Construction & Real Estate

Finance Directors Forum

23rd November 2023

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An electronic version of the slides can be downloaded here:

Agenda

10.00 – 10.10am	**Welcome & introduction** Brendan Sharkey
10.10 – 10.30am	**Topics for the Boardroom** Atul Kariya
10.30 – 11.00am	**The Autumn Statement & Tax Update** Glen Thomas
11.00 – 11.20am	**Distress & insolvency in the sector** Georgina Eason
11.20 – 11.40am	**VAT Update** Alison Horner
11.40 – 12.00pm	**Break**
12.00 – 12.30pm	**Audit, Accounts & Financial Standards** **Carlison Morris**
12.30 – 12.45pm	**ESG Audit Considerations** Mark Lumsdon-Taylor
12.45 – 1.00pm	**Sector insights, current issues and legislative points on the horizon** Brenden Sharkey
1.00 – 1.30pm	**Construction News – Top 100 review** Ben Vogel
1.30pm – 2pm	**Q & A, alongside networking lunch** Full panel

Topics for the Boardroom

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Topics for the Boardroom

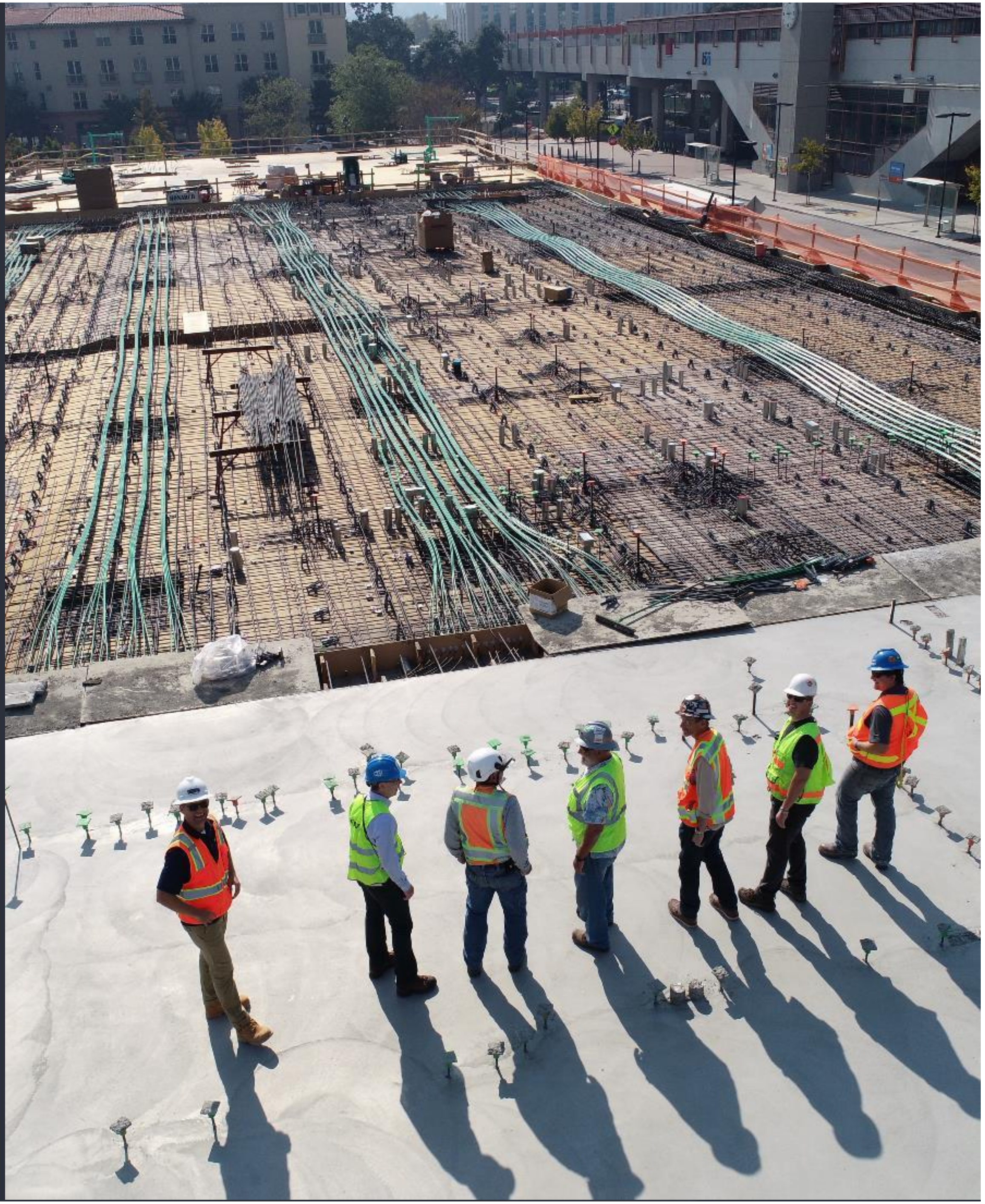
- Financial Management
- Supply Chain
- Group Structure

Financial management

- Financial controls
- Could increased costs have been seen earlier?
- Controls robust enough- Financial vs commercial challenge?
- Site management and take on risk?
- Tightening up on all contract controls, take on through to final account
- Is the margin right, can risk be managed?

