility for any property bond scheme.

The Government's Consultation Document suggests a 120m wide boundary on each side of the rail track. This zone, which is based on the boundary for the HS1 voluntary purchase scheme, includes the safeguarded area which is 60m either side of the line, but depends on the expected land acquisition boundary.

Responses to the Government's Consultation Document indicate that such a boundary would be seen as too narrow, but equally a wider boundary would need some form of evidence to justify it. It would, of course, also have cost implications. This Section considers these issues.

8.2. Options

We consider a range of generic options and their associated effects:

1. Option A – 120m on each side of the rail track
2. Option B – 300m on each side of the rail track
3. Option C – 500m on each side of the rail track
4. Option D – 1,000m on each side of the rail track
5. Option E – No boundary
6. Option F – Variable boundary.

For these options, we assume that some form of hardship scheme would be in place outside the boundary. This is important because the form of any hardship scheme would have an important bearing on the risk of a 'cliff-edge' in house prices at the boundary between the two schemes.

8.3. Options' analysis

We have assessed the strengths and weaknesses of the different options against the five evaluation criteria set out in the Government's Consultation Document.

Option A – 120m on each side of the rail track

Defining a simple distance-based boundary to determine eligibility for a property bond scheme is likely to provide greater clarity and reduce uncertainty for home-owners compared to a scheme with no boundary. Depending on what evidence underpins it, it may also be less prone to challenge and dispute and, therefore, easier, quicker and less expensive to administer. Such a boundary could in theory be set at any distance.

Previous analysis indicates that as distance increases, the likely administrative costs of any property bond scheme would rise, while the scheme's overall housing market benefits would tend to approach an upper limit.

The Deloitte report assessed the expected benefits of a proposed scheme design within a 120m boundary. It suggested that such a scheme would achieve an overall performance against the evaluation criteria, broadly equivalent to any proposed voluntary purchase scheme. It argued also that a property bond scheme might achieve somewhat greater property market benefits than a voluntary purchase scheme, in the same area. On the other hand, a property bond scheme could result in greater up-front costs than a voluntary purchase scheme, due to the need for additional valuations of properties before bonds could be issued and greater ongoing administration costs.

The designation of any area as one where properties are eligible for a property bond scheme may effect owners' **perception** of the potential blight, even if this is at odds with the underlying market fundamentals. It may also influence purchasers. If a property bond scheme's' boundary acts as a signalling device in this way, it would encourage sellers to put their property on the market and this would put downward pressure on prices until this mis-perception is corrected. In practice, all Options which define the boundary for a property bond scheme create this risk.

Options B, C and D

The implications of Options B to D will largely depend on the number of properties that would potentially benefit from a property bond scheme and the extent to which the value of those properties can be expected to be reduced as a result of the construction (and operation) of HS2. This is an empirical matter.

The diagram below shows that the estimated number of properties situated at different distances from the HS2 line increases exponentially.

Estimated number of properties within specified distances of HS2 line (Phase One, rural only, excluding over deep bored tunnels)

Source: CBRE

A wider area would tend to increase certainty (of value) for more property owners and this would improve their confidence and, hence, willingness to participate in the local housing market.

For HS2 Ltd and the DfT, this increase in confidence need not come at an increased risk of a (financial) cost in terms of bond payouts. It is preferable to a narrower area where there is a greater risk of a cliff edge effect.

If there is a perceived risk of a 'cliff edge', this could lead to acceleration of attempts to sell properties but with uncertainty about whether purchasers exist. This could depress prices and/or lead to reduced community cohesion as people leave the area.

An important consideration for all Options A to F is the potential impact on the costs of administering a property bond scheme. All other things being equal, we would expect the number of properties potentially eligible for a scheme to have an important bearing on its administrative costs. Not all of these costs would, however, be incremental since by definition properties outside the scope of a property bond scheme would be eligible for a hardship scheme and it is possible (though we have not investigated this) that the cost of running this scheme per property may be more costly because of the need to apply more complex eligibility criteria.

Option E – No boundary

In its Consultation Document, the Government accepts that a property bond scheme that is not defined by a specific boundary would attract more valid applications for bonds than options defined by a specific boundary (although some of these property owners might be expected to apply for a hardship scheme if there was no property bond scheme). Boundary-free schemes would be likely to lead to higher gross administrative costs, reflecting the need for more robust, independent property valuations. These additional costs are hard to predict with any degree of confidence because it is difficult to foresee how many property owners would apply for a bond offered without such a restriction.

The potential benefits of having no explicit boundary is that it may mitigate some of the risks associated with the emergence of a 'cliff-edge'.

Given the lack of detailed empirical evidence about the likely effect of a property bond scheme, it is difficult to determine whether any higher costs would be likely to achieve corresponding benefits.

Option F – Variable boundary

The final alternative we have considered is to establish a variable boundary whereby eligibility for a property bond scheme would be linked to some indicator of the expected effect on the underlying value of the property.[10] The boundary could be determined, based on a proxy indicator such as a noise contour which mirrors one of the main anticipated effects of HS2. In practice, however, noise is not the only driver of the impact on property values around the construction of HS2 – it provides some insight but not the only effect (and effects may change over time).

8.4. Conclusions and implications

The impact of the choice of any geographical area to be covered by a property bond scheme is linked to the preferred option for determining the protected value of properties, as well as the form of index and the time limit for any scheme.

The choice of geographical area for a property bond scheme would therefore be influenced by:

- The form of any hardship scheme and, in particular, how generous it is, relative to a property bond scheme: the greater the difference in the generosity between the hardship scheme and a property bond scheme (as reflected in the expected present value of the compensation which an owner-occupier can expect to receive), the more significant will be the potential 'cliff edge' between housing values in any bond area and outside.

- How quickly the (adverse) impacts of the development and operation of HS2 on property values decline as the distance from HS2 increases in the short and longer terms.

[10] See, for example, Andersson, Jonsoson and Ögren, 'Property prices and exposure to multiple noise sources: hedonic regression with road and railway noise', September 2008, Theebe; 'Planes, trains and automobiles: the impact of traffic noise on house prices', 2004 and Day, Bateman and Lake, 'Beyond implicit prices: recovering theoretically consistent and transferable values for noise avoidance from a hedonic property model', 2007.

- How far there is a signalling effect associated with the choice of boundary: for example, if the area is defined widely (to accommodate as many properties affected by HS2 as possible), this could be interpreted by house buyers as a signal that significant blight extends to all properties in the defined area. This could reduce their willingness to purchase properties and add to downward pressure on prices.
- How many properties would be eligible for a property bond scheme: this would tend to increase exponentially with distance.
- The uncertainties that would potentially be created if no boundary were defined (Option E) or, to a lesser extent, if a variable boundary were defined (Option F).
- How far the costs of any hardship scheme would potentially be reduced if more properties are brought within scope of a property bond scheme.

Ultimately, these are empirical matters and their implications will need to be analysed and considered by the DfT and HS2 Ltd in making their decision on a suitable boundary, should a decision be taken to go ahead with a property bond scheme.

Table 1: Assessment of options for boundary

<table>
<tr><th></th><th>Fairness</th><th>Feasibility, efficiency and comprehensibility</th><th>Functioning of the housing market</th><th>Value for money</th><th>Community cohesion</th></tr>
<tr><td>Option A – 120m on each side of the rail track</td><td rowspan="4">Risk of ‘cliff edge’ at boundary will tend to decline as distance increases – but how significant depends on effect of HS2 on property values</td><td rowspan="4">All other things being equal, administrative cost will increase with the number of properties in scope
Especially, true if a bond design option involves appraisals rather than indexation</td><td rowspan="4">Risk that perception – if not reality – of blight may be driven by distance so will increase</td><td rowspan="4">Increase cost as distance widens (and more properties in scope)</td><td>Correlated closely with impact on functioning of the market</td></tr>
<tr><td>Option B – 300m on each side of the rail track</td><td></td></tr>
<tr><td>Option C – 500m on each side of the rail track</td><td></td></tr>
<tr><td>Option D – 1,000m on each side of the rail track</td><td></td></tr>
<tr><td>Option E – No boundary</td><td>Avoids risk of ‘cliff edge’ at boundary</td><td>Harder for those potentially affected to understand eligibility – could create uncertainty</td><td>Increases uncertainty for those on “fringes” of area impacted</td><td>• Higher potential costs to implement, operate and administer a property bond scheme
• Higher administrative costs</td><td></td></tr>
<tr><td>Option F – Variable boundary</td><td>Limits boundary to affected area</td><td>Could increase uncertainty unless clearly identified and communicated
Less uncertainty than Option E</td><td>If appropriately designed, could avoid risk of cliff edge</td><td>Potential property bond cost would depend on how many properties eligible</td><td>Limited adverse effect on cohesion if appropriately designed</td></tr>
</table>

9. Process design for a property bond scheme

9.1. Introduction to the eligibility and application process

This section provides advice on establishing eligibility for a property bond scheme and how property owners would be required to apply for a property bond on their properties.

This section covers the following areas:

- Eligibility.
- The application process that is structured around process maps.

It is envisaged that any property bond scheme administrator would be HS2 Ltd, which would administrate the scheme largely on-line but with support available for paper-based processes. The on-line site would provide guidance on the scheme and enable applicants and eligible owners to track application and redemption processes. On-line support would also be provided to assist in the management of valuers and agents.

9.2. Eligibility

In carrying out this analysis recommendations related to eligibility have not been based on an assessment of cost as the data is not available in sufficient detail to inform a robust analysis; for example, there is no data available on the split of landlords versus homeowners. Analysis and recommendations have therefore been made, based on precedent, fit with other compensation schemes, simplicity and fairness.

On application an online form would question owners to verify eligibility. Answers ideally would be supported by documentary evidence as outlined on the form. Where documents are not available it would be made clear to the applicant that if false information has been given, the contract would become invalid and HS2 Ltd would reserve the right to cancel the contract. To apply for a property bond the interest in land would need to be registered at the Land Registry. This would be required in any event if the property is to be transferred or disposed of.

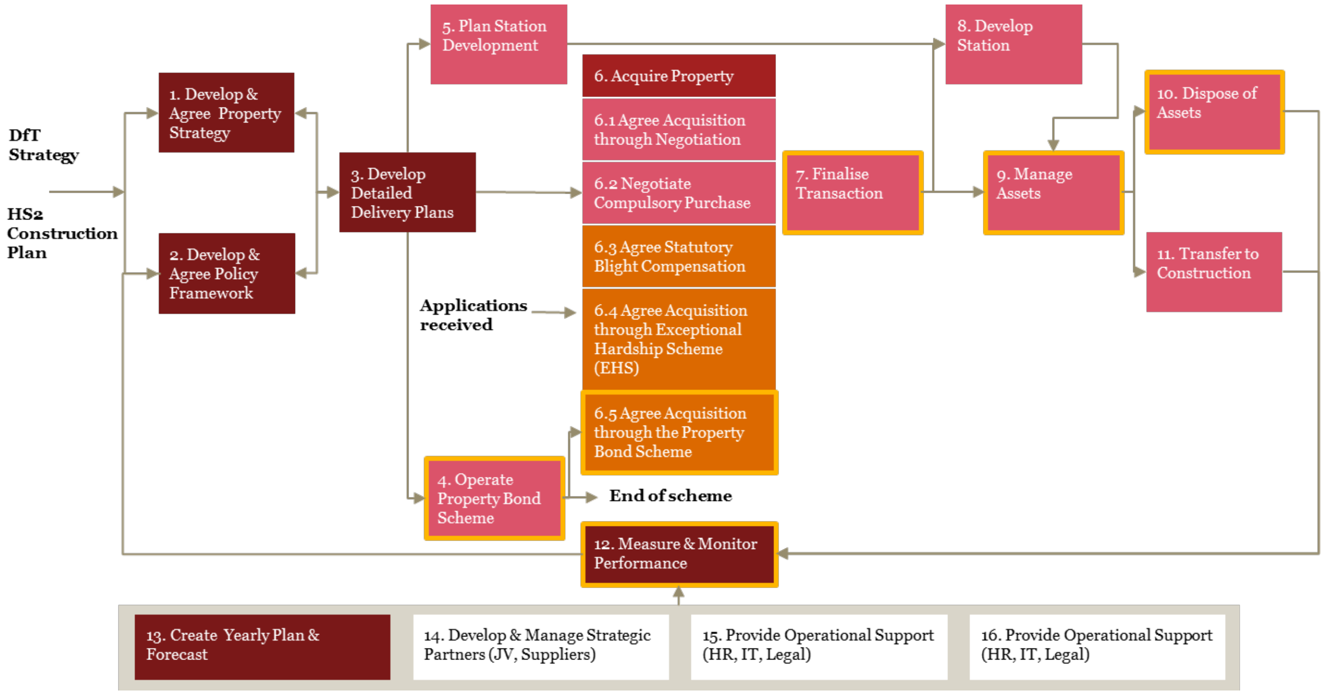
To support eligibility criteria around location, maps would be available on the proposed on-line site for a property bond scheme. The eligibility criteria were arrived at with the guidance of the DfT and HS2 Ltd and are set out in the table below, together with additional supplementary information.

Eligibility criteria	*Information*
1. Significant interest in land: Freeholds and leaseholds over 7 years in length would be eligible.	This is in accordance with the requirements for land registration.
2. Owners would be required to demonstrate that they owned and were in occupation of a significant interest before 10 March 2010.	This is consistent with the exceptional hardship scheme.
3. Landlords who can demonstrate that they were owner occupiers at 10 March 2010 would be eligible.	This has been introduced to assist those who, as a result of personal circumstance have become landlords since the announcement of HS2. Under the scheme a previous occupier, who has become a landlord can only apply for one property bond.
4. Agricultural and commercial premises up to a Rateable Value of £34,800 would be included.	This recommendation follows existing compensation schemes.
5. Property above tunnels would not be included.	Properties above tunnels would be addressed by other compensation measures if the owners are eligible under the terms of these schemes.
6. Boundaries would be set within a fixed distance within rural and town and fringe locations. The boundaries of any property bond scheme would not extend into urban areas where the line is predominantly within tunnels and/or next to existing transport route.	The definition of rural and town and fringe locations would be made with reference to ONS data on population.
7. The boundaries of the scheme each side of the track.	This is a policy decision for the DfT which would be determined with reference to noise contours, relative levels of blight (largely subjective) and cost.
8. If a property (hereditament) bisects the boundary it would be automatically eligible if a dwelling is within or part within the boundary. If the only part of the hereditament to fall within the boundary is land, the significance of this to the total hereditament would be assessed at the time of application.	If a property falls across the boundary with safeguarding, it would be dealt with under the same arrangements as those in place for assessing boundary issues under statutory blight.
9. Improvements undertaken before March 2010 would be recorded against the property bond and would be assessed within the protected value. When the property is re-inspected at the time of sale, any new improvements would be taken into account in the assessment of protected value.	

9.3. The application process

A property bond process would form part of the HS2 Ltd Land and Property processes. The Level 1 process for HS2 Ltd Land and Property is shown below.

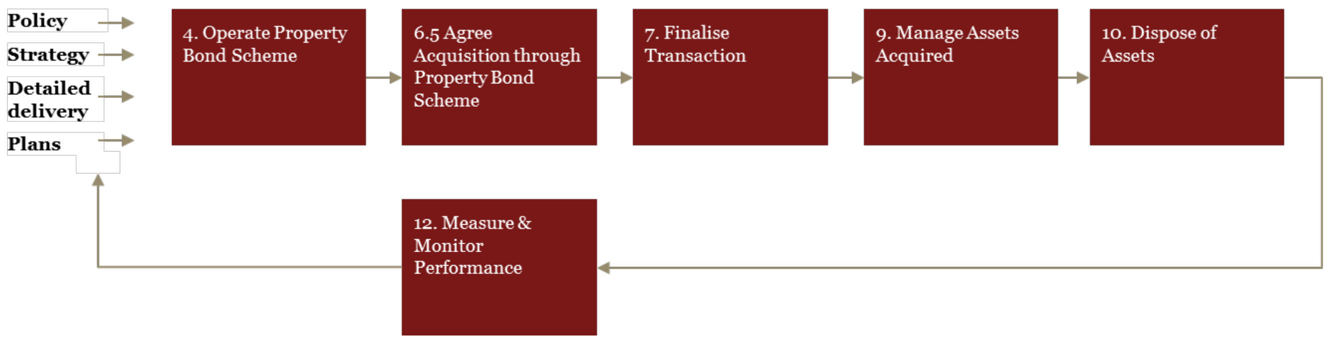
Level 1: Process for HS2 Land & Property



The following process is an extract of this process (those activities circled above) which covers the key steps of a property bond scheme:

- operate the property bond scheme
- agree acquisition through the property bond scheme, and
- subsequent management processes (finalise transaction, manage and dispose of assets), which would need to be factored into plans for the overall administration of any scheme and related costs.

Level 1: Property Bond Process

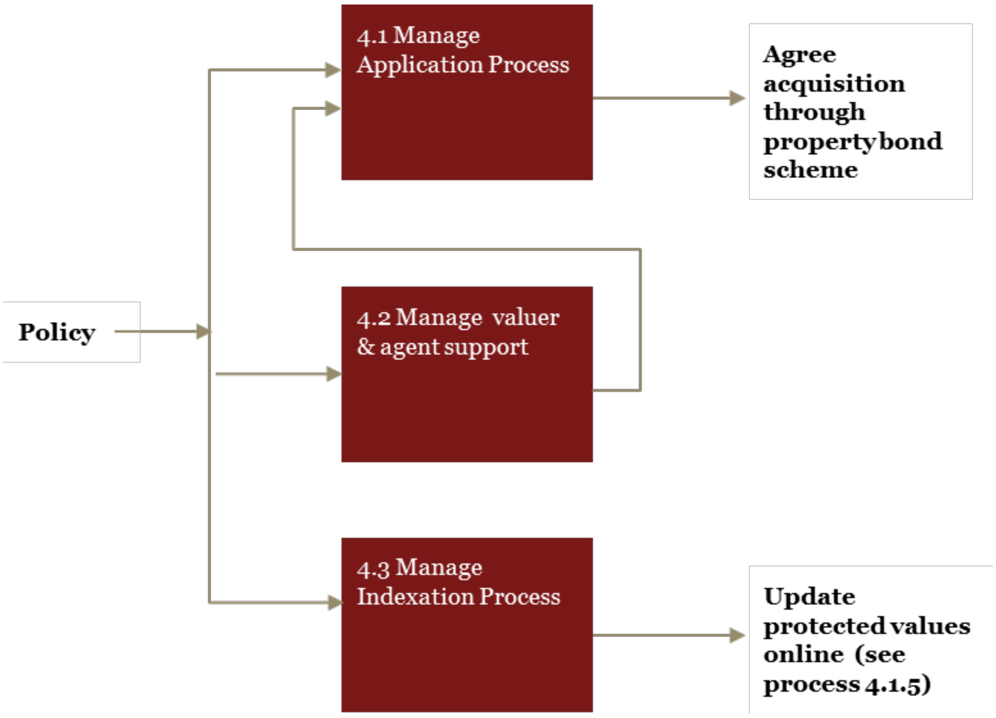


Operate property bond scheme

Under the process 'operate property bond scheme' there are three key activities to consider:

1. management of the application process
2. manage valuer and agent support
3. manage the indexation process.

4.0 Operate property bond scheme



Manage application process

The first stage in the operation of any property bond scheme would be the 'Manage Application Process'. In this process a potential eligible owner completes an application on-line. **To ensure a successful application process from the outset of the scheme, attention must be given to appropriate communication to all those who may be affected within the defined boundary of the scheme.** The answers given by applicants on-line, together with a declaration of correct information and proof of signature would confirm potential eligibility and HS2 Ltd would dispatch two valuers to assess qualifying improvements, to check that the property is within the boundary and to carry-out baseline valuations. These valuations would be assessed by an HS2 Ltd case officer. A baseline value, derived from the two valuations would be given to the eligible owner and there would be a process to manage any dispute using an expert.

If the baseline value is accepted a property bond agreement would be signed and a property bond registered at the Land Registry. The process also covers transfers of interest which would also need to be dealt with on-line. The final process box in the diagram on the following page refers to the agreed baseline being updated regularly through the use of indices, so that an eligible owner could track the approximate un-blighted value of their property. On the application form notice would be given that failure to declare openly and honestly may invalidate a property bond at a later date.

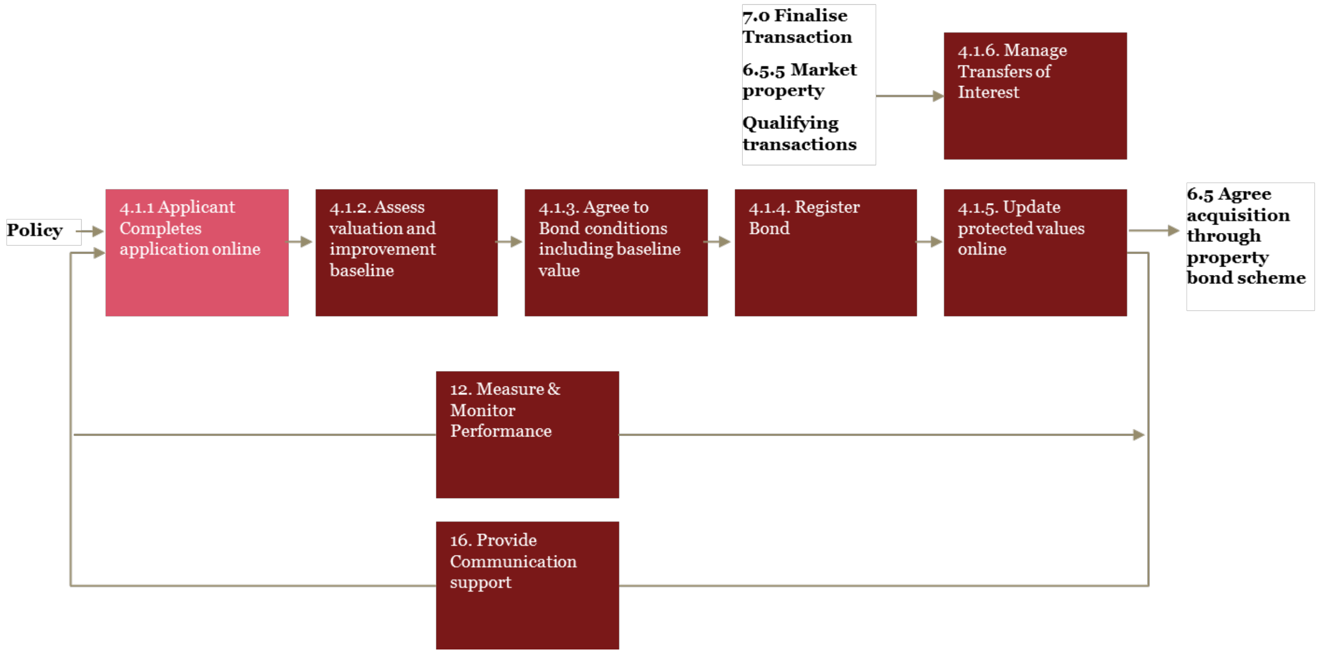
The application process and transfers of interest would be managed predominantly on-line with support available by phone. Administration would need to support on-line applications and paper-based declarations as well as a minority of paper-only applications.

Application timelines

These are shown in more detail in the process maps in Appendix B.

- The initial application process should take no more than two weeks.
- The valuation process should take no more than a month (longer if disputed).
- Completion and final registration of a bond should take two weeks after the baseline value has been agreed.

Level 2: 4.1 Manage Application Process



The table below provides further explanation.

Procedural features of the application process	*Supplementary information*
The scheme would remain open for applications for a property bond until one year before the end of any scheme.	On the grounds of fairness the scheme should remain open throughout its life, though this may raise some administration issues in maintaining appropriate levels of resource and capability.
The scheme would be phased in. Applications are most likely to be phased in on the basis of need with those wishing to sell immediately prioritised.	It would be sensible to manage risk and cash-flow by phasing in any scheme to address any start-up issues. Any phased implementation would need to be within a relatively short timescale (within a year), otherwise issues of credibility and unfairness may arise. Consideration could be given to delaying 'cashability' of a property bond until construction starts, to manage the budget with those eligible for a bond who meet the criteria on the basis of need made eligible under the exceptional hardship scheme.
Owners would not be compelled to apply; any scheme would be discretionary.	
There would be no upfront application fee.	To encourage uptake of the scheme.

