

**BUILD TO RENT
CONTINUOUS MARKET ENGAGEMENT (CME)
MAY 2015**

**INITIAL DUE DILIGENCE
GUIDANCE NOTE -
IDD1**

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Build to Rent: Initial Due Diligence Guidance

1. Introduction

Two Stage Process: HCA has shortlisted a number of propositions to enter the Initial Confirmatory Due Diligence process for the Build to Rent Fund Round 2 (BTR R2). This is part of a two stage due diligence process (with projects successfully completing stage one passing to a subsequent Detailed Due Diligence and Know Your Customer phase).

Due Diligence Team: HCA will carry out Initial Due Diligence on these shortlisted projects with the support of its financial consultants. The HCA's Business Appraisal Team will be an integral part of this process.

BTR Investment Criteria: Full information about HCA's BTR investment criteria and the assessment process is set out in the Build to Rent Round 2 Prospectus which is available on the HCA's website. In essence however,

The Build to Rent Fund has three stated objectives:

- Create a new market for institutional investment in large-scale PRS.
- Deliver up to 10,000 new homes.
- Stimulate the economy and the construction industry.

The fund is being administered as a commercial loan fund and has strict investment parameters with a 100% recovery rate and a low risk appetite, with a preference for senior lending position. It will support schemes that are viable and profitable.

Focus of Due Diligence Assessment: The slide pack made available after the workshops in mid-March highlighted the key criteria, namely:

- **Lending:** Secured lending on commercial terms;
- **Project Viability:** Focus on viable propositions delivering at least 100 units and addressing clear market demand;
- **Investor Grade Opportunities:** Priority given to propositions offering most attractive prospects for attracting investment from financial institutions or private investors;
- **Management:** Expectation that units will be retained in the private rental sector in the longer term with high quality management regimes;
- HCA funding not to exceed 50% of total scheme costs (with consequent requirement for substantial equity investment and potentially other private finance);
- Funding to be drawn down by 31 March 2016;
- Clear exit route essential (sale or refinance, ideally at or around Practical Completion but in any event within 5 years of completion); and
- Competitive process – fund substantially oversubscribed allowing shortlist and strong pool of reserve bids.

2. Purpose of Due Diligence & Areas for Confirmation

As the programme is oversubscribed, the first stage of the process is to confirm that the shortlisted proposition continues to meet the investment parameters of the programme as this is the basis on which it has been shortlisted.

The focus for the Initial Due Diligence will be to follow up on issues arising from the review of the Investment Proposal document that was submitted as part of the bid documentation.

The four broad areas have been highlighted as follows:

A. Assessment of counterparties and creditworthiness;

- Confirm identity of contracting party (ies) and guarantor (where applicable)
- Understand proposed delivery structure
- Undertake initial assessment of creditworthiness

B. Availability of equity and other funding;

- Assessment of viability of funding proposals
- Confirmation of resources to meet equity funding requirements
- Confirmation of third party funding facilities
- Understand any conditions attached to third party funding

C. Security position;

- Assessment of value of collateral available to secure HCA funding

D. Exit arrangements.

- Assessment of proposed arrangements to repay HCA funding, via exit strategy and end purchaser (where appropriate)

At the end of this initial stage, a decision will be made on whether each proposition proceeds to the next stage, which will involve the detailed due diligence on the sites and the overall proposition.

The template in Annex 1 sets the requirements under each area.

In addition, any material changes to the proposition should be highlighted as these may impact on the decision to proceed to the detailed due diligence stage.

HCA reserves the right at the Initial Due Diligence stage to reject projects or specific changes within the proposal which would have materially impacted the scoring or ranking of the project during shortlisting. In particular, changes in the nature or amount of the funding sought which would worsen the position on value for money or recoverability will not be allowed.

3. Timing

Subject to final agreement, the intention is to allow propositions to commence the Detailed Due Diligence immediately after a decision to proceed has been made following the completion of the Initial Due Diligence.

In order to undertake the Detailed Due Diligence HCA will require a greater understanding of the management platform alongside satisfaction of Know Your Customer requirements, a detailed assessment of the project, design, programme and viability. The requirements are set out in document DD2 which can be found at <http://www.homesandcommunities.co.uk/ourwork/build-to-rent-round-2>. Early submission of this information is encouraged.

4. Submission of Information

Individual project managers will work with you throughout the Initial Due Diligence stage.

You can either provide information direct to your individual project manager by email or you can submit the information via the electronic document sharing tool, Huddle.

Each bidder will have their own secure folder area where they can upload documents. We will provide each bidder with login details by email.

Annex 1

KEY TASKS	WHAT WE NEED FROM YOU
A. Assessment of Counterparties and Creditworthiness	
A1 Confirm identity of contracting party (ies) and guarantor (where applicable) A2 Understand proposed delivery structure A3 Undertake initial assessment of creditworthiness	<ul style="list-style-type: none"> • Confirmation of <u>specific</u> entity (ies) which will act as contracting party (and guarantor) • Details of ownership of proposed contracting party (including identity of any intermediate and ultimate parent companies, companies under common control and ultimate owners) • Group structure diagram (where applicable) • Most recent filed accounts for applicant and parent company/ proposed guarantor (where applicable) • Where balance sheet date in filed accounts is more than 6 months ago, supply copies of draft statutory or recent management accounts
B. Availability of equity and other funding	
B1 Assessment of viability of funding proposals B2 Confirmation of resources to meet equity funding requirements B3 Confirmation of third party funding facilities B4 Understand any conditions attached to third party funding	<ul style="list-style-type: none"> • Where part of equity contribution is being met by value of the site, an independent valuation will be required (RICS Red Book if available). Whilst Red Book Valuation is not compulsory at the initial due diligence stage, it will be required prior to HCA entering into any legal agreement. • Evidence of funds to meet equity cash contributions • Documentation from banks or other third party funders to confirm funding interest and/or facilities and associated conditions: <ul style="list-style-type: none"> - facility agreements - heads of terms - indicative letters of support
C. Security Position	
C1 Assessment of value of collateral available to secure HCA funding	<ul style="list-style-type: none"> • Site plan confirming assets to be provided as security • Details of any existing or anticipated security interests or other conditions (e.g. negative pledge, restrictive covenants etc.) • Confirmation of site value supported by an independent valuation (RICS Red Book where available). Whilst a Red Book Valuation is not compulsory at the initial due diligence stage it will be required prior to HCA entering into any legal agreement. • Scheme development appraisal.
D1 Assessment of proposed arrangements to repay HCA funding, via exit strategy and end purchaser (where appropriate)	<ul style="list-style-type: none"> • Identity of any third party exit partners (refinancing or sale) and indicative terms (where applicable) • Assumptions made on <ul style="list-style-type: none"> - exit value - LTV ratios - timing - gross/ net yields