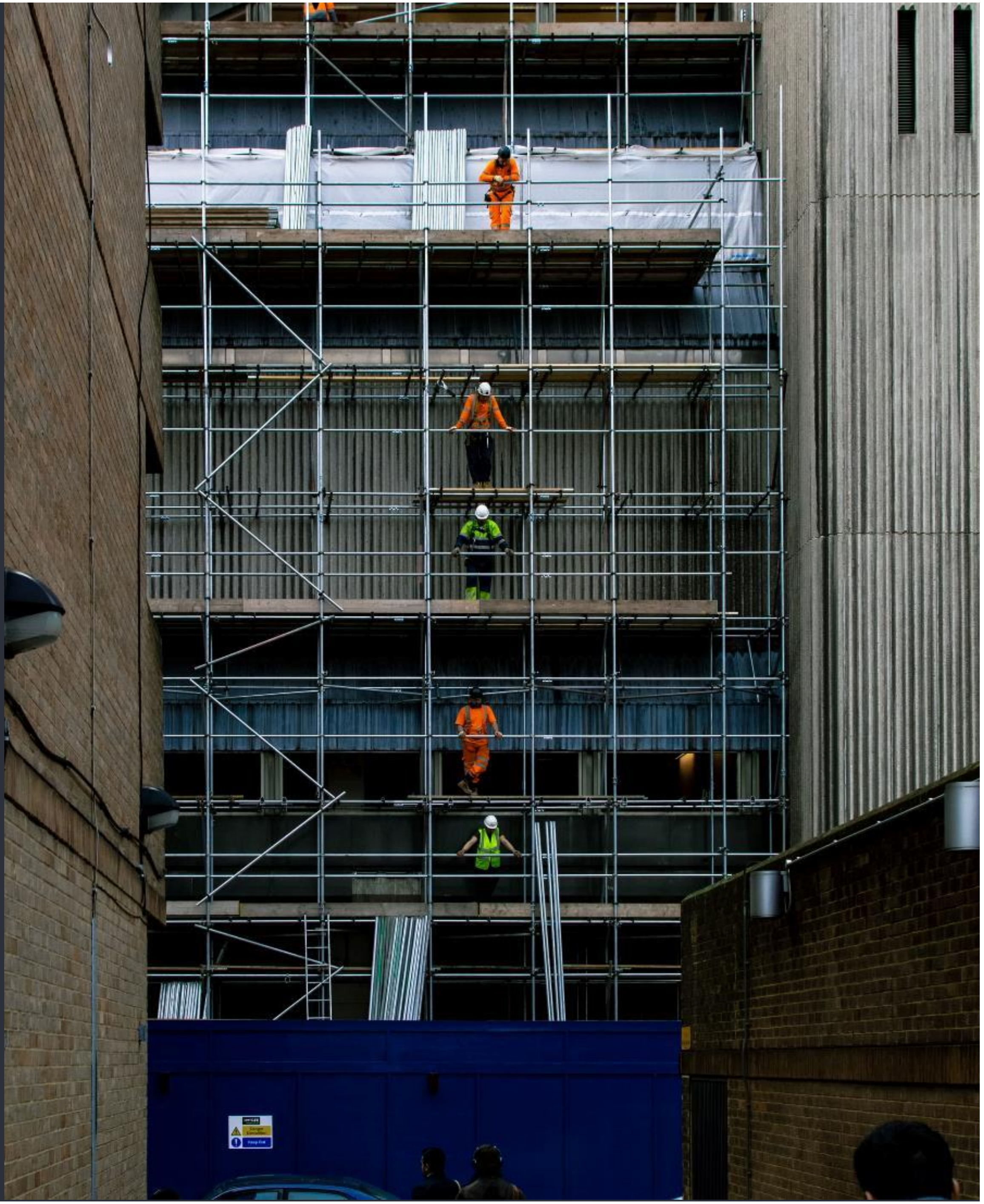
Do I know my supply chain?

- Corporate/supply chain failure continues to be heightened risk to contract disruption
- Will there be more high-profile failures?
- Process for understanding how subbies and supplier are performing?
- Do I really know the financial health of the company?
- Do I understand the financial- any unusual accounting policies to boost cash and profits?
- Robust take on and monitoring process?
- Whose responsibility is it?



Group Structure?

- Structure and ring-fencing assets
- Review of current group structure
- Are assets cash, land, property in the right place?
- Assets exposed to construction risk, PCG?
- Is the current structure right for future plans?
- Is now the time to restructure tax efficiently?
- Interaction with shareholders and generational wealth preservation
- Commerciality must be the driver