Procedural features of the application process	***Supplementary information***
The scheme would be predominantly administered on-line, but with support available to complete paper work off-line if necessary.	There is a presumption in Government digital policy that access to Government service should be on-line. However, there is recognition that while the majority of the public have access to on-line facilities those that do not would need to be catered for.
Two valuers would be required to inspect and provide a baseline value for a property at March 2010 at the start of the scheme.	• The inspections would note position of a hereditament relative to a boundary and new improvements. • The valuations would be carried out according to the RICS Red Book. • The baseline value would be assessed as the average of the two values.
An index would be applied to the baseline value to inform calculation of the protected value (on application to sell) and to provide the DfT with an assessment of liabilities.	As described in the previous section.
HS2 Ltd would select a valuer from the HS2 Ltd valuation framework; an owner would also be able to select the second valuer from the framework if they wish or leave this to HS2 Ltd. An owner would also be able to commission a third valuation independently, which would be taken into account in the assessment of baseline value if carried out according to the RICS Red Book.	It is considered important for interested owners to feel able, if they wish, to choose valuers.
If a baseline value is not accepted an owner would have recourse to an expert selected by the RICS. Both parties would share the costs unless costs are specifically awarded.	The assessment of value would be of initial importance to home owners. To increase trust in the scheme there would be a dispute process where owners can produce evidence and state their case. There are a variety of dispute mechanisms in operation for dealing with property disputes including Land Tribunal and arbitration. The use of an expert is likely to be the quickest route to a resolution and would draw upon a variety of evidence.
Owners would be able to apply for a bond more than once. If valuations have been carried out previously, the valuations commissioned for a subsequent application would need to be paid for by the applicant.	It is considered fair that owners would be able to apply more than once (if for whatever reason they had decided against proceeding through an earlier process); however, if the cost of valuations has been incurred previously by HS2 Ltd, in order to safeguard the public purse, on re-application an owner would be asked to pay for the new valuations.
There are qualifying transactions where a property bond would be transferred between owners (other than sale). These are listed in Appendix A4.	

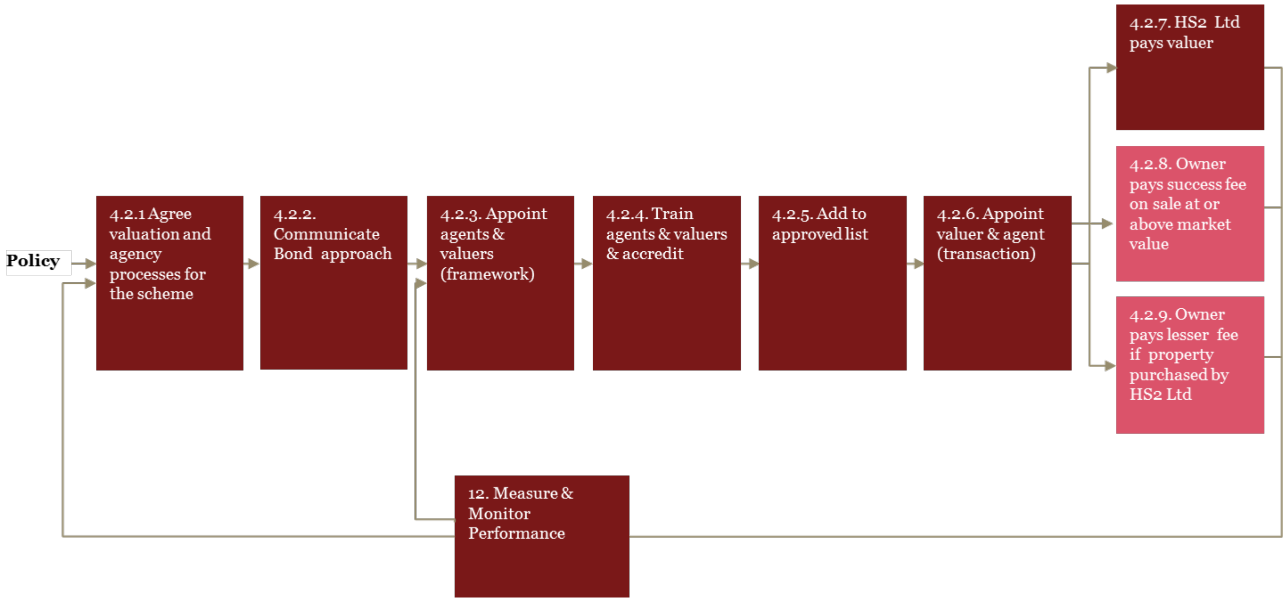
Manage valuer and agency support

The management of valuers and agents would be a key element in the implementation of any property bond scheme. They are important actors in the housing market (and can make the market). It would be important to gain their understanding and commitment to any scheme as they would be front-line in explaining and advocating the scheme. It would be particularly important that agents when selling houses with bonds can explain the benefits of the bond and describe the potential impact of the construction of the HS2 railway line in accurate terms, rather than drawing on less informed opinion and it would be essential for properties covered by a scheme to be marketed in accordance with HS2 Ltd's terms and conditions.

HS2 Ltd already has valuers appointed under a framework, but would need to widen this considerably to reflect the variety of houses and locations along the line and a framework would also be required for agents. Some practices would be able to provide valuers, agents and experts (although not for the same case); others would only be able to provide agency support. In the current processes, as written, valuers and agents would need to sign-up to HS2 Ltd processes and should be professionally qualified. If public funds are spent on the advice and performance of suppliers, then they would need to be appropriately qualified, briefed and follow the recommended processes.

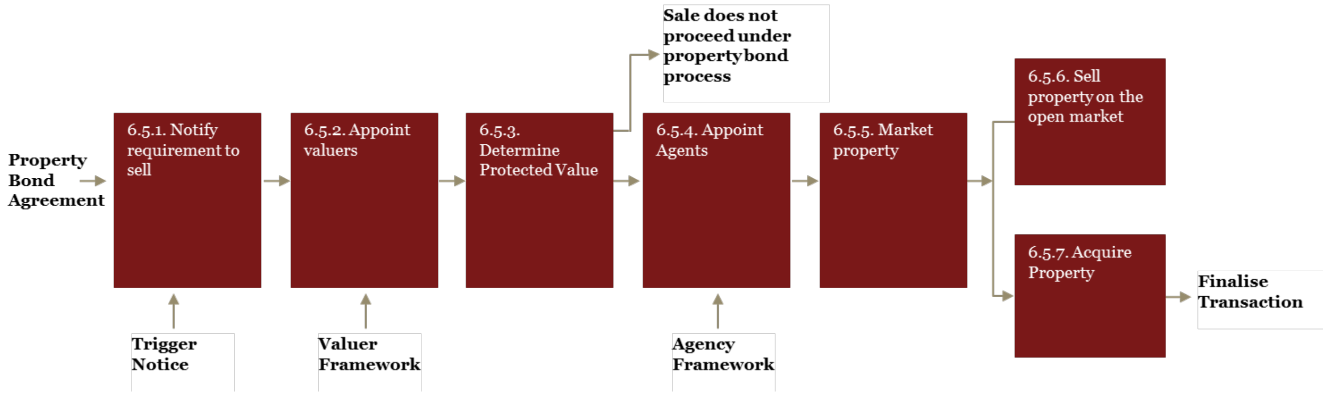
New frameworks for valuers – supplementary to those already in place – would be required and would need to be let during the timeline for implementation, which is discussed in Section 10.

Level 2: 4.2 Manage valuer and agency support



9.4. Marketing period and the bond redemption process

Level 2: 6.5 Agree Acquisition through the property bond scheme



If a property bond is in place (property bonds could be put in place at any time during the scheme) an owner would notify the scheme administrator that they wish to sell their property. The notification process would be carried out predominantly on-line. As a property bond is in place, the level of detail required at this point in the process would be minimal with HS2 Ltd performing checks to match the applicant and property to the bond documentation. Prior to carrying out the valuations, an owner would need to sign-up to the terms and conditions of the marketing process. At this point two valuers are appointed. A 'protected value' is then assessed with reference to the two valuations and indices, and agreed (other lower level processes show a dispute process if the owner disagrees with the valuation). Once the protected value is agreed, an agent or agents would be selected by the owner (from an HS2 Ltd framework) and the property then marketed for an agreed marketing period. If the property sells within the marketing period at, or above, the protected value, HS2 Ltd drop away from the process and conveyancing proceeds as it would normally for any residential property. If the property does not sell, then it would be purchased at the protected value by HS2 Ltd. If it appears that a property is not going to sell within the reasonable marketing period, HS2 Ltd would commence planning for the acquisition and subsequent management of the property towards the end of the marketing period.

Timelines

- If the owner accepts the conditions of a property bond scheme immediately the initial processing of applications to sell should take no more than two weeks.
- The assessment of protected value without any dispute should take no more than two months.

Procedural features of the marketing process	*Supplementary information*
The protected value at which HS2 Ltd would purchase a property if it has not been successfully marketed would be assessed by two valuers.	The valuation process is described in Section 6. The valuations would specifically note condition and a reasonable marketing period (see below).
If an owner does not accept the protected value the valuation would be referred to an expert selected by the RICS. Costs would be shared unless costs are awarded to a particular party.	

Procedural features of the marketing process	*Supplementary information*
If an owner does not accept the results of the expert the owner can walk away from the process. If protected value has not been agreed, HS2 Ltd cannot be compelled to purchase the property and the owner cannot sell the property with a property bond.	Under the principle of discretion an owner cannot be compelled to accept a protected value. If properties are sold on the open market with a property bond but at a lower value than protected value (i.e. at a blighted value), this would undermine the market for properties being sold through the HS2 Ltd property bond scheme and would jeopardise the success of the scheme in maintaining the market.
Fees are not charged for valuations unless an owner walks away from the process, subsequent to determination by an expert.	
If the expert supports the assessment of the protected value and marketing period, the owner would be liable for the fees.	If an expert finds for HS2 Ltd then the fees connected with the expert would be payable by the owner.
A reasonable marketing period would be assessed by the valuers at the same time as they assess protected value. If there is a difference in recommendation an average time would be taken; there would be no right of appeal on marketing period.	To safeguard HS2 Ltd a minimum marketing period of three months should be set for the route.
Valuers would not be able to act as estate agents for any individual property.	
The Agency proposal would be approved by HS2 Ltd. The Agency agreement would be with the vendor, but with a duty of care owed to HS2 Ltd. In addition HS2 Ltd would receive all market reporting pertaining to the property.	
If a reasonable and recommended offer is received by the vendor at, or above, the protected value, the vendor should accept the offer. If the offer is not accepted by the vendor, HS2 Ltd can terminate the process and would not be compelled to purchase the property. If an offer subsequently falls through, the property would be acquired by HS2 Ltd if the marketing period has expired.	
Agency and conveyancing fees would be paid by the vendor.	
Agents would not be paid a fee over and above that agreed with the vendor (normal market rates as agreed in the framework) if they are successful in selling at, or above, the protected value. But they would be eligible for a lesser payment from the vendor if HS2 Ltd acquires the property.	This lesser payment would be at an agreed rate and would be part of the terms and conditions of agents on the framework. This is important to secure agents to market property and is fair to vendors as an acquisition by HS2 Ltd can be viewed as a 'successful sale' by the vendor.
Owners who sell under the scheme cannot subsequently buy-back property from HS2 Ltd at a lower value.	Records of transactions and parties to those transactions would be kept in the system supporting the property bond processes.
Purchasers would not be incentivised with any extra cash payments to purchase properties with a property bond.	Positively incentivising purchasers with extra inducements might negatively affect parts of the market not covered by the scheme.
The final sale price should be noted against the property bond for the successor in title. Indexing would apply to this value and would become a new 'baseline' value.	

10. Administration of a property bond scheme

10.1. Introduction

This section provides an assessment of what would be required in terms of staff resources, equipment and additional expertise to run the scheme according to the processes outlined in the previous section. To do this we have considered organisation design, methods of obtaining resources through outsourcing, IT requirements, funding and accounting considerations and finally implementation timetables.

10.2. Determining the roles of a property bond scheme administrator

The DfT would act as the client for the services of land and property acquisition, management and disposal provided by HS2 Ltd; as such it is likely that a property bond scheme would be administered by HS2 Ltd. HS2 Ltd would have choices as to whether to deliver the scheme using internal resources or to act as a client themselves for delivery of the entire scheme or parts of the process. HS2 Ltd or any outsourced manager of the scheme would also need to procure and manage valuers, agents and experts who play key parts in the application and sales processes.

The first step in designing the administration of a property bond, influencing the requirement for resources and the timetable for implementation, is to make a decision between internal provision (solely using HS2 Ltd resources) or outsourced support for delivery. Outsourced providers may already have experience in providing support to these type of public facing administrative processes and may therefore provide a more efficient and less risky method of implementation than creating a wholly new administrative delivery function within HS2 Ltd. Some processes would always need to be carried out by HS2 Ltd these would generally be strategic, planning, policy and contract management activities while other delivery functions could be carried out either internally or by an outsourced supplier.

The activities that would always need to be carried out by Hs2 Ltd would be:

- development of a property bond strategy for the DfT
- development of areas of policy including specifications and processes for delivery of a property bond scheme on behalf of the DfT
- creation and monitoring of delivery plans for the scheme
- creation and monitoring of the performance management regime for a property bond scheme reporting to the DfT and relevant governance bodies (outlined in the following section)
- authorisation of acquisitions according to agreed levels of delegation from the DfT
- authorisation of asset management plans and disposals according to agreed levels of delegation from the DfT
- contract and relationship management of any outsourced suppliers.

Activities that could be carried out by a third party supplier under an outsourced contract would be:

- provision of information to support the development of strategy, plans, policies and performance management
- operation of an on-line service for the public to apply for property bonds and sales processes under the schemes guidelines
- delivery of all aspects of the application and marketing processes (as described in the preceding section) including management of valuers, agents and independent experts procured under HS2 Ltd frameworks
- management and disposal of all assets acquired under a property bond scheme.

To make decisions on organisation design and whether to outsource delivery processes a series of design principles would be required against which the options of provision wholly within HS2 Ltd or use of outsourced suppliers can be evaluated. The following are suggested design principles, these would need to be considered by HS2 Ltd along with other factors and a final set of principles agreed:

- **Design criteria 1.** Fit within implementation timescales (indicative timescales are given in the section below). Either option would need to be capable of implementation within a reasonable timescale ideally at the latest by mid-2015.
- **Design criteria 2**. Any solution chosen would need to be acceptable to a variety of stakeholders and should support confidence that the scheme would be run competently and efficiently.
- **Design criteria 3.** Capability in terms of people to provide an appropriate quality of service. Options should be capable of sourcing the right resources to run the variety of processes required.
- **Design criteria 4.** Capability in terms of IT. The options should be able to provide an appropriate quality of on-line service and data management.
- **Design criteria 5**. Availability of external suppliers willing and able to undertake the tasks. The outsourced option would not be possible to procure and implement if there are insufficient suppliers willing and able to bid for the work and to provide competition to assure value for money can be achieved from the procurement process.
- **Design criteria 6.** Ability of the scheme administrator to provide sufficient flexibility to manage volume. It is unclear what volume of applications or sale processes would need to be managed during the life of the scheme.
- **Design criteria 7.** Least risky implementation route. There are risks to the implementation of any new compensation scheme and new organisation. The implementation route chosen needs to be one that has minimal and manageable risks.
- **Design criteria 8.**Cost of implementation. The difference in cost between an in-house solution and one that uses an outsourced supplier has not been assessed as part of this project.

The two basic options of provision (i) internally and (ii) outsource are compared against the decision criteria listed above. The table is illustrative, highlighting a range of issues that might be considered by the DfT and HS2 Ltd in coming to a decision on how to design the administration organisation.

Criteria	*Provision internally*	*Provision by an outsourced provider*
Fit with implementation timescales Activities that are common to both options such as design of the client function and communications are not listed but are discussed in implementation planning	To provide the administration organisation internally would require: • procurement of a design team; • the design of all processes for the delivery function; • the design of the organisation; • creation of job descriptions; • specification and procurement of an on-line service to the public; • recruitment and training; • procurement of agents and valuers and other suppliers under frameworks; • acquisition of space for the duration of the scheme; • testing operation of the scheme prior to 'Go Live'. An initial assessment of timescales (not including a business case process) but including adequate time for decision making is c.12 months (see section below). The complete design of such a function is outside the current capacity of the team (though experience exists in operating other compensation schemes), so procurement of advisers would be required upfront. In addition, HS2 Ltd does not have IT capable of supporting direct access by the public to take part in a number of important processes; therefore time would need to be spent in specifying the system and procuring a supplier. Agencies within the DfT do have expertise in this area and could provide support.	To procure an outsource supplier would require: • procurement of a design team and procurement advisers; • contract allocations i.e. potential split of contracts over more than one provider; • agreed guidelines on all aspects of operation of a property bond where it touches the public; • an understanding of volume of activities and ways in which to flex the contract should volumes be significantly more than expected; • development of appropriate payment mechanisms; • contract specification; • rigorous management of a procurement process; • start-up activities working with the new provider; • participation in approving and testing operational processes as they are completed. An initial assessment of timescales (not including a business case process) but including adequate time for decision making is between c.13-15 months (see section below). Timescales for procurement may vary widely depending upon whether a full OJEU (Official Journal of the European Union) process needs to be followed or whether it is possible to obtain the support required through an existing Government framework. Once an outsourced provider is commissioned, implementation would be less complex and potentially less risky for HS2 Ltd to manage with IT commissioning and recruitment being the responsibility of the outsourced provider.
Acceptability to stakeholders	HS2 and the introduction of a property bond scheme would have a high profile. A Government administered scheme is likely to be perceived as more favourable than a scheme that is outsourced. Particularly as there has been negative press surrounding some recent outsourced Government contracts.	There are a number of private sector service providers that might bid for this contract. Outsourcing could be perceived negatively by MPs and the public and may undermine acceptance of the scheme before it has started, although this is not certain. A key area of capability would be the ability to set up an on-line public access service. However there are a number of Government agencies that also operate good on-line services. These include the Land Registry and to some extent the VOA both of whom could be involved with the scheme, particularly the Land Registry which would hold key data against title and also data on the property market. This may provide an acceptable solution. These opportunities have not been explored with the VOA or Land Registry.

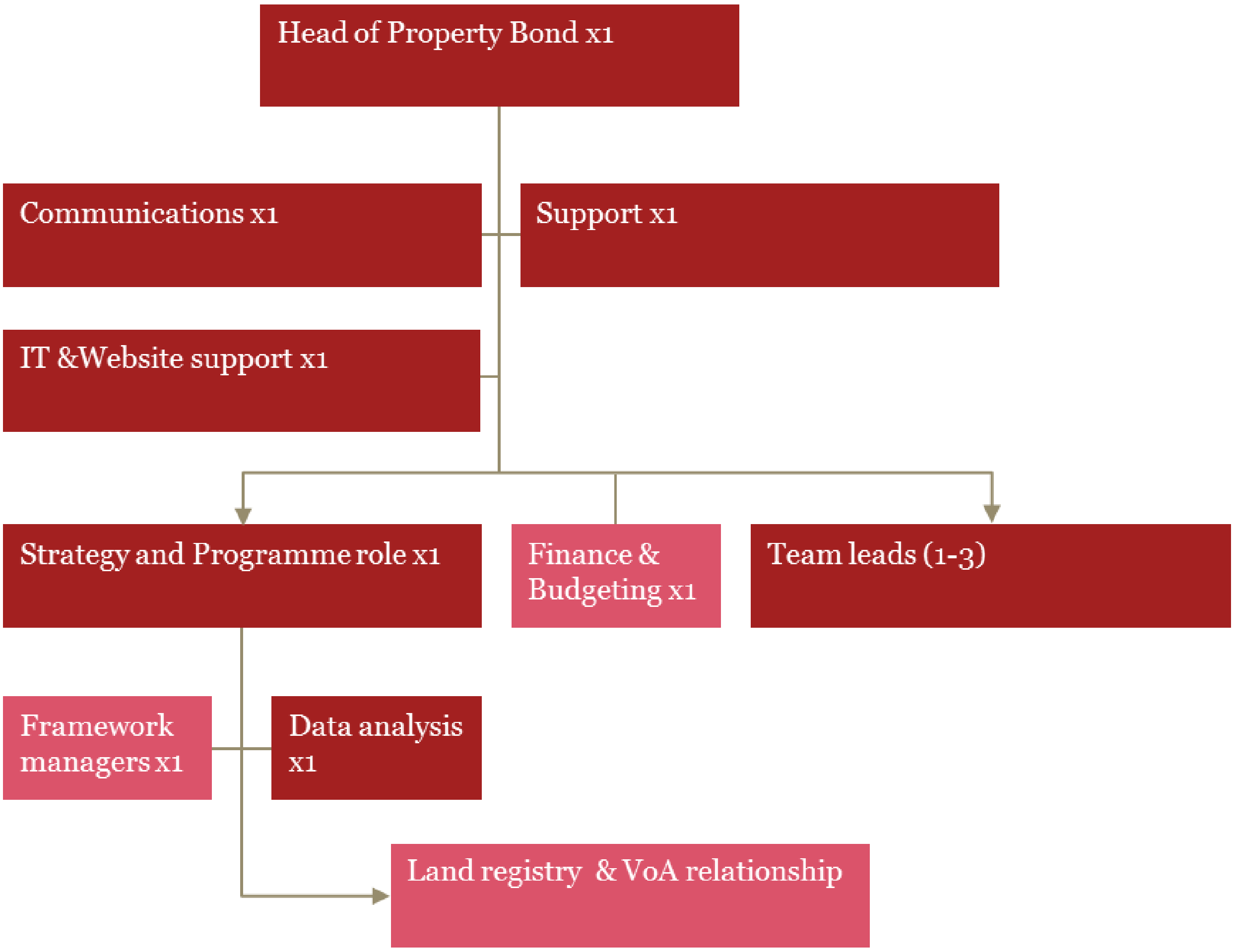
Criteria	*Provision internally*	*Provision by an outsourced provider*
Availability of external suppliers willing and able to undertake the tasks		There are a number of private sector providers that are used to providing administration for a variety of Government schemes involving the processing of applications, which are likely to have some capability around property. Soft market testing would be essential for the next phase of the project to gauge market interest and capability. It is, as yet, unclear whether other Government bodies might take on the task. This needs to be explored further.
Capability in terms of people to provide an appropriate quality of service	Recruitment would be required. Many of the administrative functions required are outside HS2's Ltd core capabilities and core focus, which is to provide land for the construction of the route.	Outsourced providers regularly recruit people to fill the type of administrative roles required. The contract would need to be tight on the processes for recruitment and the management of performance.
Capability in terms of IT to provide an appropriate quality of service	The creation of a publicly accessible on line service with an interface to the Land Registry and to HS2 Ltd systems would be complex.	External providers -both Government and private sector -possess systems which could be built upon to run the scheme. They would still need an interface with Land Registry and HS2 Ltd, but the private sector in particular is used to creating such interfaces.
Ability to provide sufficient flexibility and manage volume	The volume of take-up of the scheme is the big unknown (and also the total population affected until a decision is made on boundary). It is likely that there would be significant take-up of a property bond at the start and ongoing estate transfer activity can be assessed against market norms; however, the numbers that decide to sell through the scheme is very uncertain. An insource organisation recruiting on short-term contracts might be the most flexible way of managing volume, although there would be training requirements and potentially quality issues.	The management of volume risk would probably translate into extra cost for the Government, although a certain amount of volume risk could be taken by a provider. Use of interims and issues with quality would also be a risk for other providers, although the risk would sit with them.
Risks	Overall complexity of the task with no ability to transfer the risk of overspend to a third-party provider or to call on their size and strength to remedy any design or programme issues.	• Risk of negative perception. Failure to specify the requirement correctly. • Problems in managing the costs of changes in volume. • Potential delays in the procurement process. • If a Government agency was to be the third-party provider the timescales would not be governed by OJEU.
Costs	Costs are discussed in the following section. Given that this scheme is part of a suite of compensation measures it may be possible to derive economies of scale from managing the various processes together (whether internally or externally).	Costs would need to be carefully managed and penalties and incentive schemes woven into the contract which should be based on volume take up at the start and end of the process.

10.3. Organisation design and resources

In order to assess the volume of resources required to administer the scheme we have produced example organograms for the wholly insourced and outsourced model. The first diagram covers the resourcing structure for an in-house model. The second diagram is the organogram of the organisation that would be required within HS2 Ltd to manage an outsourced supplier. In this option the outsourced supplier would be responsible for designing their own delivery model, which would be compared in any procurement process to the model that HS2 Ltd would put in place to ensure that any third-party delivery proposals would work and would be value for money. The boxes in pink in the diagrams presume that for these functions, resources would be shared with other parts of HS2 Ltd Land and Property.

In general, the organisation required to support a property bond scheme would not be large but would vary, depending on assumptions on the boundary of the scheme, assumptions on take-up of the bond, numbers of sale processes undertaken per annum and numbers of properties acquired, which would need to be managed. Not only do these numbers vary by assumption but they would also vary, year-on-year, with peaks and troughs. This would make accurate resource planning challenging.

Internal organisation (numbers are illustrative)

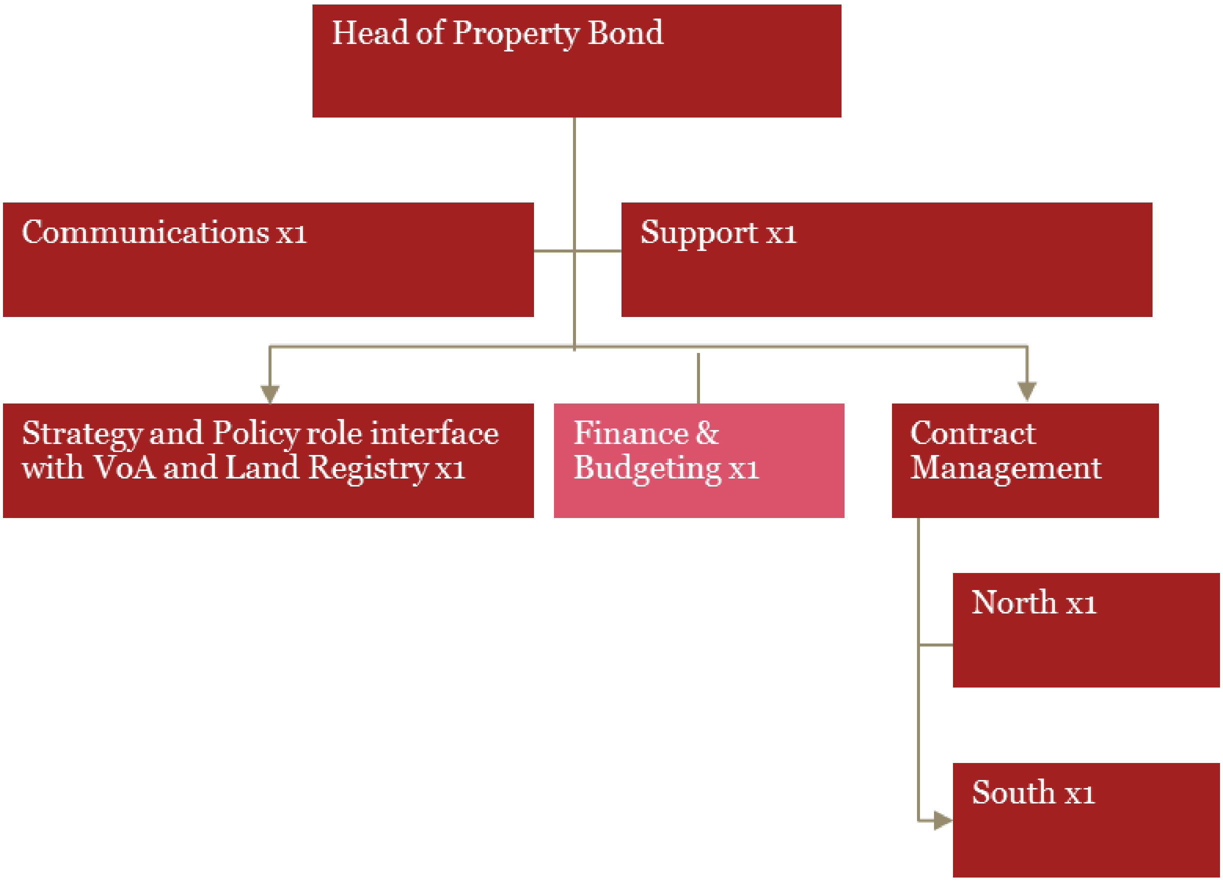


In the design for the internal organisation, it is assumed the peak number of management roles, as illustrated above, would be no more than nine with finance and contract management roles including management of the relationship with Land Registry and ONS on indices shared across HS2 Ltd Land and Property. This level of management would broadly apply to peak flows of work across all boundary scenarios, but would probably be adjusted downwards through the life of the property bond scheme. Delivery management roles would be expected to fall into three main groups:

1. administrative roles dealing with initial applications for a property bond.
2. case officer roles dealing with valuation, marketing and acquisition processes. These would require technically qualified personnel.
3. management roles to take care of planning for, and managing, acquired property; these would also be technically qualified roles.

Without further development of a specification for a supporting IT system and detailed processes, it is difficult to estimate the levels of resource required to deliver activities and to manage any scheme. For the purpose of providing indicative costs, we have assumed that administrative roles could process 175 applications a year (the majority on-line), case officers would process 30 valuation, sales and acquisition processes (of varying complexity) and property managers would manage 50 acquired properties. In coming to an assessment of these numbers we have considered the numbers of resources involved in the administration of current compensation schemes, although the processes used are not completely comparable.

Internal organisation to support an outsourced solution



10.4. Governance

The administration organisation, whether an internal or largely outsourced function would be subject to the existing governance and performance monitoring processes that exist between the DfT and Hs2 Ltd across the activities required to deliver the HS2 railway line.

The purchase and sale of property is however a particularly sensitive issue in the UK. The proposed property bond scheme would need the full confidence of HS2 Ltd and the public to work. Part of this confidence would come from the governance put in place to oversee the conduct and performance of the scheme. We would suggest that consideration is given to the establishment of an oversight board with appropriate external membership that oversees the performance measurement and monitoring processes, and has the capability to suggest corrective action if targets are missed. Consideration could be given to a governance body with representatives of the Law Society, RICS, NAEA and CLM, as well as key providers such as the Land Registry and HS2 Ltd. This board could be chaired by an independent chair.

10.5. Systems' support

To operate the property scheme effectively and efficiently any organisation would need good quality systems' support. The system or systems would need to provide support for on-line processes accessible by the public and framework providers, such as valuers and agents. An effective on-line portal would provide a good source of information for the public, increase the speed of response and provide reliable data on performance of the scheme to support a thorough approach to performance management as outlined in the following section of this report.

In addition, the on-line portal would need to be supported by internal management systems including interfaces with Land Registry in order to register the property bonds, property management systems for any property that has been acquired, and financial systems for handling payments and invoices. We understand that HS2 Ltd are implementing property management systems, but further refinement would be needed to hold specific data on property acquired through a property bond scheme. A key risk to implementation would be the specification and implementation of systems' support to the property bond scheme processes.

10.6. Timing of implementation

A concern highlighted is that the time taken to design a scheme and hence a delay in its implementation might negate the overall effectiveness of any scheme on the basis that market conditions would be more difficult to influence positively. We would expect, however, that a firm commitment to establish a property bond scheme with a clear timetable for implementation should provide some comfort to owners and help stabilise the market to some degree. Given the right investment in start-up resource and quick decision-making, it would be possible to implement a property bond scheme by mid-2015 at the latest. This would ensure that any scheme is in place to assist owners in the construction phase of Phase One. The design of any scheme would need to be of a high quality, effectively communicated to the public and administered competently if public confidence in the scheme is to be maintained through-out its life.

We have considered the implementation timetable for a property bond scheme for an in-sourced and outsourced solution. We do not believe that the timetable would vary markedly; however, public sector procurement processes may mean a longer timescale if the outsourced route is followed. It would be important also for HS2 Ltd to give consideration as to how to gear up the newly established administration organisation to implement a property bond scheme for Phase Two of HS2.

Implementation using internal organisation – indicative timetable

Activity	*Time taken* *Some activities would be undertaken in parallel*	*Target completion by*
Set up project and procure advisers	**4 weeks**	**End April 2014**
Set-up organisation		
Complete process design	3 weeks	Late May 2014
Complete operating model and organisation design	5 weeks	Mid-July 2014
Complete roles and responsibilities	6 weeks	End July 2014
Recruitment	6 months (maximum)	End January 2015
Training	1 month	End February 2015

Activity	*Time taken* *Some activities would be undertaken in parallel*	*Target completion by*
Implement IT		
Complete specification (dependent upon process design)	4 weeks	End June 2014
Procure the system	**3 months**	**End September 2014**
Design, test and implement	**6 months**	**End March 2015**
Procure agent and valuer support	19 weeks	End January 2015
Organisation ready for "Go Live"		End March 2015

Implementation through outsourcing of delivery – indicative timetable

	Time taken	*Completion by*
Set up project and procure advisers	**4 weeks**	**End April 2014**
Set-up operating model		
Complete process design	3 weeks	Late May 2014
Complete operating model	3 weeks	Late June 2014
Outsourcing		
Draft specification for strategic partner and soft market test	4 weeks	Mid June to mid-July 2014
Complete procurement strategy	4 weeks	End July 2014
OJEU procurement process	4 months	End November 2014
Supplier designs the processes and system support	4-6 months	End March to end May 2015
Processes and systems tested	1 month	End April to end June 2015
Complete changes to internal HS2 Ltd land and property organisation	**6 months**	**Late June to end December 2014**
Organisation ready for 'Go-Live'		**End April to end June 2015**

Business case

None of the timetables include the development of business cases, options' modelling or any further decision-making than that expected to be undertaken by Ministers in March 2014.

Insourced solution

If implementation starts (with planning) at the beginning of March 2014, we believe that it would be possible to fully launch the scheme by the beginning of March 2015. The main risk to insourced implementation would be the specification, sourcing and set-up of the IT solution, as well as recruitment of the necessary workforce.

Outsourced solution

An outsourced solution is likely to take slightly longer as procurement would delay detailed design. It may be, however, that an outsourced partner would be able to move the design process forward more quickly, in particular if they have the IT in place to support the on-line requirements of a property bond scheme. Again, it is assumed that implementation would start in March 2014 to enable implementation in-between March and May 2015.

The main risk to the timetable would be the length of the procurement process, whether there would be a need to use the OJEU process, which is likely, how efficiently the procurement process could be run with the right level of resources dedicated to it, unless it would be possible to obtain the required services through another Government body. The outsourced partner would also have to demonstrate capability to implement quickly and robustly.

If a decision is made to implement the bond for Phase One and Phase Two, the earlier Phase Two planning can be incorporated into the implementation programme, the greater the prospect of limiting any impact on implementation timescales. This would be particularly important regarding any outsourcing where changes to specification would delay the process.

10.7. Financing sources

In our analysis of a property bond scheme (and the assumptions that have been made in developing the cost model) we have assumed that the capital requirement for any scheme would be obtained by HS2 Ltd through a dedicated capital budget.

HS2 Ltd would be able to call on this capital budget in order to finance any acquisitions that are required under the rules of a property bond scheme and any income received from disposals would be passed over to the DfT. Given the potential size of any capital requirement to support a property bond scheme and the unpredictability of the timing and quantum of any capital requirements, further analysis and agreement is required with the DfT to ensure that HS2 Ltd would have access to the funds it requires to implement any scheme.

As we designed the scheme administration processes with the DfT and HS2 Ltd we considered whether applicants to a scheme should be charged administration fees. It was considered that this would act as a disincentive to potential beneficiaries and potentially be unfair in that the rationale for a property bond scheme is to compensate those affected by the planning and construction of HS2. It would be important for any scheme to be successful that there is a high take-up of property bonds and sales within the boundaries of any property bond scheme managed by HS2 Ltd. It was decided therefore that general charges for participation in a scheme would not be levied. However, as outlined in the previous section of the report, some charges would be made to cover disputes if found in favour of the administrator or repeat applications.

The nature of a property bond scheme does not lend itself to the use of direct private finance for a number of reasons, including:

- the lack of certainty over the required quantum and timing of any capital funding requirement
- HS2 Ltd would have limited certainty over the timing of any disposals and therefore any potential funder would not have clarity about the length of any loan and the timing of cashflows. This makes the scheme particularly unsuited for being used for any fixed-income products (e.g. public bonds or institutional investment)
- there is a possibility that HS2 Ltd could purchase assets at a protected value higher than the blighted value and it may be that this blighted value does not recover to a level either to, or in excess (in the lifetime of a property bond scheme) of, the protected value. Private funders would be unwilling to take on this risk and therefore would be likely to only lend against a portion of protected value.

It may be possible, however, once any scheme is operational and a significant property portfolio has been acquired, to enter into a joint venture or some other arrangement with a suitable private sector partner where the operation of the scheme and/or the acquisition and management of properties could be undertaken. In such an arrangement, HS2 Ltd could seek to achieve a genuine transfer of risk to a third party on the basis that all or a share of profits on disposal or management of properties accrue to that third party.

Alternatively, HS2 Ltd could seek to transfer some of the risk but retain an equity stake in a joint venture with a private sector partner to share in any profits or losses arising from the management and disposal of properties. In this instance, the disposal of properties to an external entity could assist HS2 Ltd to reduce any capital requirements needed to fund a scheme.

An agreement with a private sector partner willing to acquire – at an agreed value – properties purchased by the DfT under any scheme would also offer the potential to reduce the cash or capital commitment required from the HS2 project budget to support the operation of a property bond. This may be viewed as a positive outcome by the DfT and HS2 Ltd.

At present, we have not developed any detailed proposals around any potential joint venture with the private sector or considered taxation issues, neither have any proposals been tested with potential partners. It is therefore not possible at this stage to determine whether such an approach would be deliverable or offer HS2 Ltd a value for money option.

10.8. Accounting treatment issues to consider

As part of our work we have made an initial outline assessment of potential accounting issues relating to a property bond scheme for the DfT and HS2 Ltd to consider.

The DfT's accounts are prepared on the basis of the Government financial reporting manual (FReM) issued by HMT. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context.

The budgetary control process in the Government is designed to support assertions made in the national accounts and to restrain public spending in support of fiscal targets such as the current drive to eliminate the deficit on the national current balance.

Our initial view is that DfT/HS2 Ltd would be required to account for the potential liabilities generated by any property bond scheme from the outset. To illustrate, this would include:

- marking down the value of any properties purchased to fair value on acquisition. Fair value is the amount at which an asset can be bought or sold in a current transaction between willing parties, which in this case is likely to be 'blighted value'
- making provision for the projected overall losses and costs of a property bond scheme over its lifetime, discounted to the time at which the scheme is introduced, as a property bond could be viewed as an insurance scheme
- even before a bond is signed, once the DfT makes an offer to eligible homeowners, a constructive and possibly legal obligation may arise which may need to be accounted for as a provision.

Clearly, therefore, we would highlight that accounting for any property bond scheme is likely to be complex and that annual deficits or gains booked would be materially different from the cost and cash-flow analysis presented in the cost report.

Government accounting and budgeting approaches would also raise challenges as to how to plan and account for a property bond as predictions would need to be made annually of potential deficits and cash and capital requirements to enable the DfT and hence HS2 Ltd achieve a workable budget settlement. The uncertainty around the projected operation of any property bond scheme and the assumptions that underpin projections of deficits, costs and capital requirements would make it difficult to predict out-turns and therefore a prudent approach to forecasting is recommended.

The above represents a brief initial view, only on accounting and budgeting issues, and we recommend that a full and detailed review of these issues is carried out, should a scheme progress.

11. Performance measurement

11.1. Introduction

This section suggests an approach to assessing the performance of a property bond scheme in order that the Government could evaluate the performance of a scheme specific to HS2 and consider its potential application to other infrastructure projects.

Designing a property bond scheme is challenging as there is a lack of empirical data to underpin robust assumptions on levels of blight and the ability of property bond-type schemes to address and reduce blight. The implementation of a scheme such as a property bond could yield, potentially, a large quantity of data on the behaviour of the residential property market around a major infrastructure project, and whether blight could be managed through Government-backed schemes. Performance, good or bad would be informative.

Any performance regime put in place would need to record information to support:

- a review and audit of the success of an HS2-specific property bond scheme, delivered in the context of the timing of the announcement of the route
- a calculation of overall liabilities
- continued improvement in the operation of any property bond scheme as it progresses, so leading[11] and lagging[12] indicators would be required
- the future design of compensation schemes.

Defining the success of a property bond scheme

The key performance indicators (KPIs) should reflect the initial criteria used to evaluate a property bond scheme as a compensation mechanism. Seven KPIs have been suggested in the list below which cover: maintaining a functioning market, maintaining community cohesion, value for money and feasibility, and effectiveness and comprehensibility – referred to in this section as process effectiveness. Targets for the majority of these KPIs could be set with reference, as a starting point, to the modelling undertaken to inform the analysis carried out for this report (contained within the separate cost model report). The modelling assumes two potential outcome scenarios,- optimistic and pessimistic. The optimistic assumptions could be taken as a baseline.

We would, however, recommend reviewing these assumptions closer to the time of implementation of any property bond scheme to reflect market conditions at that time. To assist in setting targets more accurately, we would suggest that further work is undertaken along the line, possibly using independent academic researchers to better understand the levels of blight and market activity in specific locations, and affecting specific types of property. The modelling undertaken to inform the work for this report makes assumptions only in the context of a wider residential market and is not based on more accurate local data on the markets in question.

Key performance indicators

The key performance indicators outlined below reflect what would need to be measured to indicate a successful property bond scheme.

[11] Leading indicators provide an early indication of expected performance of the scheme.
[12] Lagging indicators provide historic reporting on the actual performance of the scheme.

- **KPI1a: A high percentage of eligible owners apply.**
- **KPI 1b: A high percentage of applicants are accepted as eligible owners.**

The majority of people that are eligible to apply for a property bond make an application and qualify for the scheme. It would be in the interests of a successful scheme that a majority of eligible owners apply, demonstrating a degree of commitment to the scheme, which would send positive messages to the market. The scheme administrators should aim to exceed, in the initial years, the number of applicants that have been projected in the optimistic scenario.

KPI 2: A low percentage of total sales in the market covered by the property bond, occur at blighted value (Target zero).

Few sales take place of property at blighted value without a property bond. The current model contains assumptions as to the percentage of those selling who choose to do so under a property bond scheme.

KPI 3: Percentage of sales within the boundaries of the scheme compared to x% of sales in comparable markets.

The property bond concept is aimed at supporting a normally functioning market comparable to similar markets. This would be demonstrated by a similar percentage of sales relative to comparable markets. In the cost model a percentage of sales has been assumed. This assumption could be used as an initial target, but would be dependent upon future changes in the property market and therefore would need to be reviewed and potentially refined to reflect specific locations and types of property. A successful scheme would be one where sales are not greatly in excess of comparable markets.

KPI 4: A high percentage of sales achieved at protected value or low percentage of sales (with the property bond) made to HS2 Ltd.

Sales take place at protected values. The majority of sales are to purchasers in the open market at protected value. The optimistic scenarios assumed in the cost model could provide an initial target.

KPI 5: Percentage of sales in markets adjacent to the property bond boundary compared to x% within the boundary and within comparable markets.

A property bond would not have a detrimental effect on property adjacent to, but outside, its boundary. We have not attempted to model any effect on markets outside a property bond boundary. If outside the boundary, a higher number of properties take longer to sell, and sell at lower values than in comparable markets, including a property bond supported market; then a property bond as a policy instrument would have failed this element of the market.

KPI 6: Percentage of owner-occupier to rented changes minimally (set percentage target for change e.g. no more than 10%).

Communities within the boundary of a property bond remain relatively unchanged compared to the baseline of percentage owner-occupier to tenant, percentage of business and support services provided**. We have not gathered any information on the profile of ownership in the communities along the route.**

KPI 7: NPV of asset cash-flow exceeds initial expectations.

Properties acquired by HS2 Ltd are managed efficiently, maintaining value for the tax-payer. Initial assumptions on rents and eventual sales of properties acquired by HS2 Ltd have been made within the model of the optimistic scenario. Once a property is acquired, a more informed performance target should be set for that asset, reflecting a better understanding of the property that is to be managed.

The majority of information to support the assessment of these KPIs should be available through HS2 Ltd systems and on comparable markets through valuers and agents which HS2 Ltd would manage (directly or through communication).

A survey of the make-up of current communities along the line (KPI 6) would need to be undertaken to set a target for this KPI. These surveys would need to be regularly carried out as information on these changes would not be readily available from HS2 Ltd systems.

In addition to creating a baseline against which the outputs of a property bond scheme could be measured, in order to inform future decision-making the elements of any scheme could also be evaluated against the take-up and impact of other discretionary schemes.

11.2. An indicative performance matrix

We have constructed a performance matrix based around the KPIs outlined above. We have also supplemented these indicators with a range of other measures on the effectiveness of the processes. These predominantly process-related measures would be used to improve and manage performance over the life of any property bond scheme. We would expect that the outline matrix would be developed further during any implementation phase and the collection of KPIs would be embedded into operating systems and processes. These KPIs would then be used as an active management tool in setting strategy and making changes to a property bond scheme as required.

The matrix below also contains recommendations on information that could be collected and questions that might be posed to assess the effectiveness of a scheme with a view to continuous improvement. Given the novel nature of a property bond scheme, it would be advisable to ensure that a structured research and data collection process is put in place from the outset. It would potentially provide valuable information for future use. The KPIs as outlined in the section above are shown in bold in this table.

Bond activity	KPIs and other measures
Initial eligibility and application process	• KPI 1a Percentage of eligible applicants applying • KPI 1b Percentage of eligible applicants that apply and receive the bond • KPI 2 Low percentage of sales of eligible property at blighted values without a property bond in place Additional measures covering process effectiveness: • Feedback received on the process • Effectiveness of communications (to the public and to professionals) based on take-up • Feedback on the ease of use of the on-line site • Measurement of time taken to complete applications • Feedback on why a property bond was applied for
	Continuous improvement in the eligibility and application process • Was the design of the eligibility criteria fair and reasonable? How could the criteria or their explanation and communication be improved? A high degree of dissatisfaction with the process; problems with clarity and ease of application would indicate future problems with the take-up of a property bond and therefore the ability of the scheme to support the market. • Were particular individuals (potentially related to types of property) less able or inclined to apply than others? Early feedback on the effectiveness of the application process would be an important early indicator of future success. The DfT and HS2 Ltd may wish to consider use of researchers to gather and analyse feedback on the application process and levels of engagement.
Baseline valuation process	Measures covering process effectiveness: • Closeness of valuations • Number of disputes • Number walking away from the scheme before a property bond is registered

Bond activity	KPIs and other measures
	Continuous improvement in the baseline valuation process • Difficulties in assessing values may drive owners away from a property bond scheme. Early issues in terms of accuracy of valuation or greater levels of technical dispute should be identified and plans put in place to address them with the assistance of professional bodies such as the RICS and NAEA. Issues in undertaking the baseline value process may indicate potential for issues in assessing protected value. • Is the assessment of a baseline value at an antecedent date difficult for different types of property? • Does the assessment of value get more problematic over time?
Applying to market a property	• KPI 3 The number applying to sell is greater than the average in comparable markets and greater than expected Additional measure covering process effectiveness: • Ease of use of the on-line platform
	Continuous improvement in the process of application to market a property • If the market is not functioning well a number of sales at blighted value may be taking place. Greater levels of communication with agents and owners may be required to prevent this and encourage applications. • Web-based support to a scheme and the management of the process, if not well designed, may discourage owners from applying. These KPIs need early monitoring as leading indicators that a property bond scheme may not be working. If this is the case, processes should be reviewed and improved as soon as possible. • Are different activities along the line driving applications? What is the type of property and demographics most affected? Areas where a property bond approach is not working may be localised and require specific interventions.
Assessing ‘protected value’	Measures covering process effectiveness: • Closeness of valuations • Number of disputes • Number walking away from the scheme
	Continuous improvement in the assessment of protected value • Difficulties in assessing values may drive owners away from a property bond scheme. Early issues in terms of accuracy of valuation or greater levels of technical dispute should be identified and plans put in place to address them with the assistance of professional bodies, such as RICS and NAEA. • Is the assessment of a protected value more difficult for some types of property? • Does the assessment of value get more problematic over time?
Marketing the property	• KPI 4 A high percentage of sales achieved at protected value Measures covering market: • Average percentage of offers (£) received below, or above protected value • Comparison of averages of offers received to comparable un-blighted locations • Time taken to sell within marketing period • Percentage located what distance from the line Measure covering value for money: • Expenditure against forecast (number of acquisitions and indexed baseline values) Measures covering process effectiveness: • Feedback on the efficiency of the marketing process from vendors and purchasers • Feedback from agents

Bond activity	*KPIs and other measures*
	Continuous improvement in the marketing process Information on the sales process would indicate whether HS2 Ltd would need to acquire more properties and whether extra interventions would be required to assure purchasers of the desirability of acquiring properties with a bond in order to avoid purchasing properties. However, there may be other reasons for failure to sell and these would also need to be understood to guide effective intervention. • Are purchasers clear about what they are purchasing? • What drove the purchaser's interest and offer? • Why did purchasers not proceed with the transaction? • What is the accuracy of the indexed baseline as a means of assessing potential liabilities? • Was the boundary chosen valid? Is there any diminution in acquisitions further from the line?
Management of acquired property	• KPI 6a Change in percentage rented to owner-occupied • KPI 7 NPV of asset cash flow exceeds expectations Measures covering community cohesion: • Changes to communities, closure or opening of different facilities • Take-up of school places unchanged relative to wider locality or national trends. Measures covering value for money: • Net present value at end of scheme • Income v forecast • Yield on purchase price • Length of hold of a purchased property • Investment required to bring property up to a lettable standard • Numbers sold against forecast • Prices achieved against forecast
	Continuous improvement • Is it possible to manage property to avoid large-scale disruption to communities? • Is it possible to re-coup value through renting and eventual sale? • When does blight start to disappear, for what types of property and how far from the line?