The Autumn Statement & Tax Update

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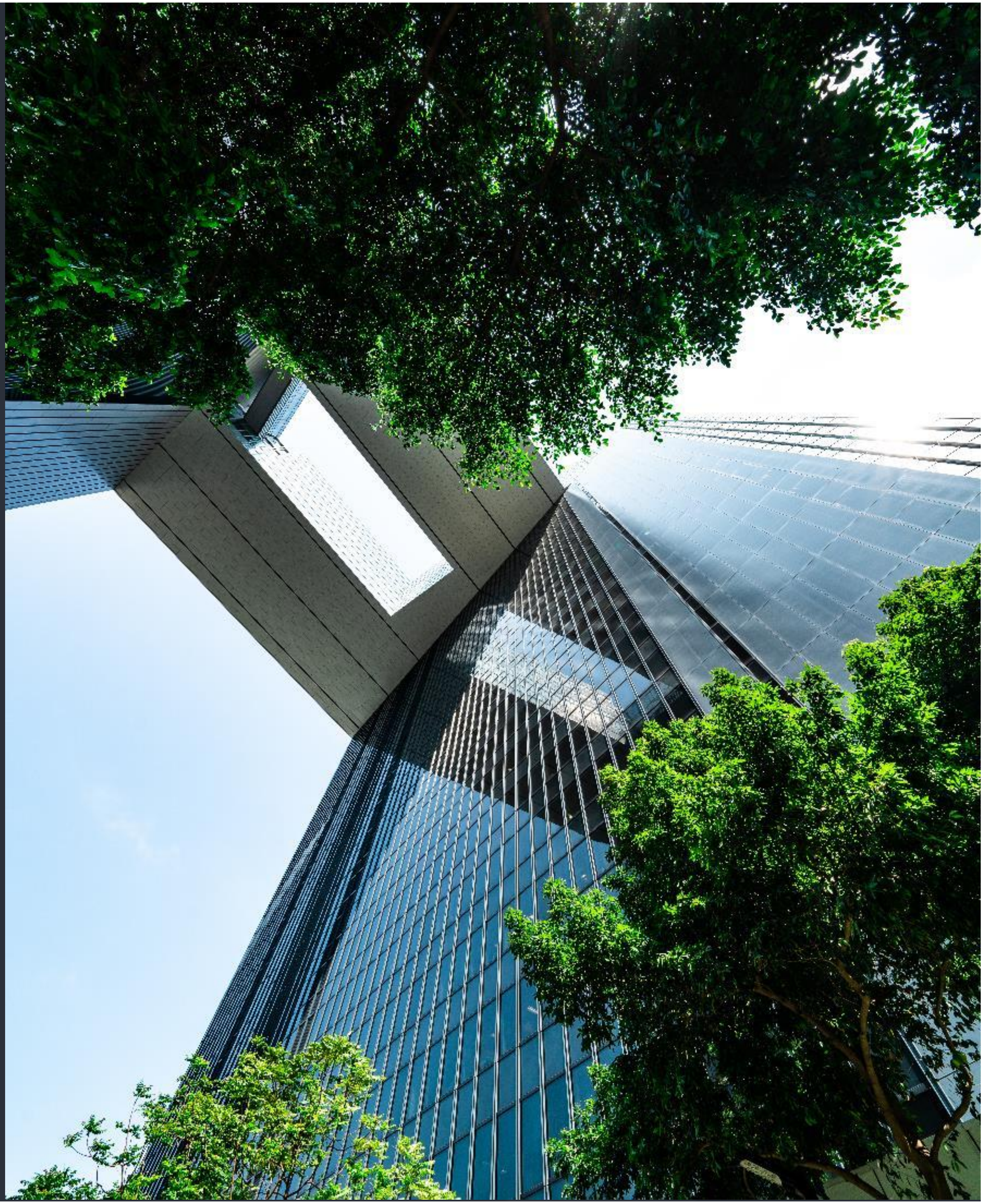
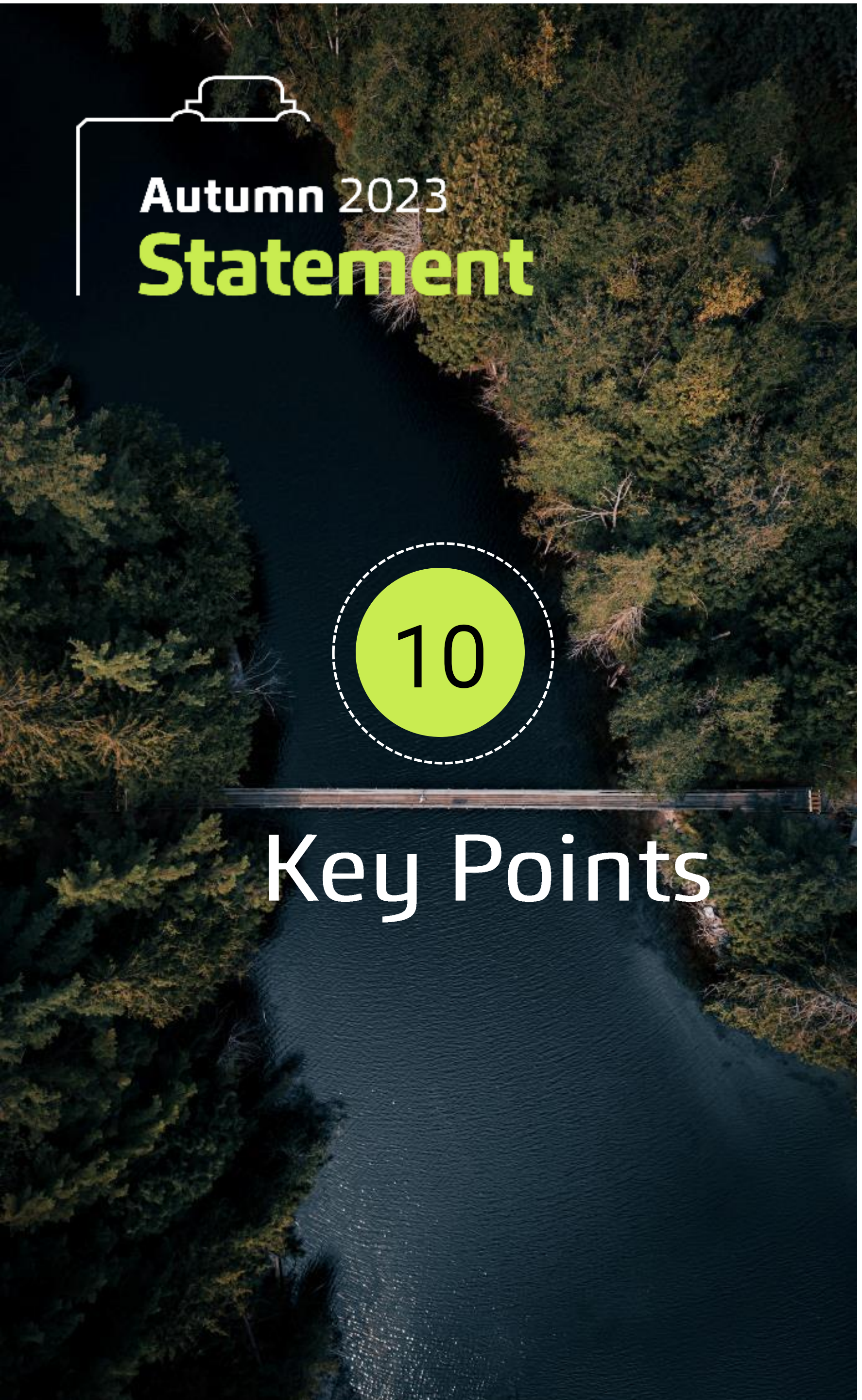
Tax

- The Autumn Statement
- CIR – what does high interest rates mean for your CIR calculation
- Capital allowances – where are we now