12. Analysis of risks and opportunities

12.1. Introduction

The following section sets out the results of an initial assessment to identify for consideration a number of risks and opportunities associated with a property bond scheme. If a decision is taken to implement a scheme we would recommend that a more detailed analysis is carried out to help inform effective implementation, and mitigate risks going forward, to give a property bond scheme the best chance of success. The risk matrices below, have been developed in consultation with the DfT and HS2 Ltd officials and use the DfT's risk management model that is set out in the tables below. These tables attempt to assess probability and impact. This section assumes that any implementation would be through an in-sourced solution rather than through an outsourced provider, which would generate a different risk profile. The risk analysis focuses on three dimensions:

1. overall concept and design of a property bond scheme
2. administration of a property bond scheme
3. implementation of a property bond scheme.

Potential financial impacts that illustrate many of the risks highlighted in this analysis are explored in more detail in the Cost Report.

This section explores all three dimensions of risk, starting with the most significant – being those relating to overall concept and design and the response of the housing market to a property bond scheme. As stated above, risks are highlighted and assessed using the DfT's risk assessment framework.

The DfT's definitions of probability and impact are shown in the table below.

Probability	**Score**	**Impact**	**Score**
75%+	Very likely (5)	Very high/ Severe	5
50-74%	Likely (4)	High major	4
30-49%	Possible (3)	Medium/Moderate	3
5-39%	Unlikely (2)	Low/Minor	2
<5%	Very unlikely (1)	Very low/Insignificant	1

12.2. Assessment

The overall concept and design of the scheme

The success of a property bond scheme would depend upon the behaviour of various parties, e.g. owners and purchasers over which the DfT or HS2 Ltd would have limited control. These risks, if evidenced in the operation of a property bond scheme, would have implications both in terms of cost, reputation and potentially in service delivery. Many of the suggested mitigating actions are dependent upon operational effectiveness including high-quality communications and high-quality service provision. Communications related to HS2 have not always achieved their aims in securing public support for the project. The design and implementation of a good quality communication programme for a property bond scheme would be vital in securing public buy-in and confidence in a property bond and the operation of the scheme. Risks around the behaviour of owners and purchasers are explored further below.

Owners

The success of a property bond would rely on the trust placed in it by owners and purchasers and its ability to generate and underpin market confidence. Trust in a property bond and confidence in its operation would make it more likely that significant numbers of owners sign-up to a scheme. If a property bond does not appeal to owners, with a subsequent low take-up in applications, then some properties would continue to trade at blighted value which would undermine those marketed at protected value with a property bond. In this scenario any property bond scheme would be likely to perform poorly or fail. This would have a consequent impact on the DfT and HS2 Ltd's budget and resources, as more properties would need to be acquired to meet obligations to owners under a bond.

It is important therefore that a property bond is able to reassure owners that there is a purchaser in place of last resort, and that there should be no need to move in anticipation of the construction or operation of HS2, unless other circumstances demand it. The insurance a property bond provides to owners of a purchaser of last resort would give a clear incentive to sign-up for any scheme.

However, for a property bond to work effectively, the supply of property coming onto the market and the number of available buyers at protected value must remain as close to normal market levels as possible. Such market conditions would avoid price reductions due to excess supply or limited demand, and support transactions at protected value.

Some of the key risks to the successful operation of a property bond, relating to owner behaviour, are assessed below.

Low take-up of the scheme

Risk	Probability	Impact	Mitigation measures
The public can be slow to respond to new Government schemes where there is a requirement to invest time and provide information, and where there is no obvious immediate reward. Slow initial take-up amplified by the press could undermine a property bond scheme as a credible solution for both owners and purchasers. If the take-up of property bonds is low and continues to be low throughout the life of the scheme with sales proceeding at blighted values, then the scheme will have performed poorly or failed. This will result in HS2 Ltd needing to acquire more properties. Accompanied by potential market failure and depressed values in the vicinity of the railway line. Poor take-up of a property bond scheme for Phase One of HS2 would also have implications for the cost and design of any scheme for HS2 Phase Two.	3	4	• Early implementation, as soon as feasibly possible in 2015 • Targeted direct communication encouraging owners to apply to the scheme as soon as possible, using property professionals, MPs, local politicians and others to advocate for the scheme • Positive and sustained communication in the press, targeted at informing and educating owners about the scheme and its benefits • Active briefing, early in the implementation programme of property and legal professionals • Design of a simple, effective and responsive property bond application process • High quality and timely administration

The volume of sales is higher than market average

Risk	Probability	Impact	Mitigation measures
The HS2 planning process and construction of the railway line influences current owners to sell in numbers that significantly exceed the average levels of sales per annum in an un-blighted rural market. HS2 is a major project with a high public profile and interest. Reports of widespread and high levels of sales within the boundaries of a property bond scheme, with limited demand from purchasers would generate press coverage which could undermine confidence in a scheme. The impact of this could be to undermine owner confidence with more properties being offered for sale. Excess supply over demand would drive property values downwards and make it more difficult to sell at protected value, resulting in HS2 Ltd purchasing more property. High levels of property acquisition by HS2 Ltd would place significant demand on HS2 project capital budgets over a number of years. Failure of a property bond scheme in Phase One of HS2 would have effects on the management of compensation measures for Phase Two of HS2. This would result in greater focus by the public on blight issues, which could further undermine confidence in a property bond solution.	3	5	• Positive and sustained communication in the press – and with stakeholders along the route of the line – on positive elements in the design and management of HS2 construction and communication of measures to mitigate any disruption due to construction. • Early implementation of a property bond scheme, as soon as possible in 2015, supported by positive communication of benefits of a scheme. • Increased levels of sales and acquisitions would require an effective and responsive organisational response to ensure confidence in a property bond is not undermined. HS2 Ltd would need to be flexible and able to increase levels of staff quickly to support increased demand on administration processes. Staffing arrangements internally or with outsourced providers to provide access to suitable resources would be required to be able to respond quickly to changes in demand related property bond processes. • Ensure operational staff have the necessary capability and knowledge to provide flexible and high-quality service delivery. • In general, effective implementation of a well-designed scheme with efficient processes backed up by targeted communications would assist in mitigating this risk.

Purchasers

For a property bond to be successful, the assumption is that sufficient purchasers willing to acquire properties at protected value would be required. In the initial stages of a property bond scheme this would depend upon the actions of owners to both sign-up to the scheme and then not seek to move in large numbers, i.e. creating a situation with excess supply of properties for sale.

If owners do not move in large numbers, then we can assume that this displays of trust in a property bond. The resulting restriction in supply of properties, may also increase the confidence of potential purchasers in the concept of a property bond. This could provide an incentive to purchasers to acquire property at protected value. However, acquiring property at protected value would, likely, be dependent on purchaser's perception and pricing of the 'insurance' value offered by a property bond that a guaranteed purchaser of last resort would offer. This is a key risk as it is difficult to predict and therefore uncertain as to whether, and how many, potential purchasers would place sufficient value on a property bond to purchase at protected value. In the absence of sufficient purchasers willing to pay protected value the number of properties that would be acquired by HS2 Ltd would increase.

Some of the key risks to the successful operation of a property bond, relating to purchaser behaviour, are assessed in the following table. It should be noted that purchaser behaviour may vary depending upon distance from the railway line.

Purchasers will not purchase property at or above protected value

Risk	Probability	Impact	Mitigation
Where property is further away from the HS2 railway line, or there is undersupply in a market with a suitable level of demand, it is possible to envisage purchasers buying at protected value. However, normal market behaviour is generally for purchasers to seek to acquire below asking price – and prospective purchasers may not sufficiently value the insurance offered by a property bond to purchase at protected value. In this case, even given the promise of a guaranteed protected value and purchaser of last resort, it is possible that HS2 Ltd would need to acquire a significant number of properties. If there are few purchasers at protected value, the cost and cash requirement of any property bond scheme would increase and the administrative focus of the scheme would be on acquisition and management of acquired properties. Where HS2 Ltd becomes a major property owner this may undermine community cohesion and could further undermine efforts to sell adjacent properties within the scheme at protected value. Reports of few purchasers within the boundaries of a property bond scheme would be quickly identified with press coverage likely and confidence in a scheme potentially undermined.	3	5	• Positive and sustained communication in the press and through other channels highlighting the continued desirability of living near the route and the positive features of a property bond and the insurance it offers to purchasers. • Active briefing (early in the implementation of a scheme), of estate agents along the route on the construction of the line as well as the positive benefits of a property bond. The activities of estate agents would need to be monitored to ensure they are making all practicable efforts to market properties within any property bond boundaries. This could be supported by a differential in fees offered to agents between a successful sale at protected value and no sale when a property is acquired by HS2 Ltd. • Acquisition processes would need to be sufficiently resourced to be efficient and the scheme administrators would need to be capable of managing and understanding the market in discrete locations to address issues of community cohesion and to ensure decisions are taken that offer value for money. Careful management of any properties acquired so as not to undermine community cohesion. • In general, effective implementation of a well-designed scheme with efficient processes backed up by targeted communications would assist in mitigating this risk.

Other risks

As outlined above, it is difficult to predict and influence the behaviour of owners and purchasers. Therefore it is difficult to predict whether the bond would support ‘normal’ market behaviour. .

However, there are a number of other risks that concern, for example, the impact of a property bond scheme on adjacent property markets and the risk that a less than successful scheme is taken as a precedent. We would note, however, that even if a property bond scheme does not achieve its aims of supporting a normally functioning market, the provision of a purchaser of last resort at protected value, could still be viewed by eligible owners as an effective method of obtaining fair compensation for blight.

A number of additional risks relating to a property bond scheme are assessed on the following page.

Risks	Probability	Impact	Mitigation/ controls
Adjacent markets Those owners with properties situated just outside any property bond scheme boundary may still feel a degree of unfairness and there may be some market distortion around these boundaries, to the disadvantage of those owners not covered by the scheme. This is a function of the requirement for a boundary and a similar impact would be likely whatever form of compensation scheme is introduced.	4	3	• Set a boundary to include the majority of those substantially affected by blight. • A property bond scheme may provide for a functioning housing market, with the potential therefore to reduce any negative impact on the adjacent market.
Precedent Any scheme put in place for HS2 Phase One is likely to form a precedent and require to be applied to Phase Two. There is a risk that a property bond scheme becomes a precedent and is applied to HS2 Phase Two, and potentially other large infrastructure projects, and yet does not deliver the desired outcomes in Phase One.	2	3	Ensure robust performance measurement of the HS2 Phase One scheme and apply lessons to improve performance in any Phase Two scheme.

The administration of the scheme

The risks around the administration of any property bond scheme are similar to the administration of any compensation schemes. However, the impact of any failure on a property bond scheme could be higher given that it is a relatively novel approach to compensation. The probabilities of risks occurring are, therefore, potentially greater given the volume of processes and uncertainty in predicting the potential reactions of owners and purchasers to a new scheme.

Risks	Probability	Impact	Mitigation/controls
Excessive time taken in processing applications Both initial applications and management of subsequent applications for sales and acquisitions. The uncertainty in level of applications for these processes makes this risk difficult to manage.	2	2	• Appropriate but flexible resourcing. • Robust planning and control processes. • Capable management of scheme in place. • Ongoing performance management. • Ensure good information and data is available. • Provide flexibility in resource budget.
Poor communication and understanding of processes Resulting in incorrect advice to the public and management, and incorrect decisions.	3	3	• Put clear processes in place. • Establish appropriate training for staff. • Ongoing performance management. • Ensure overall good governance of the scheme.
Poor processing and storage of documentation Leads to slow processing of applications, poor communications and potentially incorrect decision-making.	2	2	• Establish high quality systems support. • Ensure procedures and workflows in place to control the quality and storage of key documents on systems. • Establish appropriate governance arrangements, including audit, to provide overview and challenge where necessary.
Restricted Funding Funding is not available to meet the requirements of the scheme, both in terms of acquisition of property or to	4	4	• Negotiate flexible budget and access to additional resources when required. • Use of private sector suppliers under fixed price

Risks	Probability	Impact	Mitigation/controls
address any increase in operational workload.			contracts.
Insufficient capacity and capability of human resources	2	4	• Clearly defined roles and responsibilities. • Effective resource planning. • Sufficient flexibility in budgets. • High-quality and timely training. • Potential to use private sector to meet demand or peaks in demand. • Right employment package and location to attract staff. • Overall budget allocation.
Failures in security of public information	1	4	• Good quality processes and procedures, supported by performance management. • Secure system with access controls. • Recruitment process robust with appropriate attention to references.
Fraud and abuse A property bond scheme could potentially be open to abuse by owners seeking to commit valuation fraud by achieving a higher protected value. Due to the potential size of any scheme this could be difficult to manage. The proposed property bond scheme is, however, designed to reduce the possibility of manipulating the market.	2	3	Develop a clear fraud risk management policy: • Use of HS2 Ltd framework agreements for agents and valuers to help avoid collusion between agents, valuers and owners. • To ensure independence the same firm of agents and valuers would not act on the same property • Use of a baseline value in conjunction with an initial inspection and a robust index. • Marketing process monitored and overseen by HS2 Ltd. • No re-purchase of properties by previous owners possible at reduced value. • Provide training to scheme administrators to enable them to spot potential fraud 'red flags' when conducting initial inspections and generally administering the scheme. • Carry out regular monitoring and audit throughout the life of a property bond scheme to improve controls and fraud detection. • Clear fraud response process to be adopted once fraud detected.

Implementation of a property bond scheme

Risks to the implementation of a property bond scheme differ, depending upon whether any property bond scheme is administered in-house or outsourced. A number of risks around the implementation of a property bond scheme are detailed and assessed in the table below.

Risks	Probability	Impact	Mitigation/Controls
Unable to meet defined implementation timescales The initial risk is that implementation, as planned, may not deliver a scheme in time for commencement of construction of the route. A more likely risk is that there are delays to timescales caused by problems with procurement, and with system specification and implementation.	2	3	• Early planning as soon as possible should a decision be taken to implement a property bond scheme. • Adequate funding to be in place to support implementation with sufficient resources to manage organisation design, set-up, implementation and procurement processes. • Adequate time built in for design and testing of processes and systems.
Inadequate finance available The organisation tasked to deliver any property bond needs to be of high quality. Budgets need to be in place to ensure the right resources are available and timescales are met.	2	3	• Good quality planning and budgeting, taking into account all risks to establish adequate contingency.
Inability to manage implementation All processes and activities required to administer a property bond have been carried out before, many by HS2 Ltd's land and property function, although the combination of processes and potential volume present challenges. The main challenge for HS2 Ltd would be implementing a high-quality systems interface for use by the public.	2	3	• Acquiring third-party private sector or Government body support on implementation of areas not within current remit of HS2 Ltd.

12.3. Further considerations and opportunities

Whilst the design, implementation and administration of a property bond scheme would carry with it a number of risks that would require managing it would also present the Government with a number of issues to consider further as well as some potential opportunities. These are set out under each of the design criteria used to develop the property bond proposals.

Maintaining a functioning housing market

As stated above, to support the market adequately, a property bond would need to underpin, to a reasonable extent, the operation of the housing market. However, without a direct precedent, it is not possible to judge reliably whether a property bond scheme would achieve the objective of maintaining the housing market, as purchaser behaviour in this instance is extremely difficult to predict.

In addition implementing a property bond scheme a number of years after the announcement of the HS2 project may reduce its effectiveness in supporting or restoring confidence in the housing market, since blight is already a factor in the market along the route.

What is clear, however, is that a property bond scheme – and its announcement – would offer at least the potential to support some level of normal market activity (during the life of the property bond's existence), and could move the market some way towards pre-blight levels. However, it is impossible to predict how large a positive move this would be. Despite the uncertainty as to the impact of a property bond scheme, the potential to induce a positive response in the market is a key differentiator from other schemes that do not provide purchasers with any value guarantee to rely on. Depending on whatever scheme the Government decides to introduce, the lack of a similar guarantee could encourage crystallisation of blight in the market.

Community cohesion

Effectively communicating the potential market stabilisation effect of a property bond scheme, and any resulting increase in market confidence, could persuade existing residents to remain *in situ*, thereby supporting local communities.

In addition, the emphasis placed on supporting the conditions necessary for a 'normal' housing market suggest that this approach, should it function as intended, is more likely to aid community cohesion than approaches that focus merely on fair compensation. This should address the lessons from HS1 where a scheme with similarities to a voluntary purchase scheme resulted in significant long-term change to some communities along the route.

Any scheme operator would need to manage acquired properties effectively, by working with the local communities to ensure that housing is occupied and community facilities continue to be viable.

Value for money

The financial and cost analysis of a property bond approach, set out in the Cost Report, has enabled a view to be taken on the extent of any potential costs and liabilities.

Over the long term, renting properties and selling them once values have recovered offers the potential to generate revenue and gains, to offset up-front costs, depending on market conditions on renting and disposal. Adopting a policy of holding properties for rent would also avoid the creation of a two-tier market caused by disposing of properties at blighted values, which would undermine the effectiveness of any scheme.

However, operating a property bond scheme would require a significant cash outlay in order to purchase properties that do not sell at protected value. The cash or capital requirements are difficult to predict, but could be considerable – year-on-year – as properties are acquired. This uncertainty represents a key risk in terms of ensuring that the overall funding envelope for the HS2 project is flexible enough to accommodate variations in capital spend over the life of the scheme. The Government would need to make suitable provision for any gain or loss on acquisition prices, given the generally lengthy pay-back period before acquired properties are released back into the property market.

We consider that the announcement of any scheme may give rise to a number of early applications (the result of pent-up demand in anticipation of an announcement). This may come at a point where the overall budget for HS2 implementation is still relatively restricted before construction starts. The announcement of any scheme could help stabilise the market, but the volume of early applications and the potential impact on HS2 Ltd's cash flow may be difficult to manage. Therefore, the DfT and HS2 Ltd may wish to consider a variant that permits eligible owners to claim under any scheme, but only once construction starts. This would provide more time to plan and confirm a realistic budget.

Those with a real need to move (prior to construction commencement) could continue to be accommodated through the long-term hardship scheme, but under eligibility criteria associated with a bond e.g. location within a boundary. This is suggested as it would be undesirable for members of the public to have to wait longer than necessary for the Government to purchase properties where that is the only satisfactory solution.

Risks and uncertainty would need to be managed through effective communication and administration of any scheme. Some risks, however, such as purchaser and seller behaviour, and overall market conditions, are difficult to predict and manage. For a price, it may be possible to share or transfer some of the risks around the scheme to a third party in a commercial arrangement aimed at capping liabilities and providing more certainty as to the overall amount and timing of costs and capital requirements. The DfT and HS2 Ltd may wish to explore this option before implementing any scheme.

Meeting overall policy objectives

A property bond scheme has the potential to address a number of concerns raised by those who responded to the Property Compensation Consultation in 2013. If implemented effectively, with a relatively generous boundary, it would also be viewed as fair and may generate a more positive response by the public to the HS2 project.

The Government would also have an opportunity to put in place a scheme which could create a successful precedent that could be applied to other forthcoming infrastructure projects. However, the range of risks identified would need to be successfully managed and mitigated in order to retain market confidence and hence give any scheme the best chance of working successfully.

Appendix A

A.1. Legal analysis of a property bond scheme

A.1.1. Scope

1.1 This appendix sets out answers to specific questions contained in the 'Invitation to tender for analysis and advisory work on a potential property bond scheme for property owners affected by plans for HS2' (the '**Invitation to tender**'). Specifically, the appendix addresses the following questions as part of the legal analysis required by paragraph 15.7 of the Invitation to tender:

Question 1) How were previous property bonds issued by private infrastructure developers treated in legal and regulatory terms?

Question 2) Would a Government-backed property bond have the same status or a different status?

Question 3) Does the issue of the proposed bond create a contract between the Government and any named party?

Question 4) If the answer to question 3) is yes, what are the specific implications of contract law for the proposed bond scheme?

1.2 The answers below do not comprise an exhaustive analysis of the issues and are provided for guidance purposes only.

1.3 Where appropriate, 'Administrator' refers to the relevant administrator of the scheme being discussed.

A.1.2. How were previous property bonds treated in legal and regulatory terms

1.1 The below analysis considers four specific examples of property bond schemes being used in the context of public infrastructure projects and, so far as is possible, outlines the general legal principles underpinning those examples. For consistency, we have concentrated on the property bond schemes identified by Deloitte LLP ('Deloitte') in its final report for the Department of Transport on the HS2 property bond Option published in September 2013 (the 'Deloitte HS2 Report').

1.2 It is worth noting that, as set out in the Deloitte HS2 Report, previous property bonds developed in the UK were not designed to deal with similar schemes to the HS2 proposals. Indeed, the Consultation Document notes at paragraph 5.2.5 that no property bond scheme has yet been developed or introduced by any national or local government organisation in the UK.

1.3 The below analysis has been conducted on the basis of publicly available documentation. We have not been provided with any of the legal documentation underpinning past schemes nor is any of the legal documentation publicly available (save for any relevant legislative provisions).

EDF Main Site Neighbourhood Support Scheme ('EDF NSS').

1.4 The EDF NSS applies to residential property within a defined boundary, located close to the site of the proposed new nuclear power station at Hinkley Point.

1.5 Eligible property owners register for the EDF NSS by submitting a simple application form, giving their name and the details of their property. Draft minutes of the EDF Energy Hinkley Point C: Main Site

Neighbourhood Forum dated 25 September 2013[13] indicated that, as at 25 September 2013, 68 properties had registered for the price support scheme. The minutes also indicate that ten properties have been purchased by EDF and that the contracts for a further three are being negotiated.

1.6 The scheme itself effectively constitutes a compensation payment, which is calculated by reference to the difference between the September 2008 value of the relevant property (which is adjusted by reference to the Land Registry Somerset index link) and the value of the property at the time the property owner chooses to sell, plus £5,000 additional compensation for moving costs.

1.7 It is not clear from publicly available documentation whether a formal written contract between the property owner and EDF is entered into at the time of the property owner registering for the EDF NSS. In the absence of any formal written contract, it is unlikely that the EDF NSS forms a binding legal obligation between the property owner and EDF. It is also worth noting that, as the property owner is not providing any consideration in exchange for the compensation payment, any written contract would need to be executed as a deed in order to be binding. Of course, it is unlikely from a public relations' perspective that EDF would renege on the terms of the scheme; however, in the absence of a binding legal contract, it would appear that the EDF NSS has no legal status.

Home Owner Support Scheme (HOSS) operated by BAA and GIP

1.8 Under the HOSS, if qualifying owners are unable to sell for a price within 15% of the market value, the Operator would buy the property at an un-blighted price. If the owner were to sell for an amount within 15% of market value, the Administrator would make a contribution to sales' costs to assist with the move process.

1.9 From a legal perspective, the HOSS operates by way of an option agreement entered into between the property owner and the Administrator, which confers on the property owner the right to require the Operator to purchase the property at a certain price. The option becomes exercisable once the Administrator confirms its intention to proceed with expansion of the airport.

1.10 The option to require the Administrator to purchase the property would be exercisable for a certain period of time or on completion of the expansion, whichever came first. In the event that the property owner sold the property before exercising the option, the rights under the option would transfer to the new owner.

1.11 In terms of legal status, the option to require the Administrator to purchase the property would constitute a simple conditional contractual arrangement between the Administrator and the property owner. As the option is only exercisable by the property owner, it would not constitute an interest in land and so would not be capable of registration against the title to the property. In the event that the owner was to sell for an amount within 15% of market value, the HOSS effectively operates to provide the owner with a compensation payment.

Central Railway Property Protection Scheme (CR PPS)

1.12 In a similar fashion to the HOSS, the CR PPS invited qualifying property owners to apply for a transferable option. The option agreement between Central Railway (CR) and the property owner would give the owner the right to require CR to purchase their property at an agreed price, once construction had started in their 'area'. The agreed price would be index-linked (upwards only), include an additional payment of £3,000 for moving costs and would last for 21 years (the length of the option is likely to be a result of the law in force at the time preventing options over land being granted for a period in excess of 21 years. The Perpetuities and Accumulations Act 2009 has repealed this restriction). The option granted could be automatically transferred to a purchaser of the property.

1.13 According to the Deloitte HS2 Report, in March 2004, CR published a briefing note indicating that 1,100 homeowners had taken up the option agreement with CR (the briefing note is no longer available

[13] and available at http://hinkleypoint.edfenergyconsultation.info/websitefiles/MSNF_Minutes_25_09_13_draft_for_attendee_review.pdf

online). A copy of the form of option agreement entered into is not available publicly; however, on the basis of the explanation of the scheme, the CR PPS would have a similar legal status to that of the option element of the HOSS. That is to say, that it would constitute a simple contractual arrangement between the CR and the property owner. Again, as the option is only exercisable by the property owner, it would not constitute an interest in land and so would not be capable of registration against the title to the property.

1.14 It is worth noting that, as stated in the Deloitte HS2 Report, the CR project is not currently being pursued and so the exercise period for the options granted to property owners has not been triggered. This means that no property has been acquired by CR, pursuant to the CR PPS scheme and that there is no case law available analysing the legal status of the options granted under the scheme.

Property Market Support Bond ('PMSB')

1.15 The UK Government White Paper, 'The Future of Air Transport' (December 2003) asked airport operators to produce a voluntary non-statutory scheme to protect against the blight of properties located next to an airport. This resulted in the PMSB, which has been adopted by Global Infrastructure Partners which have since acquired Edinburgh and Gatwick airports. The PMSB has been made available to eligible property owners in respect of each of those airports.

1.16 The PMSB consists of a transferable written option for the property owner allowing them to require the Administrator to purchase their property at the value of the property immediately before the date when the potential expansion of the airport became public, adjusted by reference to a property price index, plus a separate payment relating to the costs of moving and a further payment of 10% of the final valuation of the property. The bond/option is valid for 25 years from the date of issue and exercisable between the date that the application for planning consent is submitted by the airport and the date of grant of planning consent.

1.17 As noted in the Deloitte HS2 Report, no trigger dates for any PMSBs have yet been reached and, so far as we are aware, no acquisitions have been completed under the PMSB scheme by either the BAA or GIP.

1.18 As with the HOSS and the CR PPS, the PMSB would constitute a simple contractual arrangement between the BAA/GIP and the property owner. Again, as the option is only exercisable by the property owner, it would not constitute an interest in land and so would not be capable of registration against the title to the property.

Summary

1.19 The property bond schemes that are most similar to that proposed in respect of HS2 (i.e. the HOSS, CR PPS and the PMSB) all constitute relatively simple contractual arrangements between the property owner and the relevant developer.

1.20 We expect that the written agreements between the property owner and the relevant developer would have been executed as deeds. This is because, as a matter of simple contract law, the property owner does not appear to be providing any consideration in exchange for the benefit they obtain under the scheme. An alternative possibility is that the property bond agreement was drafted as a conditional property acquisition contract, so that the sale of the property is conditional only upon the relevant conditions being met and the property owner serving notice on the operator of the scheme.

1.21 The bonds granted under the HOSS, CR PPS and the PMSB allow the property owner to require the developer to purchase their property at an unblighted, index-linked price. Although the bonds are transferable to purchasers of the property, they do not constitute an interest in the property capable of registration as the developers are not provided with a corresponding right to force the property owner to sell.

1.22 From the publicly available information, it is not clear whether the EDF NSS is legally enforceable at all. In the absence of a written agreement, property owners are forced to rely on EDF's concern for its own public image in terms of holding EDF to the terms set out in its scheme documentation.

2. Would a Government-backed property bond have the same status or a different status?

2.1 To answer this question it is first necessary to outline how a Government-backed property bond would be structured. On the basis of the Deloitte HS2 Report and the public consultation, we anticipate that any property bond would have the following legal characteristics:

2.1.1 it would consist of an agreement between the DfT and the eligible property owner;

2.1.2 the eligible property owner could trigger a sales process at any time during the term of a property bond which would require the property to be marketed in accordance with the marketing and sale conditions for a minimum period with a view to obtaining a sale of the property to a third party at or above the protected value and, if such sale to a third party is completed, the property would transfer to the new owner with the benefit of a property bond;

2.1.3 if a sale of the property to a third party at or above the protected value is not completed within the marketing period, then the DfT would enter into a property contract to purchase the property at the protected value and the DfT has discretion as to whether a property bond would terminate or continue in favour of a subsequent owner.

2.2 One point to be confirmed is what role the Government would play in respect of the proposed property bond agreement. The Consultation Document suggests that a property bond would be Government-backed. As noted above, our understanding is that a property bond agreement would be between the DfT and the property owner; however, there are a number of other options whereby the Government might back a property bond agreement, for example:

2.2.1 the Government could act as guarantor for the obligations of the Administrator (for example, HS2 Ltd) under the contract;

2.2.2 the bond could be issued pursuant to legislation and administered by the Administrator;

2.2.3 the purchase could be completed by the Administrator acting as agent for the Government. This would require a separate contractual arrangement between the Government and the Operator in order to provide the Operator with the necessary backing for any purchases it is required to make under the issued bonds.

2.3 As noted above our understanding is that a property bond contract would be entered into between the DfT and the property owner.

2.4 We understand that in order to ensure transparency and the ability of the public to search online, a property bond would be capable of registration against the title of the property at the Land Registry. The form of property bonds used in the past appeared to preclude registration against a property's title as they did not constitute an interest in land, but rather a personal right granted to the property owner.

2.5 More generally, the legal status of the bond is likely to be different as a result of the involvement of the Government in the property bond agreement. Whereas previous property bonds are entered into by the property owner and another private party and so would be governed by the principles of contract law, the involvement of the Government means that a property bond for HS2 is likely to be affected by principles of public law.

3. Does the issue of the proposed bond create a contract between the Government and any named party?

3.1 Our understanding is that the Government, through the DfT, would be the contracting party with the property owner. For completeness, we set out below the position under the four other options outlined above:

3.1.1 If bonds, similar to those issued under past schemes were used a private party would contract with the property owner. As a result, the Government would not be a party to such a property bond.

3.1.2 If the Government were to act as guarantor, the contract would be a tripartite agreement between the property owner, the Administrator and the Government.

3.1.3 If the bond were issued pursuant to legislation, the issue would be determined by the legislation itself.

3.1.4 If HS2 Ltd were purchasing the property as agent for the Government, there would be no direct contractual arrangement between the Government and the property owner; however, the question does arise as to whether the property owner would be able to 'look through' HS2 Ltd and enforce the contract directly against the Government. We suspect that the agency arrangement between the Government and HS2 Ltd would be drafted so as to exclude any 'look through'.

3.2 Any property bond agreement between the DfT and the property owner would clearly constitute a contract between the Government and the property owner. In this particular case the common law power is also supplemented by a specific statutory power in the form of the High Speed Rail (Preparation) Act 2013 to incur expenditure on acquiring property.

3.3 Ultimately, if a property bond scheme is not contractual, a property owner would need to enforce any obligations of the Government in accordance with public law (in effect under the procedures for judicial review).

4. If the answer to question 3) is yes, what are the specific implications of contract law for the proposed bond scheme?

4.1 From the perspective of contract law, there are two key issues to consider in respect of a property bond scheme and contract law:

4.1.1 Whether the entry into the bond agreement by the contracting party for the Government, be that HS2 Ltd or other operator or DfT, is considered to be ultra vires.

4.1.2 Whether the obligations of the contracting party would be governed by private contract law or public law. If private law, any dispute would be governed by ordinary contractual principles; if public law, any dispute would be governed by the law surrounding judicial review.

Vires

4.2 As mentioned above, Government departments have a common law power to enter into contracts with private individuals. Such contracts cannot be contrary to an existing statute and cannot restrict the ability of the department to exercise its general statutory powers. In the case of a property bond scheme, entering into the contracts would not appear to conflict with existing statute nor restrict the DfT's ability to exercise its general statutory powers. The wider High Speed Rail project is part of department policy for the DfT and, as referred to in paragraph 3.2 above, DfT has a specific statutory power to set up a scheme such as this in relation to the wider project. In light of this, it is our view that the general power to contract would apply here in its own right. The presence of the supporting statutory power is advantageous, but not essential. The DfT would still need to ensure that the correct internal procedures are followed to ensure that contracts are signed by someone with delegated authority to bind the Minister of State.

4.3 If HS2 Ltd are the contracting party in place of the DfT, the company would derive its power to enter into the bonds from its constitution. The company generally undertakes work as instructed by the DfT. The assumption is that the company would be instructed to enter into the property bond documentation as part of any general requirement to give effect to the scheme.

Private law v Public law

4.4 Given the status of HS2 Ltd as a public body, we believe there would be very little difference between the rights and remedies available under the contracts executed by the company and those executed by the DfT. Each would be enforceable in accordance with contract law principles, subject to the possible limitation on the ability of any court to grant an injunction or order specific performance against the Crown (as detailed in the Crown Proceedings Act 1947).

4.5 The decisions of each body are also subject to challenge under the judicial review procedure. The presence of a contractual right to remedy would not necessarily prevent a judicial review being granted. However, judicial review procedures are relatively restrictive (and subject to further restriction in the future) and so it would be safe to assume property owners would seek to enforce the terms of any property bond agreement by way of private contract law (particularly in order to access damages under contract law).

Internal governance

4.6 In addition to the above comments, we would highlight the potential internal governance implications of any property bond scheme. The DfT is currently subject to the requirement to report on an annual basis to Parliament on the expenditure incurred in relation to the High Speed Rail project. This requirement includes actual expenditure and creation of liabilities such as property bonds. The DfT should clearly satisfy itself, in discussion with HMT and/or other stakeholders, on the type of information to be included within departmental reports. Given the fact that there would be some uncertainty as to when payment would be made under the terms of a bond, it may be necessary to provide separate information on aggregate contingent liabilities arising and those crystallising in any report period.

A.2. Regulatory analysis of a property bond scheme

1 Scope

1.1 This Appendix is prepared, and should be read, in conjunction with the 'Legal analysis of a property bond scheme' (the '**Legal Analysis**'). The specific focus of this Appendix is to address the following questions as part of the analysis required by the third bullet of paragraph 15.7 of the Invitation to Tender:

- would a property bond in practice be regulated like a novel financial instrument?
- would the legislative and regulatory frameworks that apply to other broadly similar financial instruments, and other Government-backed bonds, have any application here? If so, what are the implications?

1.2 Our response to the questions, set out below, does not comprise an exhaustive analysis of the issues and is provided for guidance purposes only.

2 Understanding the facts

2.1 Pursuant to the Legal Analysis, we understand that it is currently proposed that each property bond issued under a UK Government property bond scheme would have the following legal characteristics:

(i) it would consist of an agreement between the DfT and the eligible property owner;

(ii) the eligible property owner could trigger a sales process at any time during the term of a property bond which would require the property to be marketed in accordance with the marketing and sale conditions for a minimum period with a view to obtaining a sale of the property to a third party at or above the protected value and, if such sale to a third party is completed, the property would transfer to the new owner with the benefit of a property bond;

(iii) if a sale of the property to a third party at or above the protected value is not completed within the marketing period, then the DfT would enter into a property contract to purchase the property at the Protected Value and the DfT has discretion as to whether a property bond would terminate or continue in favour of a subsequent owner.

2.2 We understand that it is proposed that the DfT would appoint HS2 Ltd to administer any property bond scheme, and that HS2 Ltd would not be liable to eligible property owners under the relevant property bond agreement.

3 The UK financial services legal and regulatory regime

2.3 Analysis regarding regulated activities in the UK is very fact sensitive. Even seemingly minor changes to any property bond scheme may affect the analysis (and in particular the availability of exemptions from the authorisation requirement under the Financial Services and Markets Act 2000, as amended (**FSMA**)).Pursuant to the Legal Analysis, we understand that it is currently proposed that each property bond issued would have the following legal characteristics.

2.4 Activities pertaining to certain types of financial instruments are highly regulated in the UK. We summarise the two key restrictions. Breach of these restrictions are criminal offences.

Regulated activities – the general prohibition

2.5 Section 19 of the FSMA provides that no person may carry on a regulated activity in relation to a specified investment by way of business in the UK or purport to do so unless that person is authorised by the Financial Conduct Authority (FCA) (and where applicable by the Prudential Regulation Authority (PRA) also) or is exempted from authorisation under the FSMA.

2.6 Engaging in regulated activities in the UK, or purporting to do so, without being authorised by the FCA (and where applicable by the PRA also) or exempt under the FSMA is a criminal offence under section 23 of the FSMA, punishable by imprisonment, a fine or both. An unauthorised person has a defence if they can show that they took all reasonable precautions and exercised all due diligence to avoid committing the offence.

2.7 The Financial Services and Market Act 2000 (Regulated Activities) Order 2001, as amended (the RAO), a piece of secondary legislation that supplements the FSMA, sets out the activities that are regulated activities in the UK and the types of investments that are specified investments. If a person engages in a regulated activity in the UK in relation to a specified investment, that person is required to be regulated by the FCA (and where applicable, the PRA) unless an exemption applies.

The financial promotion restriction

2.8 Under section 21 of the FSMA (the 'Financial Promotion restriction'), no person may communicate an 'invitation or inducement' to engage in investment activity in the course of business (a 'Financial Promotion') unless (i) the person making the communication is an authorised person (i.e. one that is authorised by the FCA and where applicable by the PRA also), or (ii) the content of the communication is approved by an authorised person, or (iii) an exemption under the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the FPO) is available to the person making the communication. A Financial Promotion can be written or oral.[14]

2.9 Breach of section 21 is a criminal offence under section 25 of the FSMA. But a person has a defence if they reasonably believed that the content of the communication was prepared or approved by an authorised person or took reasonable precautions and exercised due diligence to avoid breach of section 21.

4 Are property bonds specified investments under the FSMA?

2.10 The DfT and HS2 Ltd would only have to comply with the FSMA if property bonds are 'specified investments' under the FSMA. The RAO lists those investments that are governed under the FSMA (see Schedule 1). We consider below the two categories of specified instruments that property bonds could potentially fall into: (i) government and public securities and/or (ii) options.

Government and public securities

2.11 Government and public securities are specified investments under Article 78 of the RAO. Broadly, this covers public sector debt, including loan stock, bonds and other instruments creating or acknowledging indebtedness, which are issued on behalf of any government, regional assembly or international organisation (e.g. gilts or US treasuries)[15].

2.12 While property bonds do not necessarily fall within the category of conventional loan stock or bonds, they could be caught by the general category of "other instruments creating or acknowledging indebtedness", which captures a broad range of other instruments. The RAO provides a definition of 'instruments' – "any record whether or not in the form of a document". [16]

2.13 The RAO does not provide a definition as to what is or amounts to 'indebtedness' for the purposes of Article 78 of the RAO, so the interpretation of that term is a question of common law. English common law does not have a standard definition of 'indebtedness', but commentary[17] in relevant case law and

[14] FSMA section 21(3).
[15] Instruments mentioned in Article 77 of the RAO *(Instruments creating or acknowledging indebtedness)* are excluded from this category. Chapter 2.6.11 of the FCA's Perimeter Guidance (**PERG**) provides that *"an instrument cannot fall within both categories of specified investments relating to debt instruments"* (i.e. Article 77 or Article 78 instruments).
[16] See RAO para 3(1).
[17] See Schedule 2.

other UK legislation suggests that a three-element test should be applied to establish whether a debt is in fact in existence:

1. the debt must be an identifiable sum;

2. the debt must be payable at an ascertainable date;

3. the liability to pay should be certain.

Under this test property bond instruments themselves do not appear to be 'instruments creating or acknowledging indebtedness'. Arguably a debt would not arise until an eligible property owner has exercised their right to require the DfT to purchase their property, and the DfT has entered into a property contract with the purchaser, which would confirm the amount owed (the protected value) and when such indebtedness would be due and payable. That property contract would not be considered to be a financial instrument regulated under the FSMA because it is a contract for the purchase of real property.

2.14 A debt obligation would only arise between the DfT and the eligible property owner in the unlikely event that the DfT failed to meet its obligation under the property contract with the purchaser to complete the conveyancing transaction. Such an obligation creates a contingent liability rather than indebtedness.

2.15 Therefore, in our view, property bonds would not constitute government and public securities under Article 78 of the RAO.

2.16 The analysis above may be subject to challenge, and differing interpretation, and ultimately the determination would be a matter for the courts of England and Wales to determine whether the property bonds would amount to the type of indebtedness governed under the FSMA and the RAO.

Options

2.17 Article 83(1) of the RAO provides that options to acquire or dispose of certain financial instruments amount to specified investments for the purposes of the FSMA.

2.18 The eligible property owner would receive an option to require the DfT to purchase their property. Options to acquire real property (e.g. a domestic residence) do not fall within types of options covered under Article 83(1).

2.19 Therefore, property bonds would not amount to the option type of specified investment under Article 83 of the RAO.

5 Would the activities relating to promoting and issuing property bonds be regulated?

3.1 In our view, because property bonds are not 'specified investments' for the purposes of the FSMA, the activities relating to their promotion, issuance, sale and execution would not be regulated under the FSMA and the RAO.

3.2 Therefore, approval from the FCA to carry on regulated activities in the UK would not be required for:

- the DfT to issue property bonds, and

- HS2 Ltd to provide various administration services (including promoting the scheme) in connection with a property bond scheme.

But we note that if property bonds were found to be specified investments under the FSMA, the requirements mentioned above in relation to regulated activities and financial promotion would apply.

Therefore, this issue should be kept under review if the proposed structure of a HS2 property bond scheme or the characteristics of the financial instruments employed in it change.

Schedule 1

Specified investments

The following investments are specified investments under the RAO for purposes of the FSMA:

1. Deposits;
2. Electronic money;
3. Rights under a contract of insurance;
4. Shares or stock of anybody corporate (wherever incorporated) or unincorporated body constituted under the law of a country or territory outside the UK;
5. Instruments creating or acknowledging indebtedness, including debentures, debenture stock, loan stock, bonds, certificates of deposit, or any other instrument creating or acknowledging indebtedness;
6. Alternative finance investment bonds;
7. Certain Government and public securities;
8. Instruments giving entitlement to investments, including warrants or other instruments entitling the holder to subscribe for any type of specified investment;
9. Certificates or other instruments representing securities, which confer contractual or property rights;
10. Units in a collective investment scheme;
11. Rights under a pension scheme;
12. Greenhouse gas emissions allowances;
13. Certain types of options;
14. Certain types of futures;
15. Contracts for differences;
16. Lloyd's syndicate capacity and syndicate membership;
17. Funeral plan contracts;
18. Regulated mortgage contracts;
19. Specified benchmarks;
20. Rights to or interests in investments;
21. Regulated sale and rent back agreements.

Schedule 2

English common law sources as to what constitutes 'indebtedness'

There is no one standard definition of 'indebtedness' or what constitutes a 'debt' in English law. It is therefore necessary to look to English common law and UK legislation:

- "... a debt is a sum of money due by certain and express agreement..."
  - *Source: Blackstones Commentaries*
- " ... a debt is a sum of money which is now payable or will become payable in the future by reason of a present obligation ..."
  - *Source: Webb v Stenton (1883) 11 QBD 518*
- "the debt ... is for a liquidated sum payable.... either immediately or at some certain future time....."
  - *Source: Insolvency Act 1986 s267(2)(b)*
- In the Marren (Inspector of Taxes) v Ingles case [HL, 1WLR 1980 at 983], the House of Lords set out the criteria of what would <u>not</u> be a debt:
  - Lord Wilberforce stated that: " *...No case was cited, and I should be surprised if one could be found in which a contingent right (which might never be realised) to receive an unascertainable amount of money at an unknown date has been considered to be a debt ...*"
  - Lord Fraser Stated that: " *... the word debt ... does not apply to ... a <u>possible</u> liability to pay an <u>unidentifiable</u> sum at an <u>unascertainable</u> date. The words to which I have added emphasis bring out the three factors of this obligation which cumulatively prevent it being a debt ...*"

A.3. Observations on transmission situations

The following document entitled ‘Property Aspects to Consider’ attached at A4 sets out at section 2 (Transmission Situations) a range of potential property transmission situations, and details considerations as to whether a property bond would continue to benefit successors in title. This document has been updated to reflect discussions in workshops with the DfT and HS2 Ltd. However, there are a number of issues that we would like to draw to your attention:

1. Houseboats/Caravans

We have considered how houseboats and caravans should be dealt with. These would be outside the anticipated eligibility criteria. However, they can be primary residences. Although their nature as moveable items suggests that they would be less affected by construction of HS2, it is conceivable that there may be situations in which an owner in the affected area would need to relocate, and would have difficulty in finding new moorings or a site for a fixed caravans. We have suggested that, if there are any such cases, these would be dealt with under a separate discretionary scheme e.g. exceptional hardship.

2. Shared ownership leases

The scheme would need to deal with shared ownership leases. These leases allow an occupier to share ownership with a housing association, and often provide that the owner can acquire further equity at market value. This can ultimately result in a transfer of the freehold or the grant of a new lease, once all the equity has been acquired (under ‘staircasing’ provisions). The Council of Mortgage Lenders has noted to us that this is an area that needs to be expressly dealt with as part of a property bond scheme.

The scheme should be drafted so that these leases are covered by a property bond, provided that they meet the other qualifying criteria.

We had considered whether there should be mechanisms to ensure that the bond only protects the value of the share of equity held by the occupier. However, it was considered that such mechanisms would be overly complicated, especially as they would be overlaid onto contractual provisions in the lease relating to assignment. For example, the standard leases that are used by the Homes and Communities Agency provide that:

(a) in the case of shared ownership leases of a house, where the sale of the house has occurred before full staircasing has occurred, the purchaser may be required to buy the rest of the equity (“back to back staircasing’);

(b) the occupier of a shared ownership house may notify the landlord of an intention to sell, and the landlord may appoint a nominee within a fixed period;

(c) there are restrictions on the assignment of shared ownership flats. These can apply from the date of grant up until the expiry of 21 days from final staircasing. The leaseholder is to give notice to the landlord that it wishes to sell or assign its lease. In such circumstances the landlord can require that the leaseholder surrenders the lease, or assign it to a person nominated by the landlord. This would be at a price that is no more than the market value of the leaseholder’s equity share of the property.

The bond scheme should not interfere with the mechanisms in such leases to deal with pre-emption and nomination; the DfT could not operate as a purchaser of last resort in such circumstances, which would not constitute open market sales in any event. However, if the property is offered for sale in the open market – which may occur with a shared ownership house, or if the nomination process does not result in an offer or a transfer within a set period – then the bond scheme should apply. This could mean that the housing association ends up benefitting from the existence of a bond. The DfT would be the purchaser of last resort at the protected value, which could ultimately enhance the level of payment due to the housing association in respect of its equity share. This would (together with the exercise of powers of sale by mortgagees in certain situations) be an exception to the principle that the bond only protects owner-occupiers.

If final staircasing has occurred and any restrictions on assignability have fallen away, then the bond scheme would operate in the normal fashion for the leasehold interests (or for any freehold interest that can be acquired on final staircasing).

It should be noted that, if there is a blight effect from the construction of HS2, then housing associations could be placed at a disadvantage if occupiers could acquire equity at blighted prices. However, it would be difficult for the scheme as presently conceived to underwrite the value of such equity shares, as there would be no purchaser of last resort – the only party that could acquire the equity stake would be the occupier. If this is a concern, then the matter could be looked at in the context of other compensation schemes.