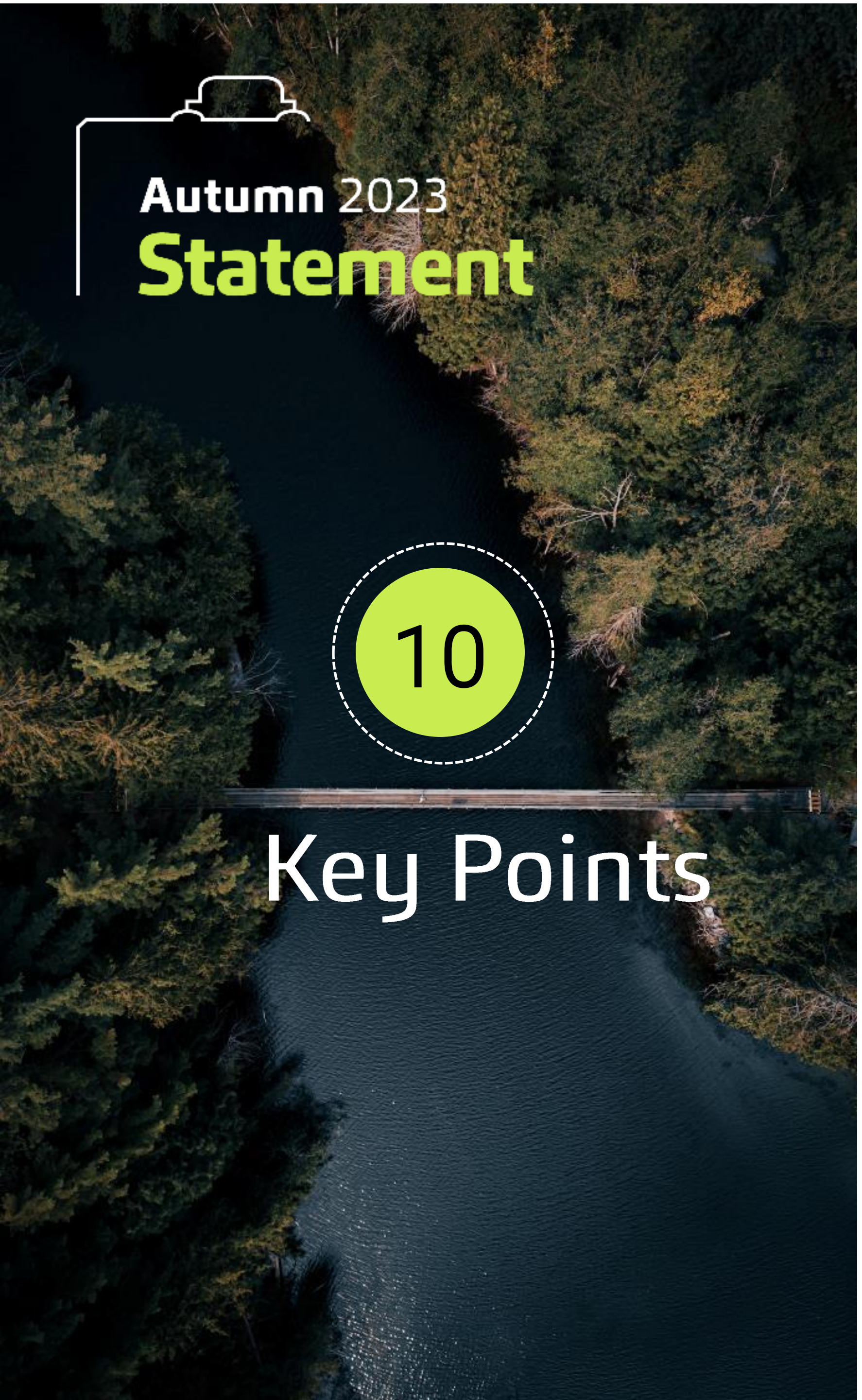
1. The main 12% rate of employee national insurance contributions has been cut by two percentage points to 10%. For the self-employed, Class 2 National Insurance (NI) for self-employed will be abolished and the rate of Class 4 NI reduced by 1%.

2. National Living Wage – increase to £11.44 per hour for workers aged 21 and over. National Minimum wage rates for younger workers will also increase to £8.60 per hour.

3. The existing 75% business rates relief for retail, hospitality and leisure has been extended to 2025. The small business multiplier for business rates is frozen.

4. A unified R&D Scheme will be created and come into force from 1st April 2024 onwards. The rate at which loss-making companies are taxed within the merged scheme will be reduced from 25% to 19%

5. Financial incentives extended for Investment Zones and tax reliefs for Freeports from five to 10 years. Three further investment zones announced, and a second investment zone in Wales.



6. Full capital expensing is made permanent, allowing companies to offset investment in items such as new IT equipment and factory machinery against tax, allowing them to claim back 25p in corporation tax for every £1 invested.

7. £500m of funding for UK artificial intelligence over the next two years to fund more "innovation centres".

8. £4.5bn funding for manufacturing up until 2030, to attract investment into strategic manufacturing, automotive, renewables, and life sciences sectors.

9. Reforms to speed up the process of applications and address the planning application backlog. Under the reform, local authorities will be able to recover the full costs of major business planning applications.

10. Local housing allowance rate will increase to the 30th percentile of local markets rents, giving 1.6m households have an average of £800 of support next year.

Corporate Interest Restriction – Recap 6 years on

- Introduced with effect from 1 April 2017 as a result of BEPS Action 4
- How much of an impact has it really had? Whilst interest rates low, minimal?
- Case law?
- Administrative burden
- Sharp rise in Interest rates in the last 12 months – will it now be relevant to you?

Rules refresher

UK entities + > £2m ANTIE + Losses / insufficient profits = CT liability

Fixed rate ratio – 30% of Tax EBITDA

Group ratio – Only useful if it is higher than 30% (by election)

Interest disallowances – carried forward indefinitely. Do you have a deferred tax asset?

Interest reactivations – can be used indefinitely.

Excess Interest Capacity – carried forward for 5 years.

Issues

Negative UK EBITDA	Short period reduces £2m de minimis
Difficult to reactivate disallowances	Loss of excess interest capacity on a takeover.
Identifying the CIR group	PIE Exemption

Public Infrastructure Exemption

- Qualifying Infrastructure Company (QIC)