3. Sales of part

Several options have been considered for dealing with sales of part. In general, it was considered that it would be undesirable to allow a property bond to be called on an unlimited number of times for sales of part of a property. If the scheme simply allowed claims on a pro rata basis for every disposal of part, then the system could be subject to abuse. A property owner could call on the bond repeatedly in respect of small strips for which there was no real market, forcing the DfT to gradually acquire a property. The bond scheme has also been designed to protect dwellings of owner occupiers that could be affected by HS2, and not (for example) to underpin the value of potential development land in large plots. Several options were considered:

- A property bond could exclude sales of part, and would only apply if the whole of the property was being sold. It would only be capable of transmission to a party that acquired the whole of the property. This would have the benefit of clarity and ease of administration. However, it could mean that (for example) small transfers of boundary strips between neighbours would result in a property bond terminating in respect of the balance of the property, out of which the strip was transferred. This is a potentially undesirable outcome, and there could be wider implications on the property market. If sales of part result in the loss of the protection offered by the bond, then such sales would become unattractive, potentially making it difficult for parties to 'downsize' or release development potential. This option was discounted.

- A property bond could be exercisable if part of a property was being marketed, but the scheme administrator would only acquire the whole of the property that is subject to a property bond. This would prevent parties trying to remain in occupation while calling on the scheme by making disposals of surplus parts of their land. However, it was discounted on the basis that it could result in parcels of land being acquired by the scheme administrator, which were larger than the area being marketed, extending the liabilities under the scheme.

- A property bond would continue for the benefit of successors in title if there were disposals of part, but could only be exercised once. If called on, it would only relate to the value of that parcel alone, and would then fall away. There would be no restriction on the type of land that could have the benefit of the bond. This option was discounted on the basis that it would no longer be seeking to link the bond to a parcel of land that included a dwelling of an owner-occupier.

- The last option was a modified version of the proposal above. A property bond would continue for the benefit of successors in title if there were disposals of part, but could only be exercised once. It would only protect '*the part of the property that contained the dwelling*'. This is the option that has been suggested for the bond scheme.

We had also considered how the bond should deal with a situation where a dwelling itself is divided by transfers of part. This could happen if, for example, habitable outbuildings or parts of larger buildings were disposed of.

This could be dealt with by permitting new bonds in respect of each of the parts of the dwelling that was formerly in common ownership. However, this would involve the creation of bonds in respect of new freehold/leasehold interests, which would not be consistent with the aims of the scheme. If such a proposition was accepted, then logically the scheme should also protect a number of other scenarios, including the division of larger properties into a number of flats after the qualification date.

The solution that would appear appropriate would be for the bond to continue, but only in respect of the 'retained land'– i.e. the part that is kept by the party who was the owner/occupier of the whole of the dwelling before the transfer.

4. New buildings constructed after damage or destruction

There may be circumstances where a property that is subject to a bond is destroyed (other than by a conscious act) and is subsequently reinstated in a substantially different form.

A property bond should continue if a property was reinstated in exactly the same form as before. However, it is unlikely that this would be the case in practice. We have already noted that a property bond scheme should not discount alterations or improvements. It would be consistent with these principles for the bond to relate to the value of the property as at the point that it is called upon, regardless of what has been built on it following a fire or other event.

It should be noted that if a property bond continued to run and applied to new buildings of a considerably higher value, then there is a potential for liabilities under a property bond – ultimately borne by the taxpayer – to increase considerably. Equally, liabilities under the bond could fall if the new buildings were of a lower value.

The alternative – for a property bond to protect the value of the land had the buildings not been damaged or destroyed – comes with a number of challenges. There could be an evidential issue in determining what the value would have been prior to the damage or destruction. The scheme would also need to detail when such mechanisms would apply. The most obvious trigger – for the reinstated buildings to be substantially different to what was there before – could be open to considerable differences of interpretation, and potentially result in disputes between the landowner and the scheme administrator. The alternative could also introduce uncertainty into the level of the protection offered by the scheme, which might undermine the role of the bond in underpinning the market.

A.4. Transmission situations

HS2: Property bond

Property ownership and transmission situations

1. Property ownership and rights over property

Interest in Land/Rights affecting land	*Interest protected by the bond (Y/N), subject to satisfying qualifying criteria*[18]	*Comments*
Freehold	Yes – for residential property and business interests which would otherwise qualify for blight compensation	• Unregistered freehold land should be subject to a requirement for registration at the Land Registry to qualify for a property bond, at the cost of the owner. • Limit the scheme to owner-occupiers as at the qualification date. • Business interests whose rateable value does not exceed £34,800 (in line with blight compensation under Part 1 of the Land Compensation Act 1973).
'Residual' Freehold following enlargement of a lease	No	• Section 153 of the Law of Property Act 1925, enabling enlargement of certain long leases to a freehold interest. Under the current Land Registry policy, the Registry leaves the original landlord's title open following a tenant's application, and creates a new, second title number for the freehold interest granted to the tenant. The original landlord's title should be outside of the scope of a property bond; it would not, in any event, fall within the owner/occupier criteria.
'New' Freehold following enlargement of a lease	Yes, depending on timing	• New freehold granted to a tenant following a section 153 application • If the freehold title is created prior to the qualification date, then it could qualify for a property bond, subject to meeting the other qualifying criteria. • If a property bond is issued in respect of a leasehold interest that is subsequently the subject of an enlargement application, then the bond should transfer to the new freehold (this could be limited to the value of the original lease, although in practice there may be little difference in value). This would happen following registration at the Land Registry and an application to the scheme administrator, who would place a notice on the new title.

[18] i.e. Qualification of being within agreed boundary; owner-occupier as at the qualification date of March 2010

Interest in Land/Rights affecting land	*Interest protected by the bond (Y/N), subject to satisfying qualifying criteria*[18]	*Comments*
Leasehold: Term of 7 years or more (Residential)	Yes	• Although the qualificati0n criteria could refer to the amount of the unexpired term as at the qualification date (in addition to the length of the whole term), it is considered that this is unnecessary as there would be a declining value for the property interest protected by a property bond towards the end of the term. • Unregistered leasehold land should also be subject to a requirement for registration at the Land Registry to qualify for a property bond, at the cost of the owner. • The term of 7 years or more is intended to cover registerable interests, so that a property bond can be recorded by way of a restriction at the Land Registry. • Only leases granted before the qualification date should be included (save in the circumstances detailed in respect of an 'Agreement for Lease' below).
Leasehold: Term under 7 years (Residential)	No	• Excluded from the operation of the bond scheme, for the reasons above. It is considered that there would be little value in shorter leases.
Leasehold: Commercial	See comments	• A property bond scheme should apply to commercial premises where the rateable value is less than £34,800 (in line with the provisions of Part 1 of the Land Compensation Act 1973 relating to blight), provided that the leases are over seven years in length. • Lease renewals under the Landlord and Tenant Act 1954 which are concluded after the qualifying date are to be excluded, on the basis that (a) these are new interests and (b) the rent under the renewal lease should reflect the presence of HS2. • New leases granted to a former tenant or guarantor under section 19 of the Landlord and Tenant (Covenants) Act 1995 after the qualification date should be excluded from the bond scheme • Only leases granted before the qualification date should be included (save in the circumstances detailed in respect of an 'Agreement for Lease' below).
New lease issued following surrender or regrant?	No	• See comments below regarding lease extensions, where a new lease is granted in accordance with statute (i.e. Leasehold Reform, Housing and Urban Development Act 1993). • There are other situations where a surrender and regrant may occur in relation to a lease that has the benefit of a property bond. This can happen expressly, or there can be a deemed surrender and regrant (for example, if the term or the demise were extended). The Land Registry would issue a new title

Interest in Land/Rights affecting land	*Interest protected by the bond (Y/N), subject to satisfying qualifying criteria*[18]	*Comments*
		number in such circumstances. These should not be covered by a property bond, as these would be new interests in land created after the qualification date. Their inclusion would also open up the possibility of abuse of the system, as parties could seek to extend the duration of the protection offered under the scheme. It is acknowledged that some parties may enter into a deed of variation in ignorance of the fact that it would form a surrender and regrant, although (a) a warning as to the consequences of doing so can be built into the documents that are to be provided to any applicant for a property bond, and (b) any party entering into such a deed should rely on independent legal advice as to the consequences of their actions. • Any bond issued in relation to the old lease should automatically terminate on a surrender and regrant.
Agreement for lease: (a) to grant a residential lease, or a qualifying commercial lease, in either case for a term over 7 years; (b) entered into prior to qualification date,[19] but which was not completed prior to the qualification date	Yes	• Parties may have entered into a conditional agreement to grant a lease, for example in the context of potential development of land – e.g. the grant of the lease is conditional on the grant of planning, construction obligations, etc. • Leases granted under such arrangements after the qualification date **should** be included in the scheme once they are registered • Variations to the agreement for lease which are entered into after the qualification date, and which would have the effect of bringing leases into the qualification criteria, should be disregarded.
Reversionary lease	Yes	• A lease that takes effect when the term of an existing lease has expired (NB void if it is granted for a term that would not begin for more than 21 years after the date of the lease) – these can qualify for a property bond, provided that other qualifying criteria are met. A lease of the landlord's interest, which is itself subject to a lease, would not be included in the scheme, as it would fall outside of the owner-occupier test. • The grant of a lease that takes effect in possession more than three months after the date of the grant is compulsorily registerable. • An initial lease and any reversionary lease granted prior to the qualification date to the same parties should be considered as being an aggregated 'term' when determining eligibility for a property bond, which would be registered against the title numbers

Interest in Land/Rights affecting land	Interest protected by the bond (Y/N), subject to satisfying qualifying criteria[18]	Comments
		for all the relevant leasehold interests. • Reversionary leases granted after March 2010 would be excluded from the operation of the bond. • The terms of the property bond scheme can also expressly state that reversionary leases taking effect a certain period after the commencement of the scheme would not be capable of protection by a property bond. The timeline of the construction of the railway should be ascertainable when the scheme is established; it would therefore be unnecessary to include in the scheme reversionary leases which took effect after (say) a year after the projected opening dates for the scheme.
Leasehold: Tenancy at will	No	• Insufficient interest for inclusion in scheme. Not transferable.
Farm business tenancy	No	• I.e. a tenancy that was created under the Agricultural Tenancies Act 1995, where the character is wholly or primarily agricultural. • No blight/effect from HS2 • NB freeholds/long leasehold interests which include farm dwellings would qualify under the criteria set out above.
Licence to occupy	No	• Insufficient interest for inclusion in scheme. Does not confer interest in the land that can be transferred
Periodic tenancy	No	• Insufficient interest for inclusion in scheme
Easements	No	• Compensation for the effect of HS2 on the operation of easements is outside the scope of the property bond scheme.
Mineral rights (including mining leases)	No	• Outside scheme – no blight/effect from HS2. • Fracking rights excluded on the same basis.
Manorial rights	No	• I.e. rights retained by the lord of the manor when former copyhold property became freehold, such as sporting and mineral extraction rights. • No blight/effect from HS2.
Entitlement to chancel repair payments	No	• No blight/effect from HS2.
Rent charge	No	• Constitutes a legal interest in land – section 1(2) of the Law of Property Act 1925. • No blight/effect on value for the party with the benefit of the rent charge. • Situations where a rent charge can be created are now limited following the Rent Charge Act 1977 (new creations are mainly estate or statutory rent charges). • It is possible for a party with the benefit of the rent charge to have a right of re-entry, which could result

Interest in Land/Rights affecting land	*Interest protected by the bond (Y/N), subject to satisfying qualifying criteria*[18]	*Comments*
		in the land subject to the rent charge being forfeited (this could potentially trigger a transfer of property, with the benefit of a property bond, to the rent charge owner).
Profits à prendre	No	i.e. rights for: • The removal of part of the land itself, for example, soil or minerals. • Taking something growing on the land, such as, timber, turf or grass. This includes 'taking' by animals, for example, a right to graze sheep or pasture cattle • The killing of wildlife living on the land, for example, hunting and fishing rights. • No blight.
Options	No	• I.e. put/call options. Only relevant to a property bond if there was a transfer of land following the exercise of the option, in which case a property bond would transfer with the land (although there should be a notification requirement to the scheme administrator). The value of the right contained in the option itself would not be protected by a property bond.
Right of pre-emption	No	• If the right of pre-emption was exercised, any property bond would transfer with the land. The value of the right itself would not be protected by the bond.
Commonhold	See comments	• A form of freehold, albeit one with additional registration requirements at the Land Registry. There has been, to date, low levels of adoption of commonhold structures, and there may not be any affected by the property bond scheme. • The common parts would be registered in one title, with each individual unit registered in a separate title. Any title for the 'common parts' would not be eligible for a property bond, although individual residential units could be.
Caravan Sites/Moorings/Houseboats	No	• The right to moor a boat, or ownership of a static caravan, would not be considered a qualifying interest in land for the purposes of the bond scheme. • Caravan parks, which are run as a business, would not fall under the owner/occupier criteria. • The exclusion would be consistent with other schemes – mobile homes/caravans would be unable to serve a blight notice under Part 1 of the Land Compensation Act 1973.

Interest in Land/Rights affecting land	Interest protected by the bond (Y/N), subject to satisfying qualifying criteria[18]	Comments
		• It is appreciated that there is a potential for a static caravan or boat to be a main residence, and hence subject to council tax. However, the moveable nature of such items would indicate that they should be excluded from the property bond scheme. • It is suggested that any specific cases of hardship relating to caravans and houseboats is dealt with as part of a separate discretionary scheme – there is precedent for this in the powers in section 20A of Part II of the Land Compensation Act 1973, together with the Regulations set out in the Highways Noise Payments and Movable Homes (England) .Regulations 2000 (SI 2000 No 2887) as amended by SI 2000 No 3086 and SI 2001 No 1803 (in Wales the Highways Noise Payments and Movable Homes (Wales) Regulations 2001 (SI 2000 No 604)). This would cover exceptional circumstances – for example, a party may have a caravan that is their principle residence, but could experience difficulties in finding alternative sites.
Charge	See comments	• A property bond would attach to the property, rather than the charge itself. • We have suggested that consideration should be given as to how a property bond would operate if a power of sale was exercised. Payments should, in those circumstances, be made in priority to holders of the charge. • The above assumes that the mortgage is made to owner-occupiers. A property bond should not apply if a power of sale has been exercised under a buy to let mortgage.
Charging order	No	• Payments should be made in priority to a judgment creditor if an order for sale is obtained, and a property bond should reflect this.

2. Transmission situations

Transmission (other than in connection with a charge)

Event	*Bond continues?*	*Comments*
(A) Transmission (other than in connection with a charge)		
Open market sale of whole to unconnected party	Yes	• The seller is free to market the property at any point during the lifetime of a property bond. If a sale is concluded in the open market without a property bond being called on, then a property bond will continue until the end of the scheme.
Property sold to party other than the DfT following a call on a property bond and marketing by the scheme administrator	See comments	• A property bond should continue if the property has been sold in the open market following the bond being called on at a level equal to or above the protected value.
Property sold to the DfT	See comments	• The DfT can market with or without a property bond, at the discretion of the DfT.
Transfer to connected party (for value)	See comments	• If there is a transfer to a connected party and there has been no prior claim under the property bond, successors should have the benefit of a property bond.
Sale of part	See comments	• We have considered the question as to what should happen if only part of the land that is the subject of a property bond is sold in the open market . • There are several options for dealing with such a scenario: a) the bond could not be called on in relation to a sale of part of a property, but could be called on in relation to a sale of the whole. The bond would terminate if there was a disposal of part, and would not continue for successors in title. b) a property bond could continue for the benefit of successors in title, but on the basis that there could only ever be one claim in respect of a bond if it was sold in parcels. The value of any claim under a property bond for a disposal of part would be the market value of the part that was the subject of a claim under the bond. There would be no restriction on which part of the property the bond would continue to protect (e.g. the grounds or the dwelling). c) a property bond could continue for the benefit of successors in title if there were disposals of part, but on the basis that it would only protect the part containing the **dwelling** that the property bond attached to. There would only be one claim permitted in respect of a property bond Option (c) is, for the reasons set out below, the preferred option. • It could be argued that excluding transfers of part from the operation of a property bond altogether is consistent with the basis of the scheme, which seeks to guarantee the value of the whole extent of specific land holdings that existed as at the qualification date • However, it is acknowledged that there may be circumstances where parties would want to make transfers of parts of land over the lifetime of a property bond. It may be that owner-occupiers would seek to stay in a house, but allow grounds to be sold off to raise funds. There is also

Event	Bond continues?	Comments
		potential for neighbours to enter into agreements to transfer strips of land. This may be necessary to assist with issues of access, or to facilitate the use of neighbouring land. If a property bond dropped away altogether once any sale of part took place, then such transactions could become more difficult for landowners. There is a possibility that terminating a property bond could lead to distortions in the market – for example, parties would no longer be able to realise value from selling off unwanted gardens for fear of losing the protection of a property bond altogether, meaning only undivided estates would remain marketable. The scheme should therefore introduce some flexibility, to allow a bond to continue in some circumstances if there have been sales of part. • It is not intended that a property bond would apply to multiple disposals of part. Apart from the administrative difficulties of dealing with a fractured land ownership, there would be potential to abuse the system. Owners of larger plots of land could try and maximise revenue by selling in lots, especially if there is potential development value. An owner could also market a succession of small strips which it would be unlikely to successfully sell in the open market, forcing the DfT to gradually acquire the land and make a sequence of payments to the occupier. Moreover, the scheme is intended to protect the value in the dwellings that are owned as the qualification date, a point which is consistent with including a test of owner-occupation to qualify. • The best balance would therefore be appear to be struck by: a) allowing the protection of a bond to continue if there are multiple disposals of part, provided that it only does so in respect of the parcel or parcels of land that contain the dwelling that existed as at the qualification date; b) only allowing a single claim under a property bond if there have been multiple disposals of part. The single claim should only be permitted if the area in respect of which the claim is made contains the whole of the dwelling that existed as at the qualification date. This is subject to the comments below relating to situations where dwellings are divided. • Effectively, this would allow a landowner to make small disposals of land, but still have the benefit of a property bond in respect of the 'main' property. It would also permit sales of parts of the grounds, with a property bond falling away in respect of those areas. This is consistent with a view that sales of such areas would likely be made with the intention of redevelopment; the transfers would create new titles at the Land Registry which were not present at the qualification date. The retained land which had a dwelling on it would still be protected by a property bond, and the protected value would be the value of that 'reduced' plot of land alone • A more complex situation could arise if a landowner tried to split the ownership to a dwelling that was protected by a

Event	*Bond continues?*	*Comments*
		property bond (for example, selling off part of a large structure). In such circumstances, a property bond should continue for the benefit of successors, but only in respect of the part of the land that is retained by the party that previously owned the whole of the dwelling. Allowing the party to whom the part was transferred to benefit from a property bond would extend the scheme to new interests created after the qualification date. • There would be a need to ensure that titles registered at the Land Registry are updated if there is a sale of part. This could be achieved by having a notification requirement on the holder of a property bond to notify the DfT if there are any sales of part. The DfT could then provide a release in respect of the property bond scheme restriction for any parcels of land that were no longer protected by a property bond.
Sale subject to contingent or deferred consideration	See comments	• Such situations open a potential for abuse – a landowner could try and claim on a property bond by arguing that the only open market transaction that it could negotiate involved deferred consideration, depressing the initial transaction value. • This could be addressed in the terms and conditions of a property bond. These could stipulate that, if a property holder indicated that the marketing only produced a deferred/contingent consideration sale, the value of the offer would be deemed to be the maximum aggregated payments achievable under the agreement, including sums payable after completion. The DfT would only be obliged to acquire the property as a buyer of last resort if the aggregate figure was below the protected value. • If there is a sale with deferred or contingent consideration, and no claim has been made under a property bond, then a successor in title should have the benefit of the property bond. However, it should not be able to make a claim under the scheme on the basis that the open market value of the property has been reduced because of ongoing obligations to make payments to its vendor, – i.e. because the contract that the claimant chose to enter into reduces the market value below the protected value.
Exchange	See comments	• Exchanging a property that is subject to blight (and which has the benefit of a property bond) for one that is unaffected – this would essentially transfer the benefit of the property bond to another party . • Likely to be rare in practice, as the value of the other property would need to make the transaction commercially worthwhile.
Grant of leasehold interests out of land that has the benefit of a bond	No	• A landowner could try and realise value by granting a long lease of the whole or part of the property after March 2010. • A property bond will not apply – these would be interests in land created after the qualification date.

Event	Bond continues?	Comments
Exercise call option	Yes	• If a property subject to a property bond is transferred following the exercise of a call option, then the property bond should transfer to the new owner (subject to Land Registry application and the scheme administrator being informed). If the option is only exercised over part of the land, then the comments above (see 'Sale of Part') would apply. • If the option is to call for the grant of a lease, the tenant should be able to obtain a property bond provided that the option was created before the qualification date and the lease met the other qualification criteria. This would be consistent with the treatment of an agreement for lease.
Exercise put option	Yes	• If a property subject to a property bond is transferred following the exercise of a put option, then the property bond should transfer to the new owner (subject to the scheme administrator being informed). If the option is only exercised over part of the land, then the comments above (see 'Sale of Part') would apply. • If the option is to call for the grant of a lease, the tenant should be able to obtain a property bond, provided that the option was created before the qualification date and the lease met the other qualification criteria. This would be consistent with the treatment of an agreement for lease.
Pre-emption right	Yes, but see comments	• No claim under a property bond if an existing pre-emption right is exercised. If the agreed transfer value was below the protected value, it would give the seller a windfall. • The right of pre-emption should be exhausted before a property bond can be called on.
Option to purchase freehold contained in lease	See comments	• If the tenant had an existing property bond, then this would transfer to the new freehold interest. A property bond would only relate to the value/term of the original interest. • There should be no property bond in respect of the 'old' freehold, as the owner/occupier test would not be satisfied.
Merger with superior title	See comments	• Only a property bond for the superior interest should exist going forward (subject to registration of the merger and notification to the scheme operator). This may result in the tenant's existing property bond being transferred to the freehold title (although the protected value would be the value of the leasehold interest pre-merger).
Transfer not for value/gift	See comments	• No claim under a property bond to be allowed at the point of the transfer. Successors in title may claim under a property bond.
Transfer to beneficiary under will	See comments	• If the individual passed away prior to March 2010, and a beneficiary subsequently became an owner-occupier, then it should still be able to apply for a property bond once the transfer has been registered. (NB there are qualifying provisions in section 11 of part 1 of the Land Compensation Act 1973, requiring the property to have devolved before the qualifying date; this could be different to the date of registration).

Event	*Bond continues?*	*Comments*
		• Where there has been a death after March 2010, the benefit of a property bond should pass to beneficiaries and successors in title who satisfy the owner-occupier test. • Applicants who are beneficiaries, but not owner-occupiers, should not be able to apply for a property bond.
Land Registry rectification of title entries	Yes	• If the Land Registry rectifies title entries, such that the proprietor changes, then the benefit of the property bond passes to the new owner following registration with the Land Registry and the scheme administrator.
Land becomes *bona vacantia*	No	• Land which becomes 'ownerless', i.e. estates of persons who die intestate with no relatives; assets beneficially owned by a company that has been dissolved; assets that were the subject of a failed trust. The Treasury solicitor would need to deal with the land, either by disposing or disclaiming it. If land does become *bona vacantia*, the property bond should terminate, as the insolvent party would effectively have little control over the disposal of the property and there would therefore be little issue over a lack of 'fairness'. • The DfT would have the option to subsequently issue a new property bond if an application was made to it. It may wish to do this to prevent the property being marketed at a 'blighted' value.
Escheat	No	• Process by which any ownerless property reverts to the Crown following disclaimer. Any property bond should terminate; the Crown is not, strictly, the successor in title in these circumstances – a new title number would be issued if the Crown subsequently sold the land. • The DfT to have the option to issue a new property bond if an application was made to it.
Land subject to a bond becomes subject to application for adverse possession	No	• The property bond terminates in respect of the land that is the subject of a successful application for the party claiming adverse possession to be registered as proprietor. The party seeking adverse possession would otherwise gain a benefit which it did not have at the qualification date.
Lease – landlord or tenant exercises break clause; other termination events (including surrender)	No	• Property bond terminates.
Divorce – marital property transferred to sole name; split of proceeds on sale	Yes	• E.g. sale of property orders in proceedings for financial orders, which the court may make to adjust the parties' resources and achieve a fair outcome on divorce under section 24A of the Matrimonial Causes Act 1973. The property bond would pass with the property.
Compulsory purchase	No	• Property bond terminates in respect of the area that has been the subject of the compulsory purchase.
Transfer to an insurer	No	• Property bond terminates. Insurer would not be an owner-occupier.