- Income Test and Asset Test

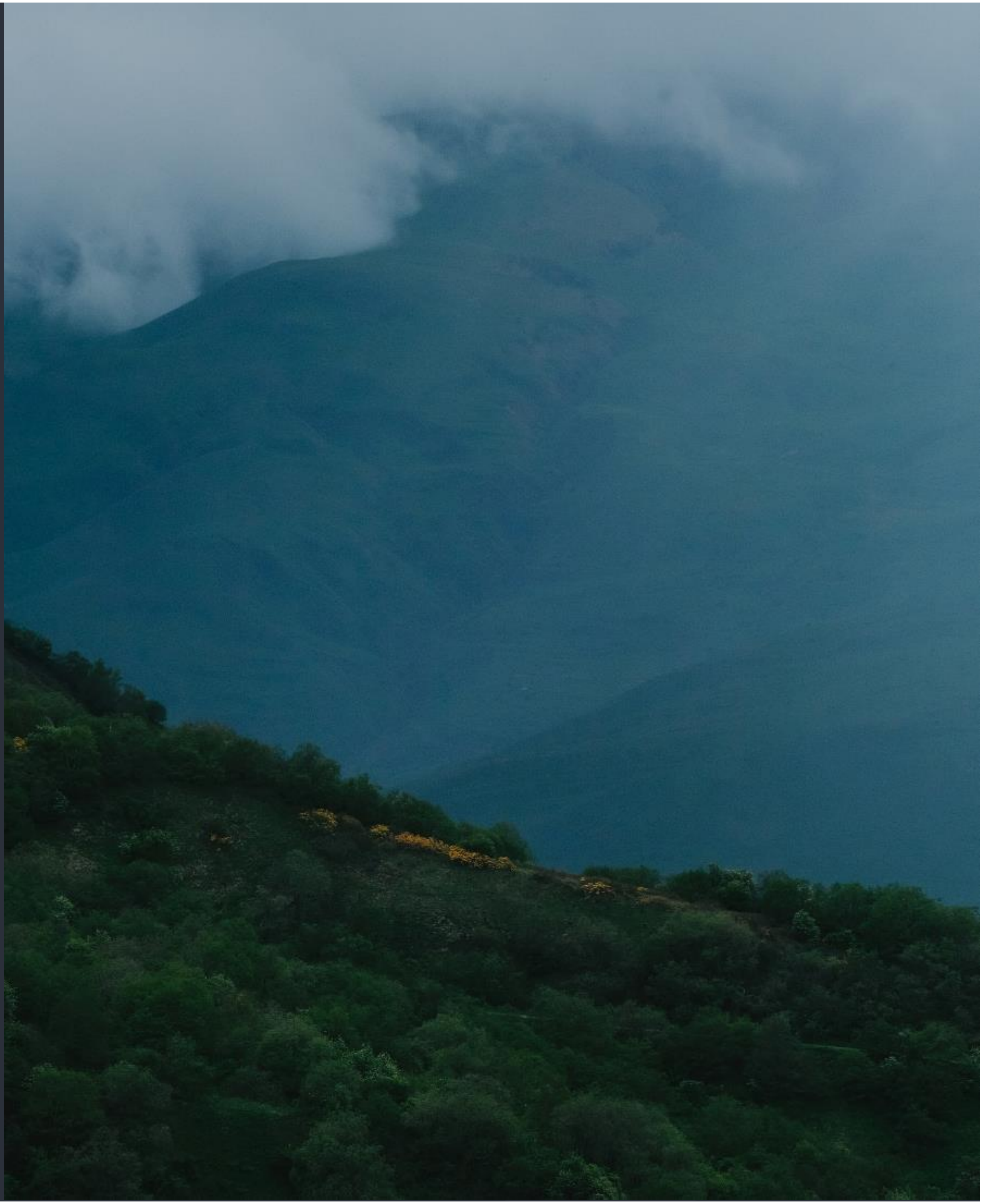
- Election by end of Accounting Period

- Tax-Interest Expense excluded

  - Unrelated Creditor
  - Related QIC
  - Related QIC with ‘Old loan’ – Pre 12 May 2016

- Qualifying Infrastructure Activities

- Public infrastructure Assets
  - Public Benefit Test
  - Buildings let to unconnected parties



Considerations – what can you do now?

Complex rules

- The CIR rules are complex.
- Do you know your CIR Group? Has everyone consented to the group reporting company?
- Have you modelled your expected net tax interest expense?
- Can you forecast your group position.

Opportunities

- Opportunities for effective tax planning where CIR issues are identified early.
- Opportunity to use hindsight – have you reviewed earlier years which may have been “ignored” as no perceived impact

Compliance

- Can you refile returns? Turn abbreviated into full return?
- Can you make any elections now which may improve the situation? Take care!
- Can you amend any inter-company agreements? Are you refinancing in the near future?

CIR Election recap

Election	Notes	Revocable / Irrevocable
Appointing a group company		Stays in place for subsequent periods until no longer eligible or revoked (must be revoked within 12 months of the end of the AP)
Abbreviated return election	submit a simplified return where there are no disallowances	Can be revoked and replaced with full return but must be for the AP in question and intervening periods. (Thus not really on an AP by AP basis).
Group ratio election	can only be used where a group reporting company has been appointed	Revocable
Group ration (blended) election		Applies to a single period of account and is revokable
Group EBITDA (chargeable gains) election		Irrevocable
Interest allowance (alternative calculation)	only relevant to the group interest	Irrevocable
Interest allowance (non consolidated investment) election		Revocable
Interest Allowance (consolidated partnerships)		Irrevocable

Capital allowances – which do you choose?

Pool	Rate	Type of asset	Time period
Main Rate Pool (“MRP”)	18%	Plant & machinery	Ongoing
Special Rate Pool (“SRP”)	6%	Integral features	Ongoing
Long life Assets	6%	Useful life of more than 25 years (when new) but limited application in reality	Ongoing
Structural Buildings Allowances (“SBA”)	3% (straight line basis)	Cost related to construction or renovation of commercial structure	Ongoing (introduced in 2018)
Short Life Assets	18%	Assets with a useful economic life of less than 8 years	Ongoing
Annual Investment Allowance	£1m	Can be allocated to any “pool” but not cars.	Ongoing
Super Deduction	130% on MRP 50% on SRP	As categories above BUT other conditions apply	1 April 2021 to 31 March 2023
First Year Allowances	100% MRP 50% SRP	See below	From 1 April 2023 Now permanent

Full Expensing / First Year Allowances ("FYA")

Qualifying Expenditure

The conditions for Full Expensing are the same as those for the Super Deduction.

- The asset must be new and unused.
- The asset must not be used for leasing or hiring out to other persons (exceptions for property lessors).
- Cars do not qualify. Note however that new cars with zero CO_2 emissions qualify for 100% First Year Allowances until 31 March 2025.

Property Investors PropCo/OpCo Structures, and Leasing as Part of a Service

Full Expensing and 50% FYAs are not available on assets to companies that lease or hire out the asset to other persons, unless:

- Leasing as a service
- Property letting

Disposals

Where a company sells an asset on which 100% or 50% FYAs have been claimed, the company will be charged to tax on the full disposal proceeds as a balancing charge.

Full Expensing / First Year Allowances ("FYA")

Full expensing (MRP)	FYA at 50% (SRP)
Machines such as computers, printers, lathes	Integral features of a building:
Office equipment such as desks and chairs	Electrical and lighting systems
Vehicles such as vans, lorries and tractors (not cars)	Cold water systems
Tools such as ladders and drills	Space or water hearing systems, powered systems of ventilation, air cooling or air purification systems
Construction equipment such as excavators, compactors and bulldozers	Lifts, escalators and moving walkways
Certain fixtures such as kitchen and bathroom fittings and fire alarm systems in commercial properties and furnished holiday accommodation	Solar Panels
Computer software (by election)	Cars are generally Special Rate but they do not qualify for the 50% allowance.
Storage systems	Thermal insulation of buildings (conditions apply).
Car park lighting	Cushion Gas
Portacabins moved from site to site in the construction industry	

Full Expensing or AIA?

Feature of Scheme	Full Expensing	Annual Investment Allowance
Limit	Uncapped	£1 million across groups and connected companies
Type of expenditure	Main rate only	Main rate and special rate
New/Second hand	Must be new and unused	May be new or second hand
Businesses	Companies only	Companies and unincorporated
Assets leased to others	Not eligible (except background plant in a building)	Eligible, except most residential
Disposal	Immediate balancing charge	Reduces the pool of expenditure, may create balancing charge

Key Takeaways –
what can you do today

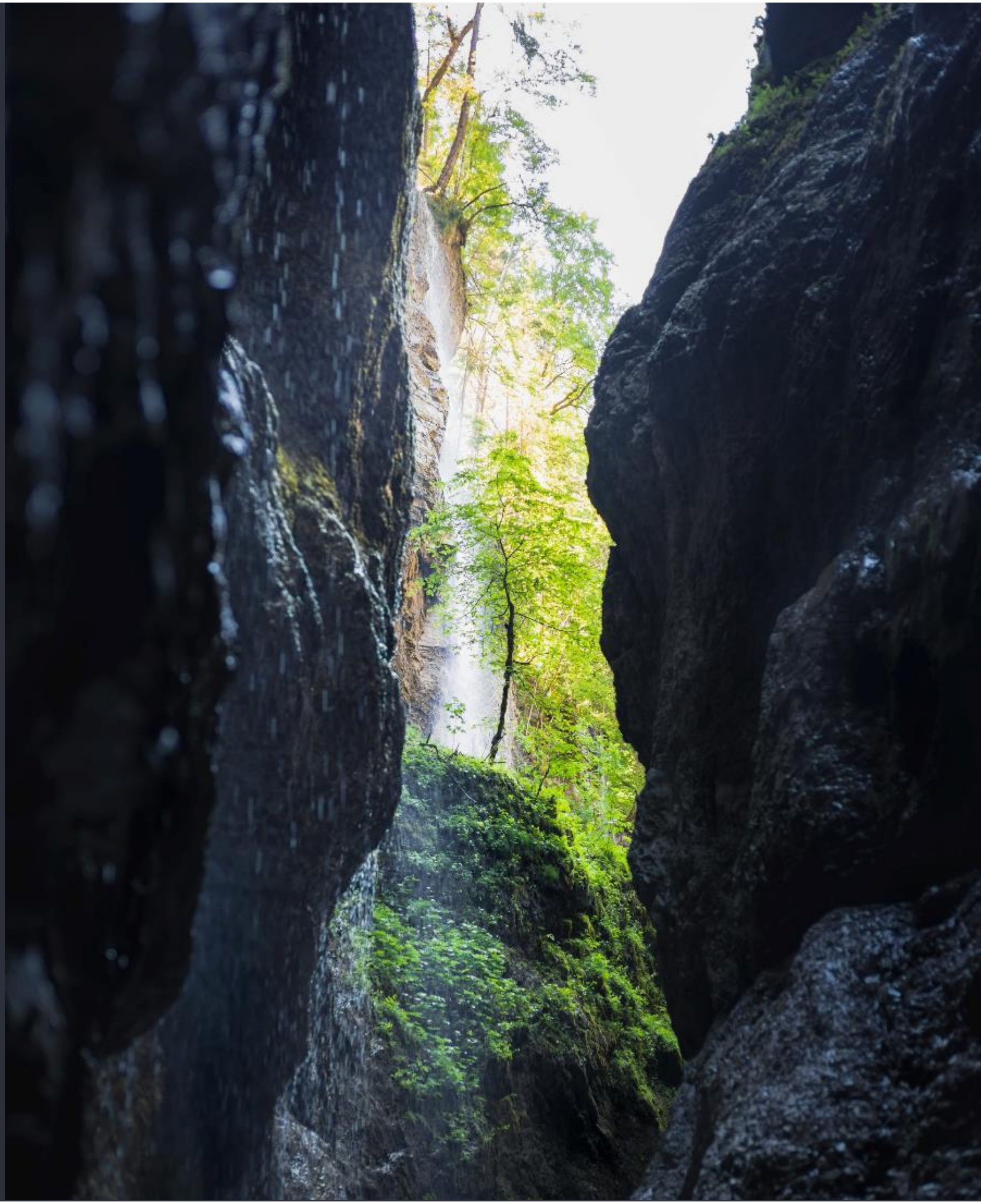
Tax modelling:

This has never been more important

Can you forecast the impact quickly to enable you to make effective decisions

Governance:

Is your CIR documentation up to date – Returns / Elections



Distress & insolvency in the sector

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Construction Insolvency Statistics

- Construction companies accounted for **16.9%** of all insolvencies in England and Wales in September 2023.
- In the year to September 2023, the total number of construction firms becoming insolvent was 4,287, which is an **increase of 8.3%** on the previous year.
- Within the construction industry, firms categorised as providing **specialised construction activities** are consistently the most affected across the UK.
- Particular challenges include rising inflation, Covid loan repayments, high energy costs, shortages and rising costs of materials and equipment, longer lead times, schedules and cost overruns.

Real Estate Insolvency Statistics

- The real estate sector has accounted for **4.27%** of company insolvencies so far in 2023, with a total of 1066 insolvency appointments in 2023 so far.
- This is an **increase on real estate insolvencies by 29.06%** on 2022.
- First half of 2023 saw **fewer real estate finance transactions** compared to the previous year.

Managing your risk

- What can those in the construction/real estate industry do to manage their risk? What specific things should you be taking on board at this point in time?
- Engagement with professionals
- Remain close to clients, project monitors, agents and seek advice where there are suspected issues early
- Review cash flows
- Monitor production of monthly management accounts
- Request you are informed about disputes such a retentions, delays or penalties
- COVID-19 financial support scheme loans - bounce back loans/CBILs loans

Residential/Commercial property loans

- ROT – important to understand other security and priority
- Is it empty? Consider a letter of waiver and consent
- Type of property to be charged: Short lease/ Contaminated land/ Foreign borrower/ Foreign guarantor/ Work to live unit/ Mental fitness of the borrower/ UN1s/planning permission/ Listed building consent/ Conservation area – prevent alterations
- What do you have on file – H&S assessment/ Fire risk assessment/ Environmental – Japanese knotweed
- Licensed premises – CQC etc

Early Warning Signs

- Negative cashflow/alternative source of funding sought
- Reducing profitability/increasing losses
- Late or missed payments to suppliers
- Late or missed payments to the Bank
- Employees are looking to leave or management structure is changing
- Negative rumours in the market as to the viability of the company
- Suppliers terminates contracts or refuse to continue to supply
- Lack of communication/ delay in responses

Lenders attitude to their loan book

VAT Update

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Plastic Packaging Tax

A PPT is now applicable in the following countries:

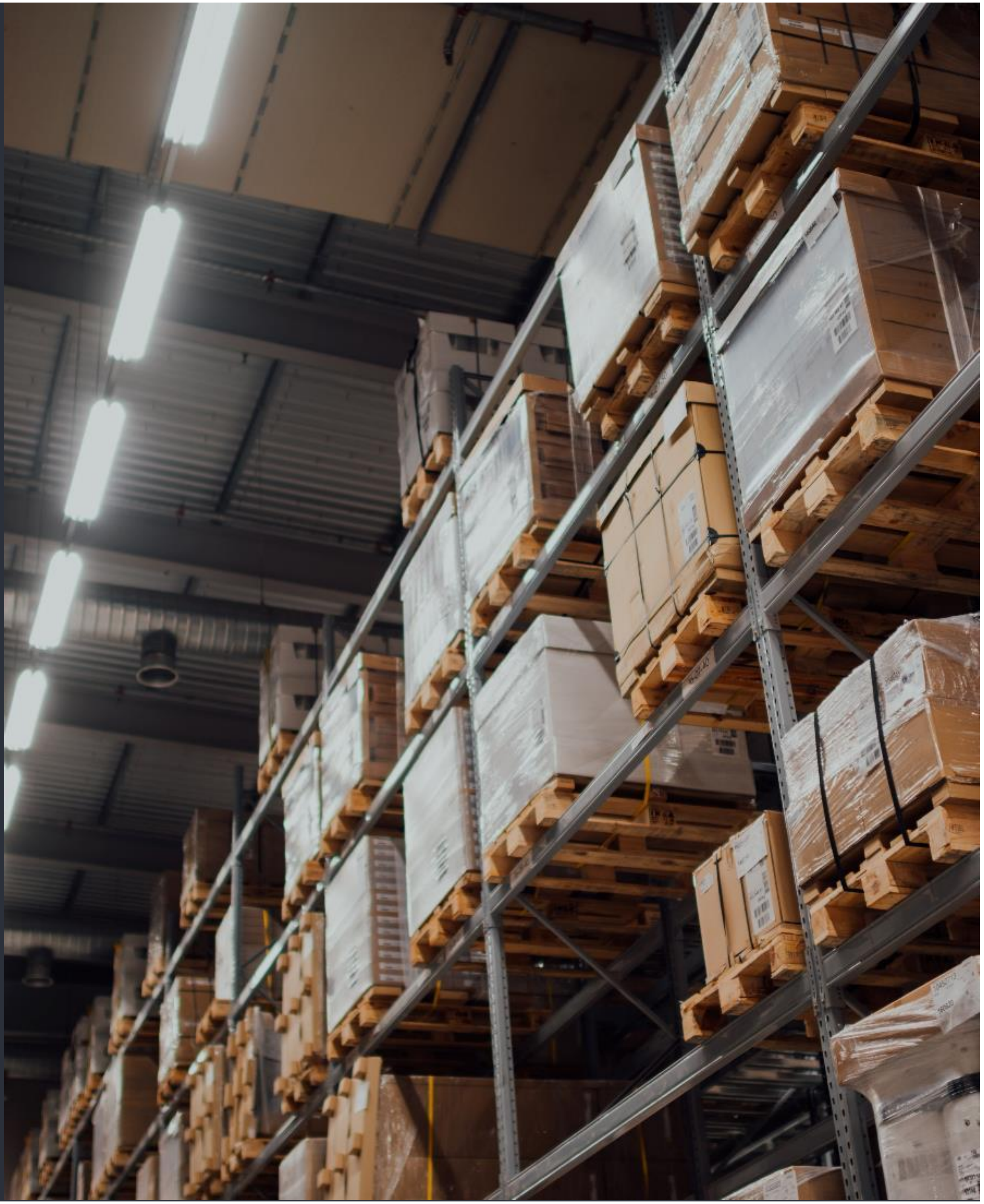
- UK – from 01/04/2022
- Spain – from 01/01/2023
- Italy – from 01/01/2023
- Germany are to introduce from 01/01/2024

Plastic Packaging Tax

What are the tax rates?

Country	Tax
UK	£210.82 pMT
Spain	€0.45 per kg*
Italy	€0.45 per kg*
Germany	Annual levy

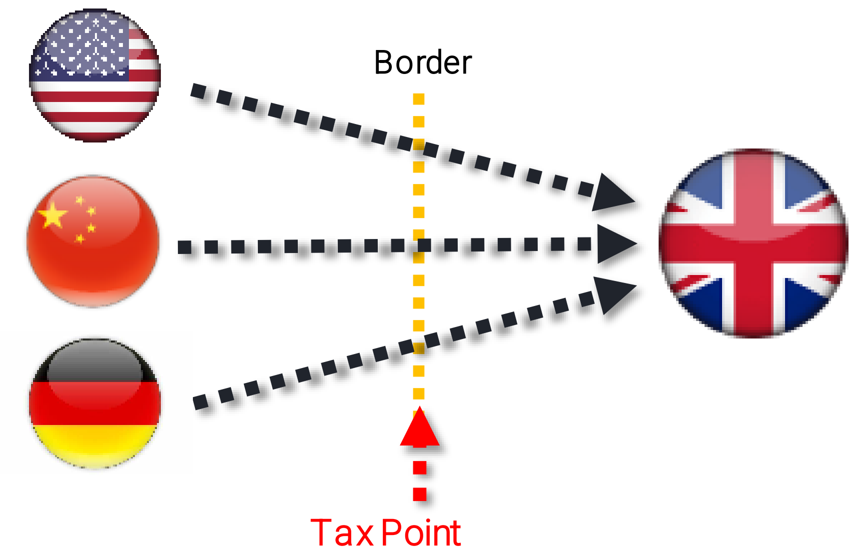
* Tax only due on non-recycled content



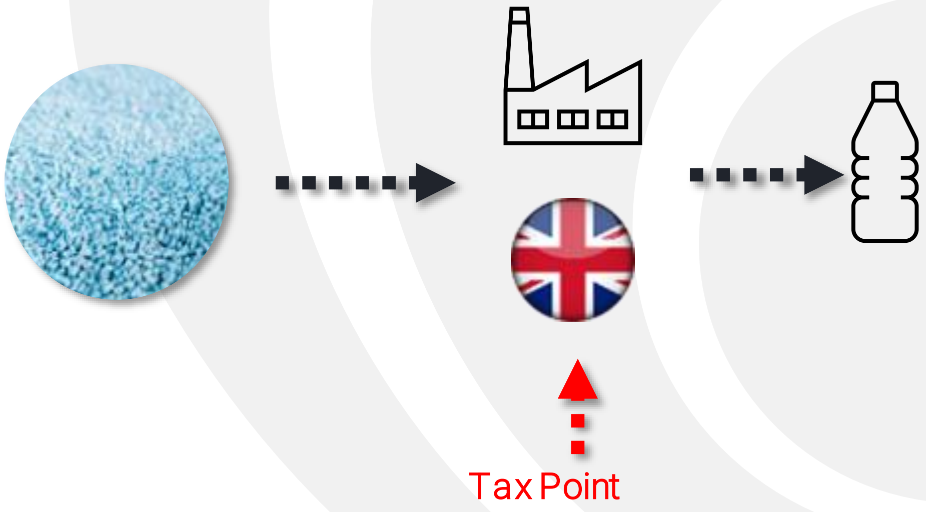
Plastic Packaging Tax

When does it apply?