Event	Bond continues?	Comments
Underlease granted for a term that matches or exceeds the length of the residue of the term of the headlease	Yes	• Underlease takes effect as an assignment of the headlease. • Any property bond held by the undertenant would transfer to the headlease, provided that an application has been made to change the register and the scheme administrator is notified.
Lease with perpetual right to renew	See comments	• I.e. if the 'new lease' which is to be granted pursuant to the option is to contain an option to renew the new lease, it could create a perpetually renewable lease, which would be converted into the grant of a lease for 2,000 years (paragraph 5 of Schedule 15 to the Law of Property Act 1922). This could create a situation where a tenant claims that their short lease should qualify for a property bond, by virtue of not excluding an option to renew in the description of the renewal lease. • A property bond should be granted provided that the Land Registry's registration requirements have been satisfied.
Shared ownership leases/Staircasing	Yes	• It is recommended that a property bond should apply to shared ownership leases. In such circumstances, the occupier may only own a portion of the equity, with the balance being held by a housing association. This would mean that the scheme could benefit those associations, who (although not owner-occupiers) would be entitled to a share of the proceeds from such leases. • It is common for shared ownership leases to provide that the occupier can acquire further equity. On completion of 'final' staircasing, there can be mechanisms for the occupier to acquire a new interest, i.e. in the case of a house, acquiring the freehold; in the case of a leasehold interest, the grant of a new lease. • If a property bond has been issued in respect of the shared ownership lease, it should transfer to the new interest/title on final staircasing (subject to registration and notification to the scheme administrator). • NB In many shared ownership situations, occupiers may acquire further equity at market value. The existence of HS2 may mean that housing associations would therefore need to sell equity stakes to occupiers at 'blighted' prices. However, we have noted that the proposed operation of the scheme means that they would be beneficiaries if a property bond was called on – and a property bond would guarantee the protected value, of which the association could be entitled to an equitable share. Further consideration of the effect of this scheme on housing associations is outside the scope of this report. • A property bond could only be called on in respect of sales in the open market. The number of such sales may be limited, as shared ownership leases can provide for pre-emption or nomination provisions if the owner wishes to assign. If these apply, then the owner could not comply with the marketing conditions. A property bond could not be called upon until the owner of the property is able under the terms of the lease to offer the property for sale in the open market (it should be noted that there may be limited

Event	Bond continues?	Comments
		windows for the exercise of such rights, and deadlines under a property bond scheme would need to be considered in light of those periods). • A property bond could not be called on in respect of 'back to back staircasing' (where a purchaser of a leasehold interest is required to acquire the balance of an association's equity stake). • A property bond would continue if the property was sold to a successor nominated by an association under the terms of a lease. A property bond cannot be called on if a purchaser is nominated at a value below the protected value – the leaseholder would be obliged to sell to the nominee under the terms of the lease, and the DfT could not be a purchaser of last resort.
Tenants exercise rights of first refusal under Landlord and Tenant Act 1987 and acquire superior interest	See comments	• Landlord should not have an interest as it is not an owner/occupier – if it does, then the interest should determine. • Property bond in relation to the tenant's interest continues. No new property bond could be created in respect of the superior interest.
Lease extension of a residential tenancy under the Leasehold Reform, Housing and Urban Development Act 1993	See comments	• If the residential tenancy was subject to a lease extension as at March 2010, then the property bond would cover the extended term of the new lease. • A property bond would not continue to apply in respect of lease extensions entered into after March 2010. Tenants may have commenced the process before that date, but would not be bound to accept the new lease – and have the option of restarting the process on the basis of any 'blighted' value.
Enfranchisement: Leases of houses (right to buy the freehold or take a new lease for an additional 50 years) – Leasehold Reform Act 1967	Yes	• Freehold – property bond of the tenant transfers to the new freehold following registration and notification to the scheme administrator. The landlord should not have the benefit of a property bond, but any one in existence would terminate.
Right to buy*:* a secure tenant of a house acquires the freehold pursuant to the terms of the Housing Act 1980 (where the freeholder is the council or one of a number of other public bodies)	Yes	• Property bond issued to the secure tenant transfers to the freehold following registration of the tenant as the new proprietor and notification to the scheme administrator. • Landlord is not an owner-occupier.
(B) Charges		
Exercise of power of sale	Yes	• Property bond works in the same way as a property marketed by a private individual; can be sold in the open market independently, or the party exercising the power of sale could claim under a property bond. • The party exercising the power of sale is to be paid sums under the bond in priority to other parties. • NB If the power of sale is exercised in respect of a buy to let mortgage, then holder of the charge would not be able to make a claim under the property bond.
Mortgage repossession	N/A	• A property bond scheme is only concerned with the sale process.

Event	Bond continues?	Comments
		• It has been suggested that the scheme could incentivise lenders to repossess homes with the benefit of a property bond, as they are aware that they could sell back to the DfT at the protected value as a purchaser of last resort. However, there would not appear to be any viable method of preventing lenders from exercising the powers contained in their mortgages. Moreover, the likelihood of such behaviour is difficult to predict – if the existence of a property bond helped to perpetuate the functioning of a normal property market, the lender could have more confidence that it could find a buyer other than the DfT at any time.
Charging orders	Yes	• If there is an order for sale, then a property bond would work in the same way as a property marketed by a private individual; it could be sold in the open market independently, or there could be a claim under the property bond. • Mechanisms would be introduced to pay judgment creditors in priority to other parties.
Remortgage	N/A	• Property bond continues as before. • Mortgage providers would need to be comfortable with the terms and conditions of the property bond. • No claim under a property bond can be made which derives from a buy to let mortgage.

Other scenarios

Scenario	Affected by the bond?	
Marriages	N	• The property bond is only concerned with the operation of the market on sales, and attaches to the property, rather than the individuals.
Alteration in ownership – Joint tenants/tenants in common	N	• A property bond scheme is only concerned with the operation of the market on sales, and attaches to the property, rather than the individuals.
Change of situation – owner/occupier becomes landlord	See comments	• The party claiming under a property bond should be an owner/occupier at the point of the claim – this could follow the qualifying provisions of Part 1 of the Land Compensation Act 1973. Section 168 of the Town and Country Planning Act 1990 includes a test of 'owner occupiers' and 'resident owner-occupiers' that could be replicated. • The party applying for a property bond would need to make a declaration that they were an owner-occupier at the qualification date. There should be a warning as to the consequences of making a false declaration. This would not invalidate a property bond that has been passed with transmission of the property. However, the original party who made the application could be liable for losses and costs incurred by the DfT in relation to a property bond that should not have been issued. A property bond agreement would provide that the original applicant consents to the scheme administrator, contacting the electoral officer and the local authority (who would have records of council tax payments) if the scheme administrator wished to check any details. • We had considered whether there should be a further test of owner-occupation as at the point when a property bond was called upon. As an example, there could be minimum occupation criteria for the previous year. However, there has been particular concern raised about the potential for injustice in the event of a 'reluctant landlord' – for example a party who has moved for work purposes, but who is still trying to sell the property. In light of concerns over such situations, and the additional administrative burden and delays which would arise with a further test, it is suggested that there is no additional test of occupation as at the point that a property bond is called upon. This does open the possibility that a property bond could protect properties where the owner ran a property rental business at some point during the life of a property bond. It would therefore be prudent to have a requirement that, if the DfT were obliged to acquire a property, it would be transferred with vacant possession. • A property bond scheme would have a requirement for notification on changes of owner. At this point, there could be a requirement for the new owner to declare whether they intend to be an owner-occupier. This, together with a requirement that the DfT (as a purchaser of last resort) would not acquire a property subject to tenancies, would give comfort that the DfT would not acquire property rental

Scenario	Affected by the bond?	
		businesses. This would not prevent a landowner ceasing to be an occupier for a time, letting out a property, and then returning to the property or letting it fall vacant before claiming on a property bond. However, it is considered that attempts to terminate a property bond if a party ceased to be an owner-occupier for a time would potentially be difficult to operate and unfair on a party that returned to occupy a property.
Property vacated	See comments	• The owner may have moved to another property after the qualification date, and be trying to sell. • It would be consistent with the comments above (under 'change of circumstance') for the scheme not to have a test of occupation at the point that a property bond is called on.
Landowner who has received compensation under a bond seeks to buy back the property at a lower price, i.e. it has taken 'gain' out of the property	Y	• We have considered whether the scheme administrator should preclude sales back to a previous owner that has claimed under a property bond. This is a policy decision for the scheme administrator, and would not need to be addressed directly in the property bond – the DfT would have discretion to do so. If a party makes a claim under a property bond, and subsequently tries to buy it back for a 'blighted' price, it would effectively be taking the difference between the two values and ending up back in occupation.

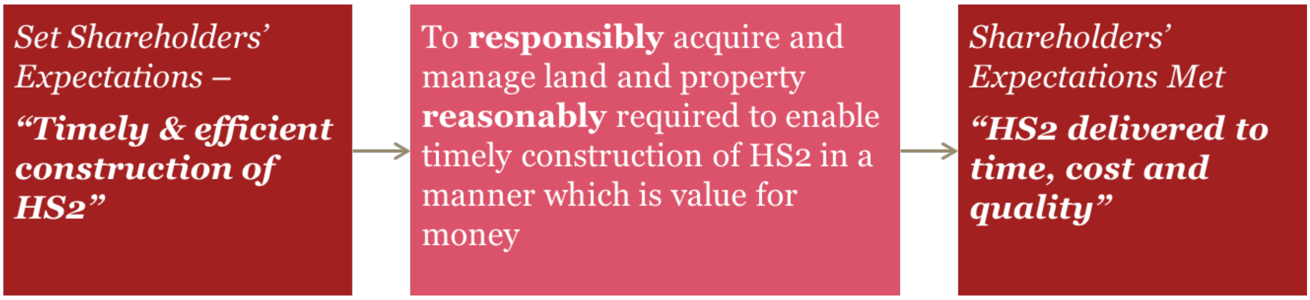
Other issues

Issues	Comments
Common land/Village greens	• Exclude from the property bond scheme.
Property owned by a public body	• Exclude from property bond scheme.
Effect of 'Registration Gap' on LR applications and the qualification process	• It is possible that there may be situations where the register has not been updated to reflect ownership as at the qualification date. The scheme administrator would be able to issue 'late' property bonds on completion of registration, as it is not intended that there is a fixed period for applications.
Amendments to Schedule 4A of the Leasehold Reform Act 1967 made by sections 301 and 302 of the Housing and Regeneration Act 2008	• The Government has, with effect from 7 September 2009 designated over 13,000 small rural settlements as 'protected areas', in which shared ownership homes must remain shared ownership. The Government has also published criteria to apply to any future designation of protected areas. • The Government has passed secondary legislation requiring new shared ownership leases in protected areas to contain: - a restriction limiting the level of equity that can be bought, to 80%, and/ or - a covenant by the tenant to sell the house back to the provider at market value if the tenant wishes to sell (together with a covenant by the provider to buy back the property). - If any properties are affected by these designations (which would need to be checked) no property bond should be issued.
Buildings owned by the National Trust as part of its inalienable estate; Crown properties; cathedral land	• Excluded from the operation of a property bond.
Properties which comprise several title numbers (including a mixture of freehold and leasehold interests)	• Single property bond to be issued.

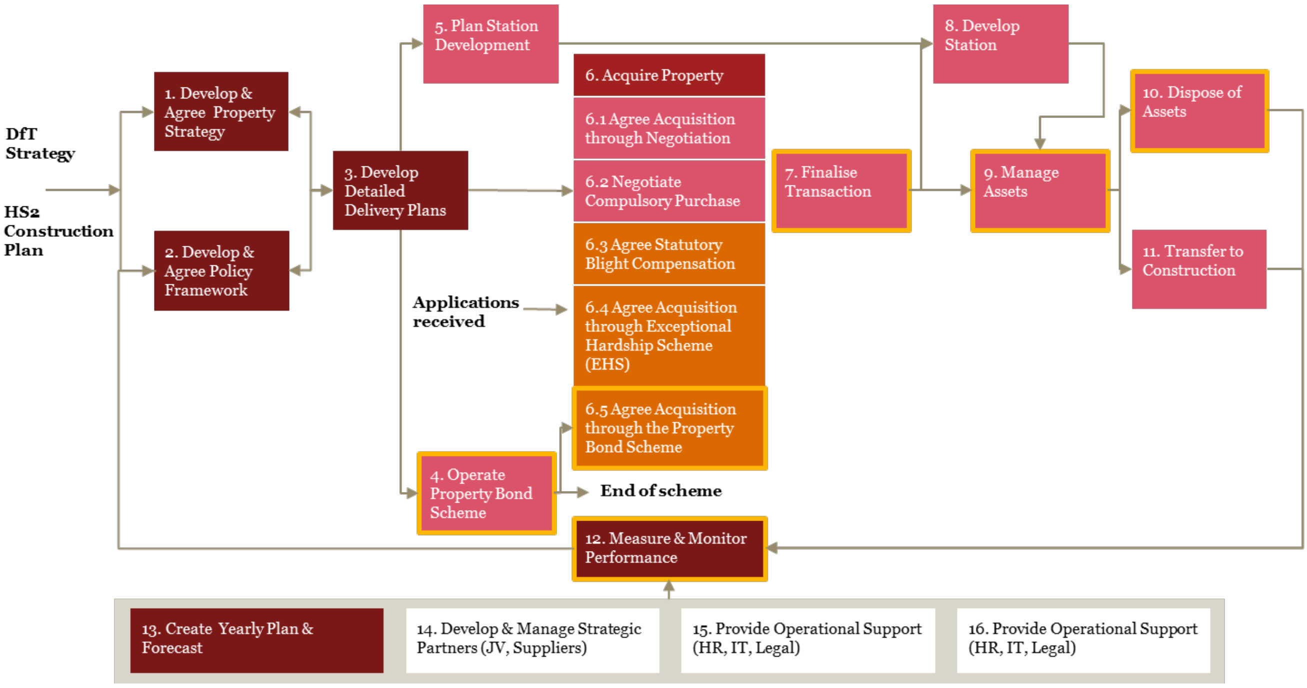
Issues	Comments
Improvements	• A property bond would not exclude any improvements, as it is viewed that property owners should be free to make alterations during the course of the scheme. Improvements that would be notified to a mortgage provider should also be notified to the DfT.
Rebuilding following damage or destruction	• A property bond would cover the value of the rebuilt property, provided that it is still an owner-occupied dwelling. This may result in variations in the protected value, which may be lower or higher than the protected value of the property prior to the damage or destruction.
Property partly within and partly outside the boundary of the scheme	• Land that is partly within the safeguarded area is excluded from the operation of a property bond. • Land which is partly inside and partly outside the outer boundaries of the property bond scheme (but which is not within the safeguarded area) would have a property bond covering the whole of the property.

Appendix B – Processes

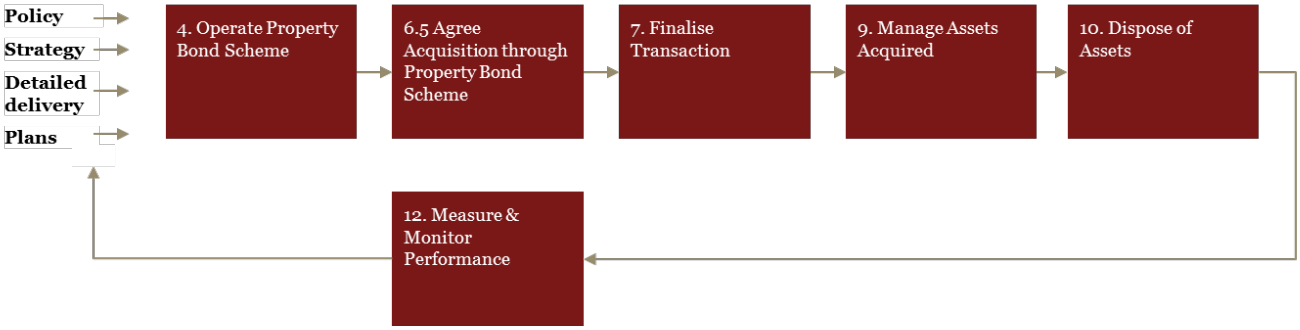
Level 0: Process for HS2 Ltd Land & Property



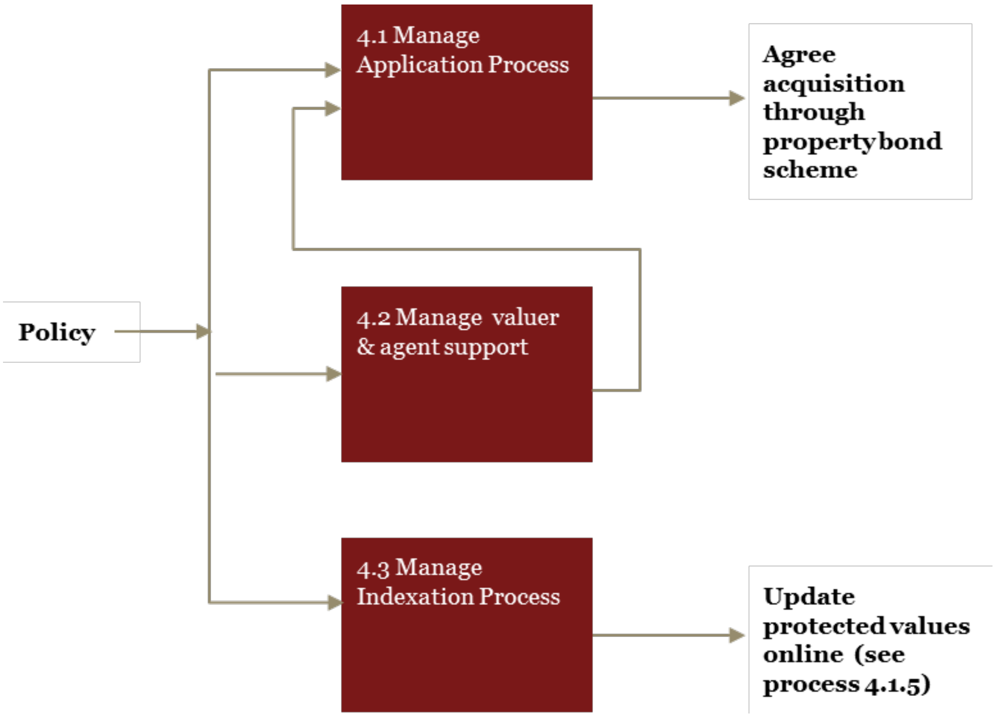
Level 1: Process for HS2 Land & Property



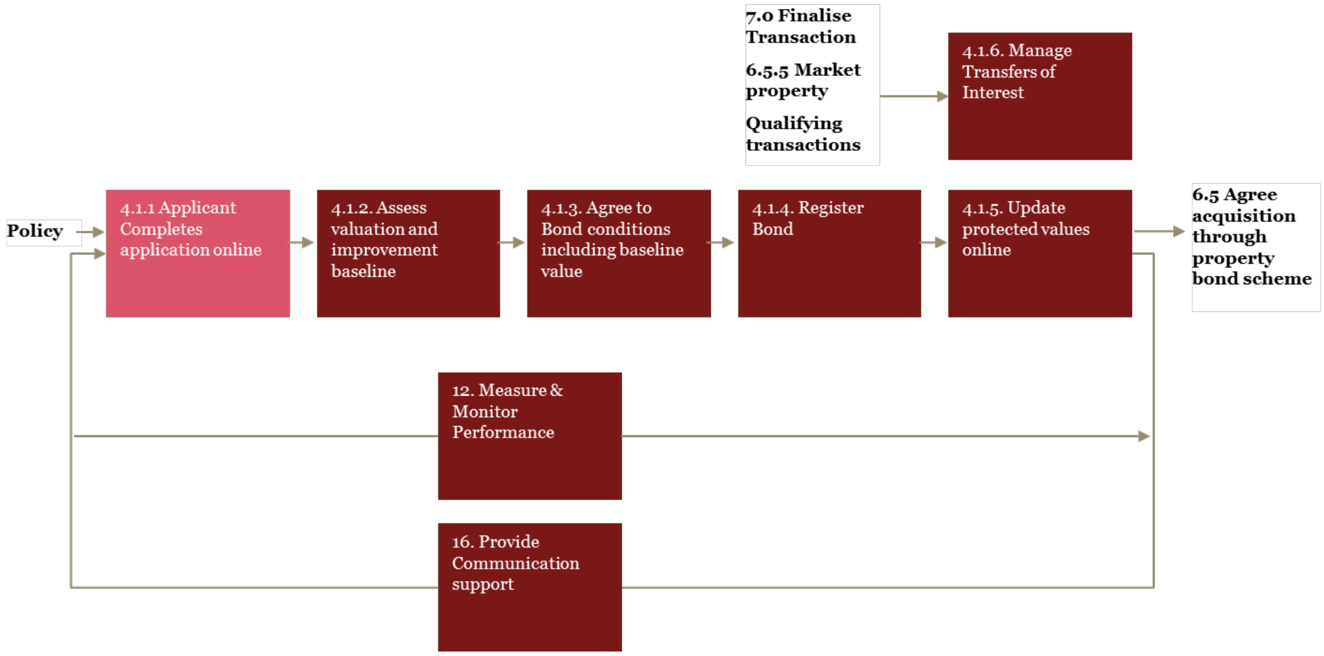
Level 1: Property Bond Process



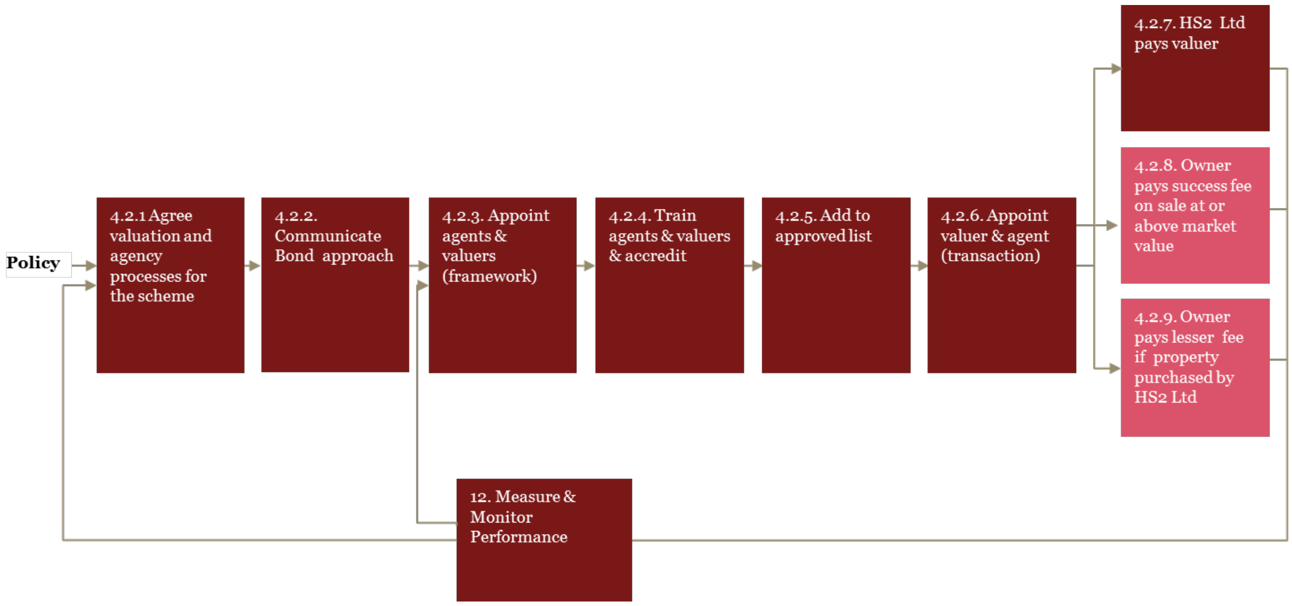
4.0 Operate property bond scheme



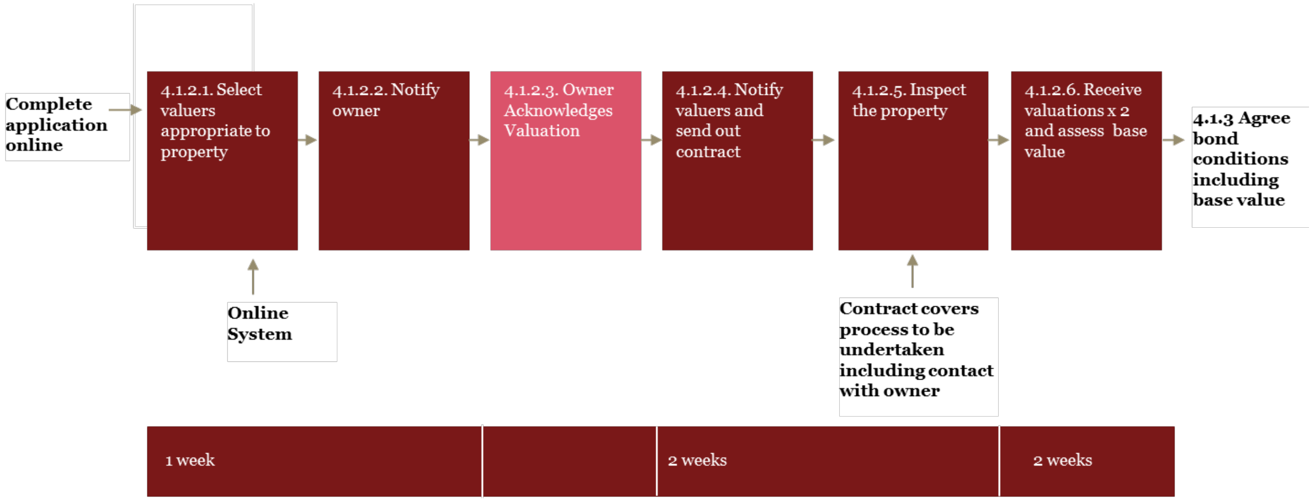
Level 2: 4.1 Manage Application Process



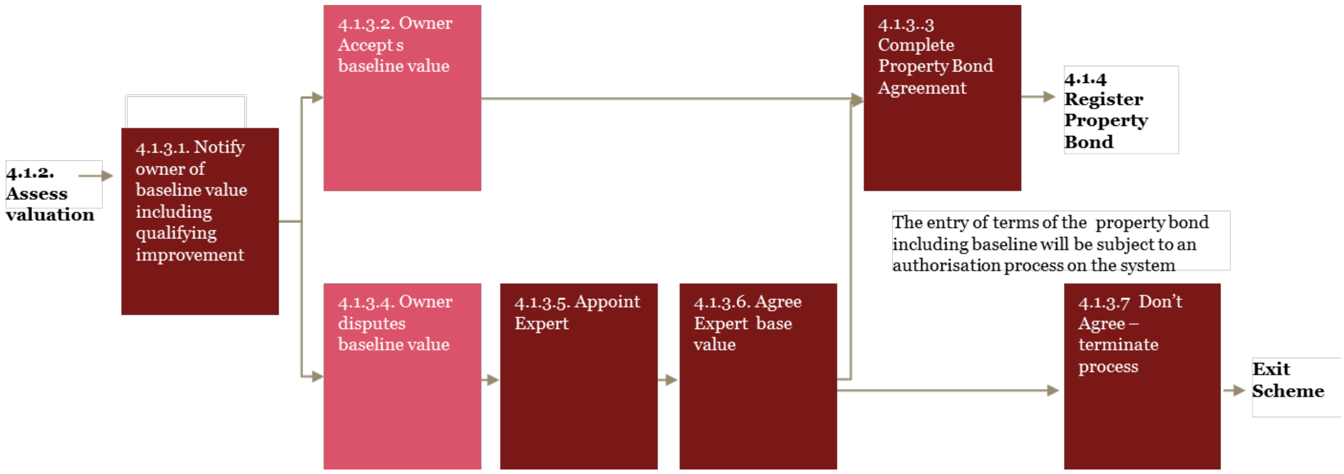
Level 2: 4.2 Manage valuer and agency support



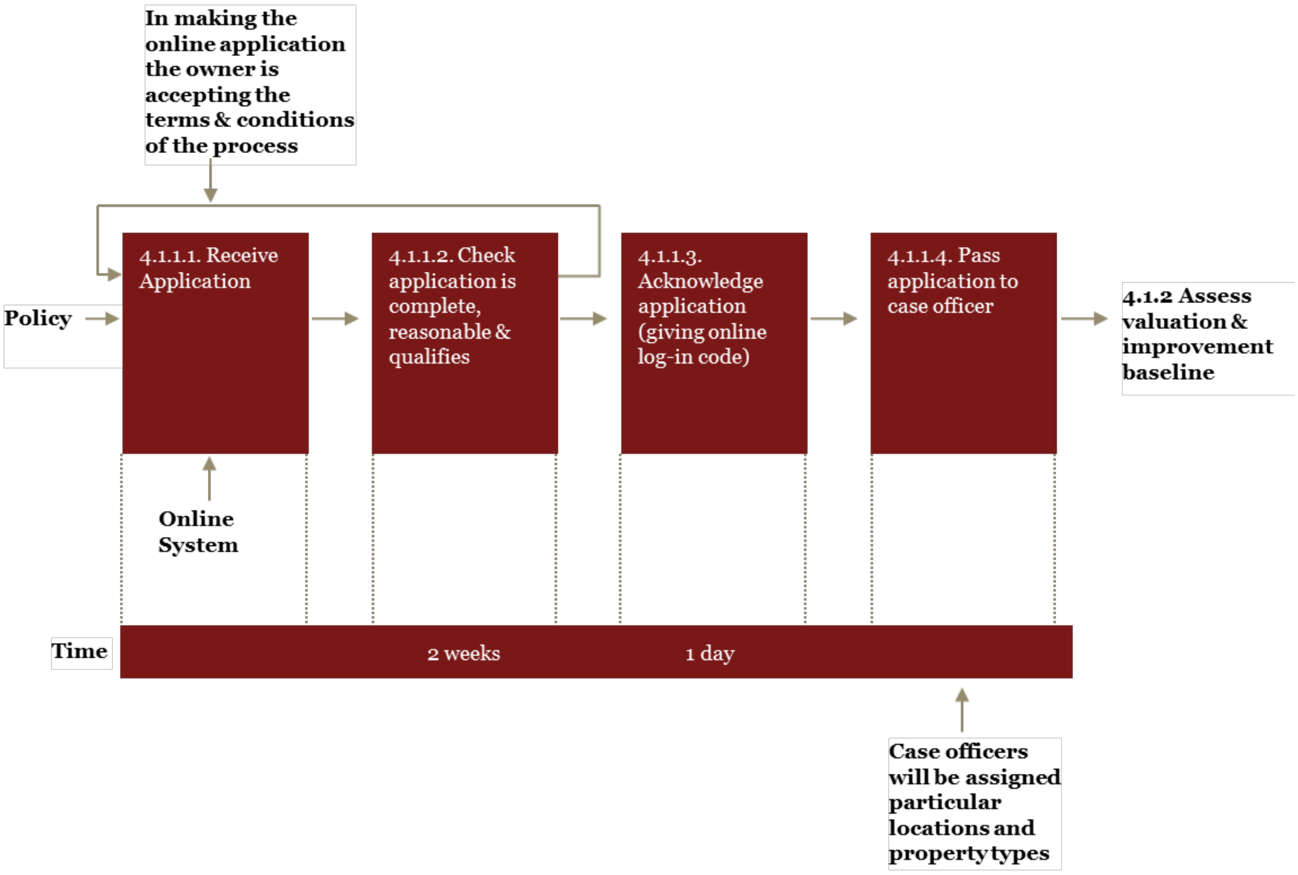
Level 3: 4.1.2. Assess the valuation baseline



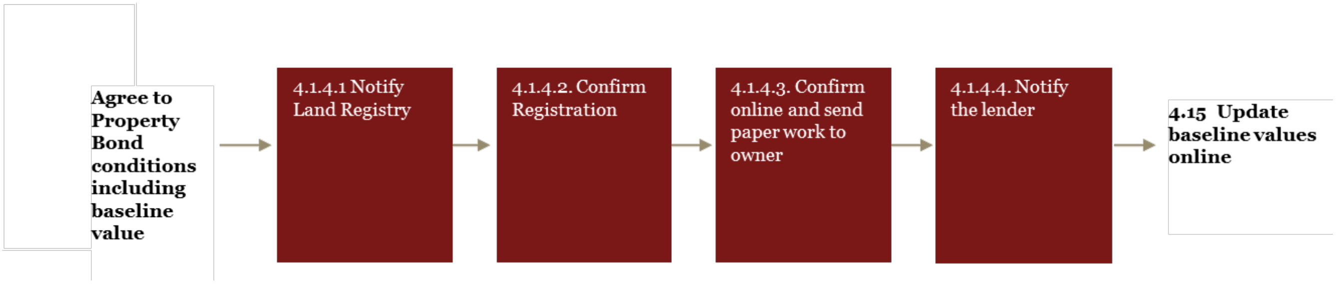
Level 3: 4.1.3 Agree to property bond conditions including base value



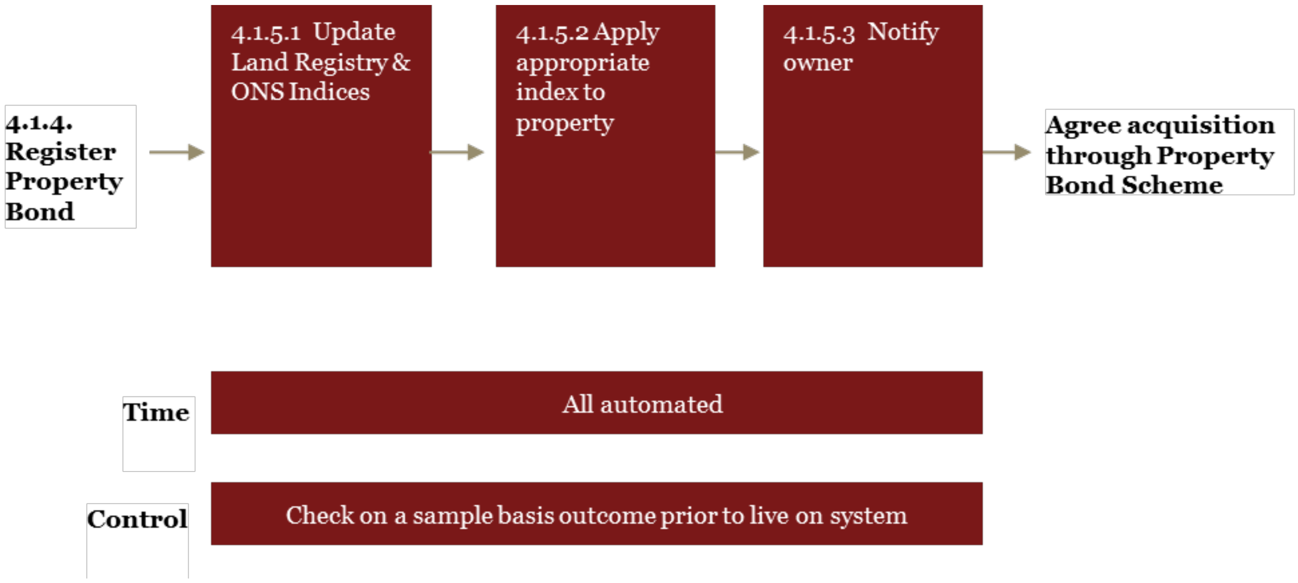
Level 3: 4.1.1. Complete application online



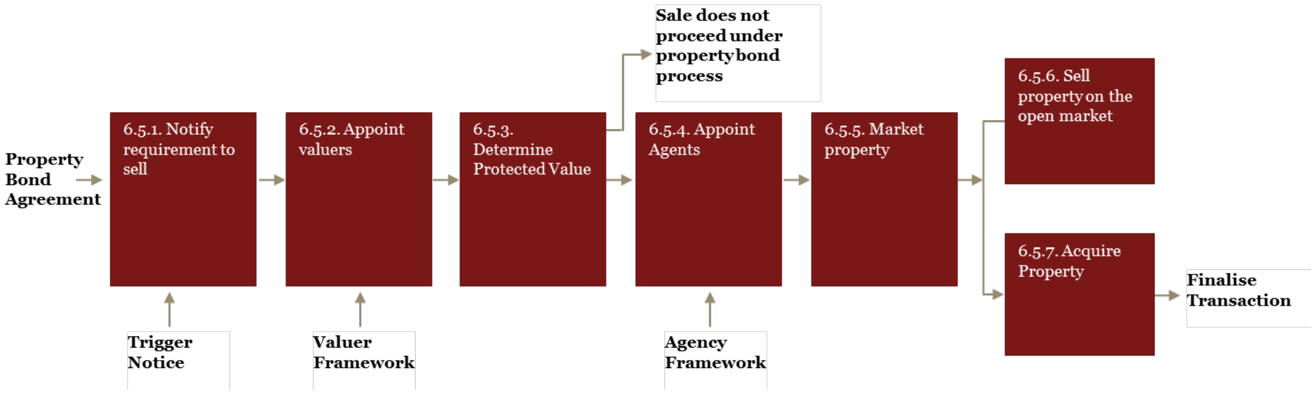
Level 3: 4.1.4 Register the property bond



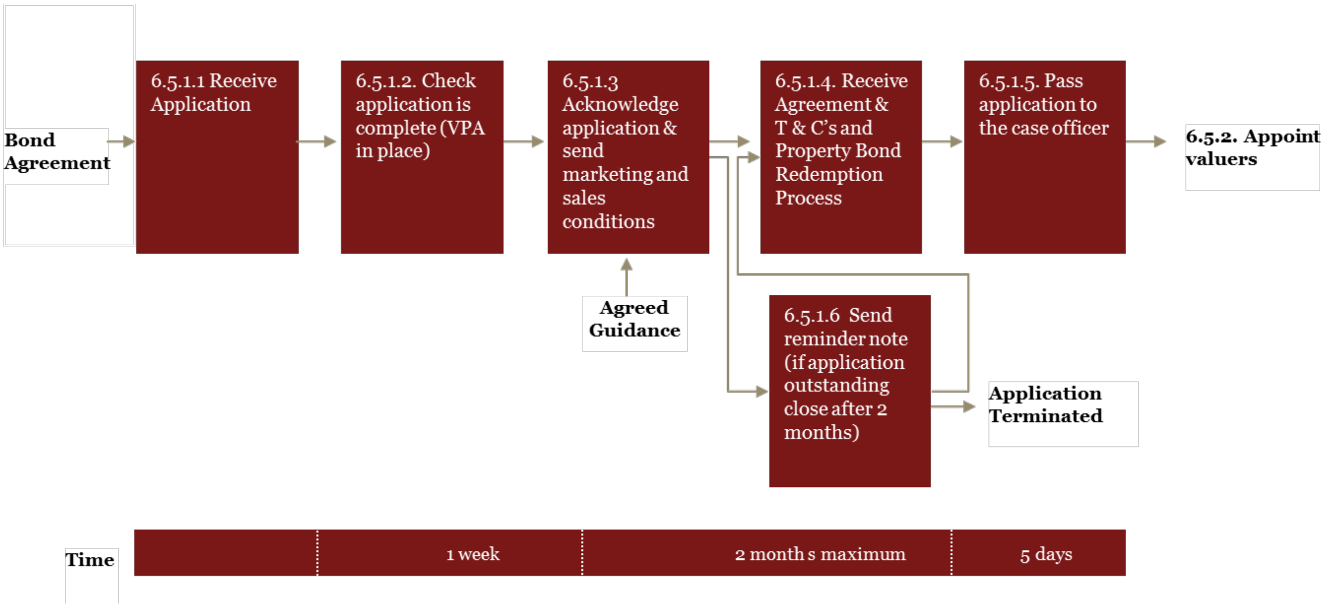
Level 3: 4.1.5 Update values online (quarterly)



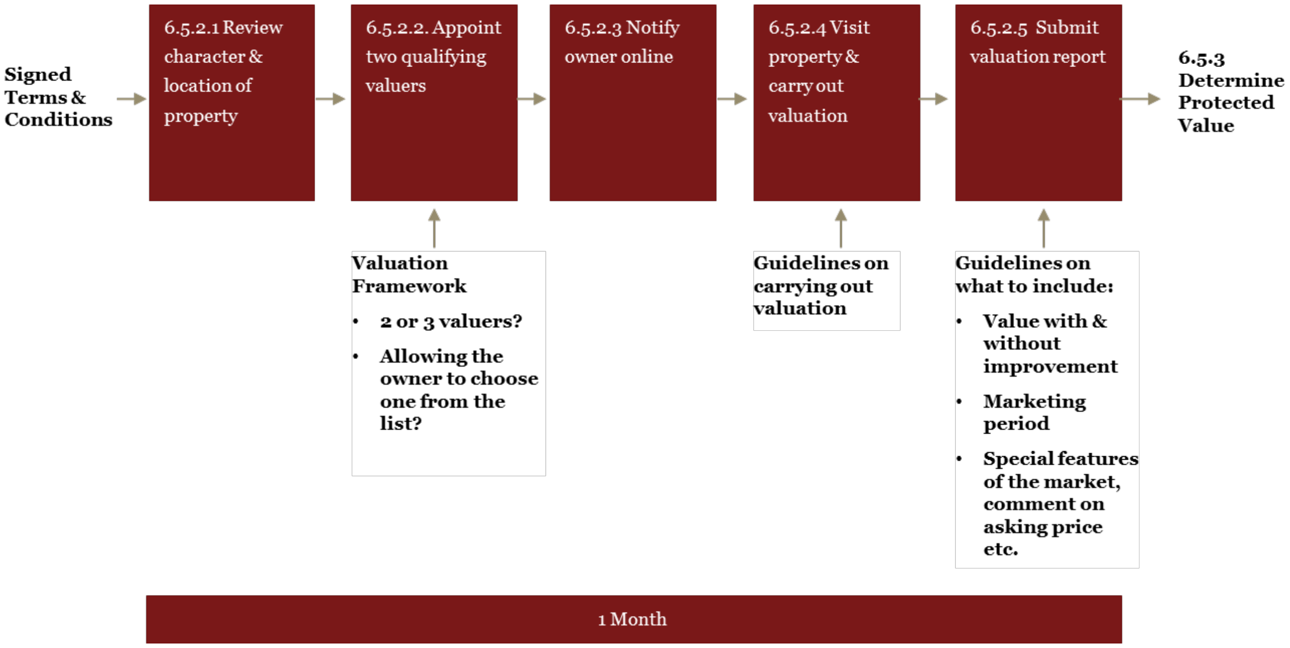
Level 2: 6.5 Agree Acquisition through the property bond scheme



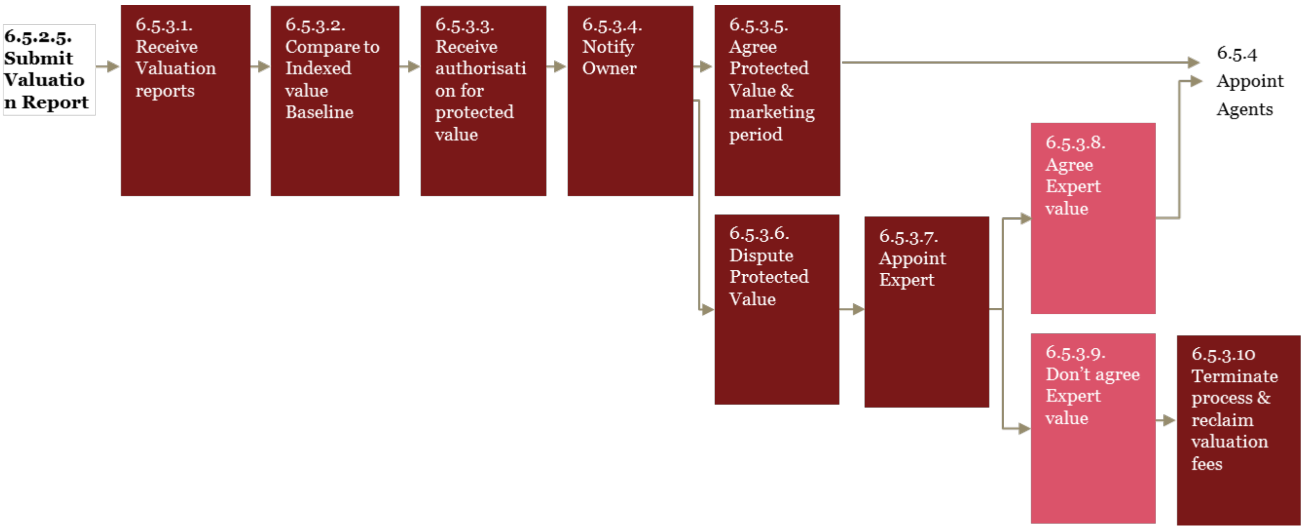
Level 3: 6.5.1 Notify requirement to sell



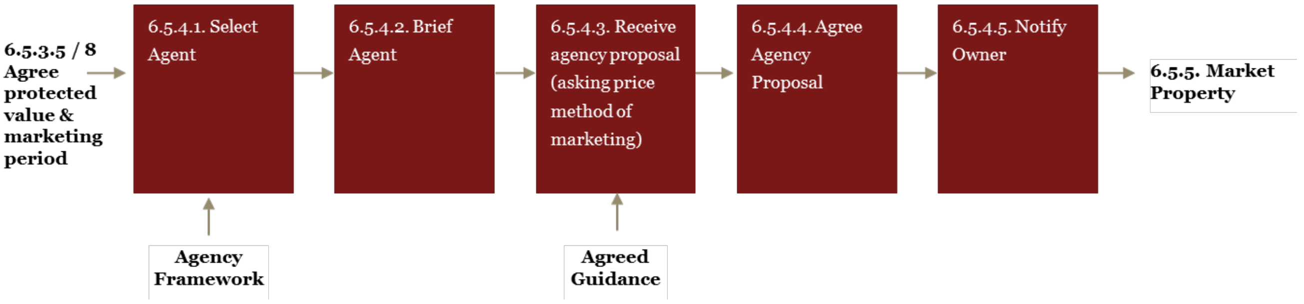
Level 3 6.5.2 Appoint Valuers



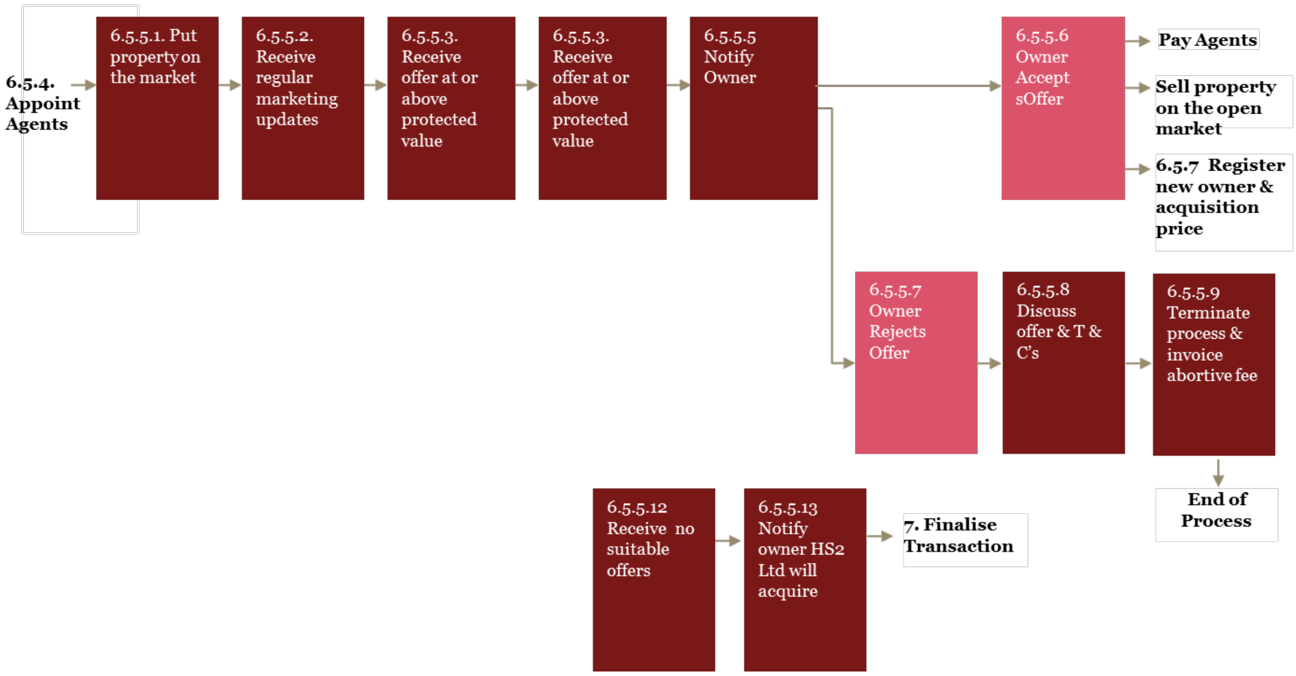
Level 3: 6.5.3. Determine Protected Value



Level 3: 6.5.4 Appoint Agents



Level 3: 6.5.5. Market Property



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