Import



Manufacture of finished plastic packaging component



Plastic Packaging Tax

Bottles designed for single use	Carrier bags	Biscuit wrappers	Clothes hangers designed for use in the supply chain
Bottle tops or caps	Bin liners and refuse sacks	Pallet wrap	Plant pots designed to be sold with plants inside
Labels designed to present the goods	Food bags (such as sandwich bags)	Plastic film around a box	Kimble tags
Ready meal trays	Flexible food pouches	Nappy sacks	Reusable plastic crates
Film designed to protect produce	Film windows on items	Disposable plastic bowls and plates	Pick bins used in warehouses
Yoghurt and soup pots	Salad bags	Gift wrapping such as ribbon and sticky tape	Ready meal and vegetable pouches and packets
Wrap designed to group products together	Crisp packets	Tamper proof seals	Medical sharps bin (single use)

Plastic Packaging Tax

UK Approach

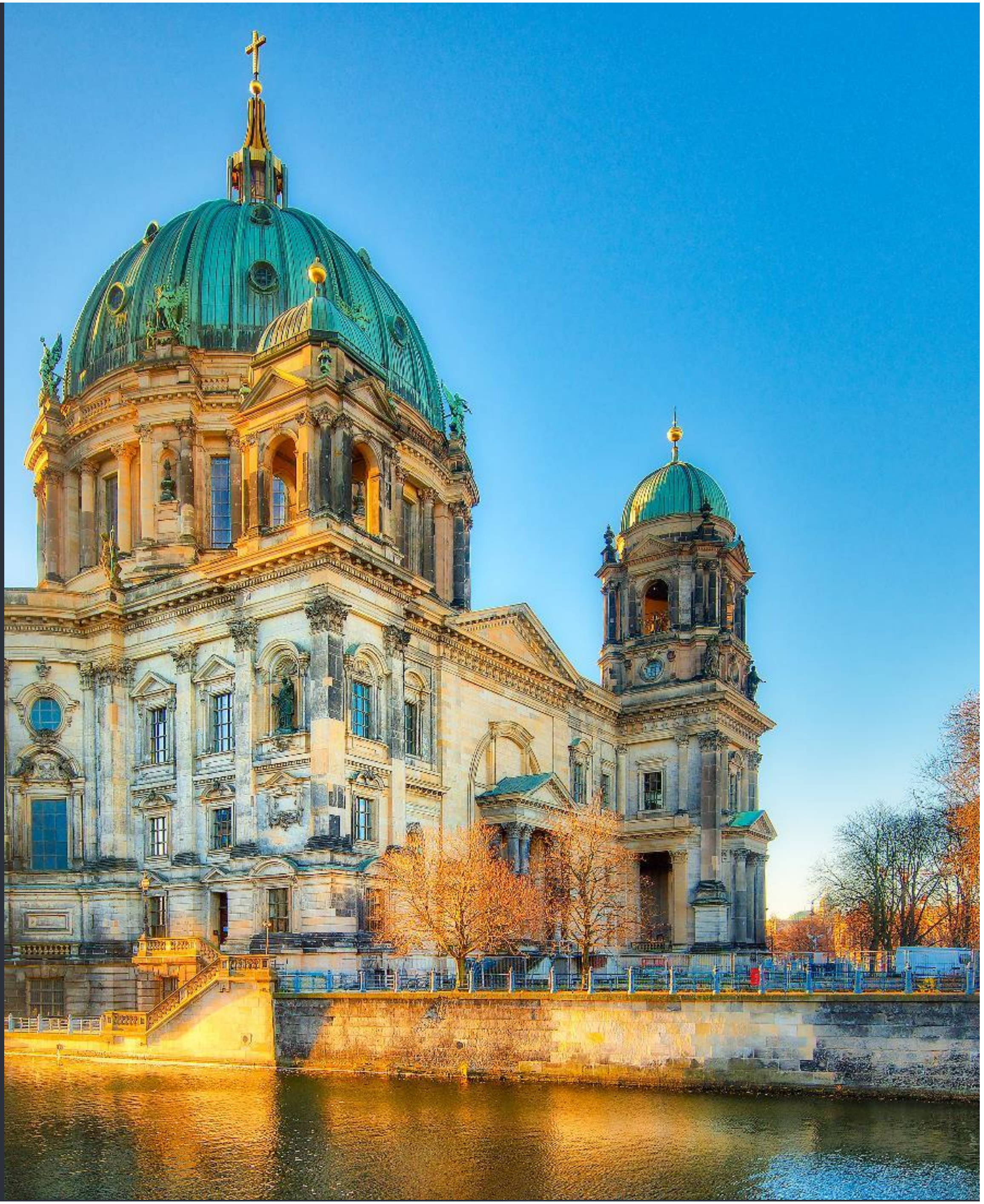
- Exemption on packaging with 30%+ recycled plastic content
- Other exemptions are on packaging for human medicines, point of sale, etc.
- Registration threshold is 10MT of taxable plastic packaging per rolling 12-months
- Registration process is simple – now generates automatic penalties
- PPT return is also simple but supporting evidence may be substantial

Plastic Packaging Tax

German Approach

- EU Directive no Tax but administrative fees.
- In Germany: Single-Use Plastic Fund Act – no tax and tax rules do not apply
- Register
- Ban from placing such products on the market for non-registered persons
- Plastic fee for 2024 will be determined in 2025

https://www.bakertilly.de/en/news/detail/plastic-tax-in-germany-single-use-plastic-fund-act-leads-to-new-obligations-for-manufacturers.html



Plastic Packaging Tax

Risks/key considerations

- DDP imports will render the seller subject to PPT obligations
- Seller may need to provide accurate specifications on plastic content and weights (e.g. on product spec/commercial invoice)
- Accurate records must be retained to evidence weights and recycled content
- Failure to register on time will incur penalties
- HMRC are reviewing registrations and raising automatic penalties

Plastic Packaging Tax

Risks/key considerations for Construction Industry

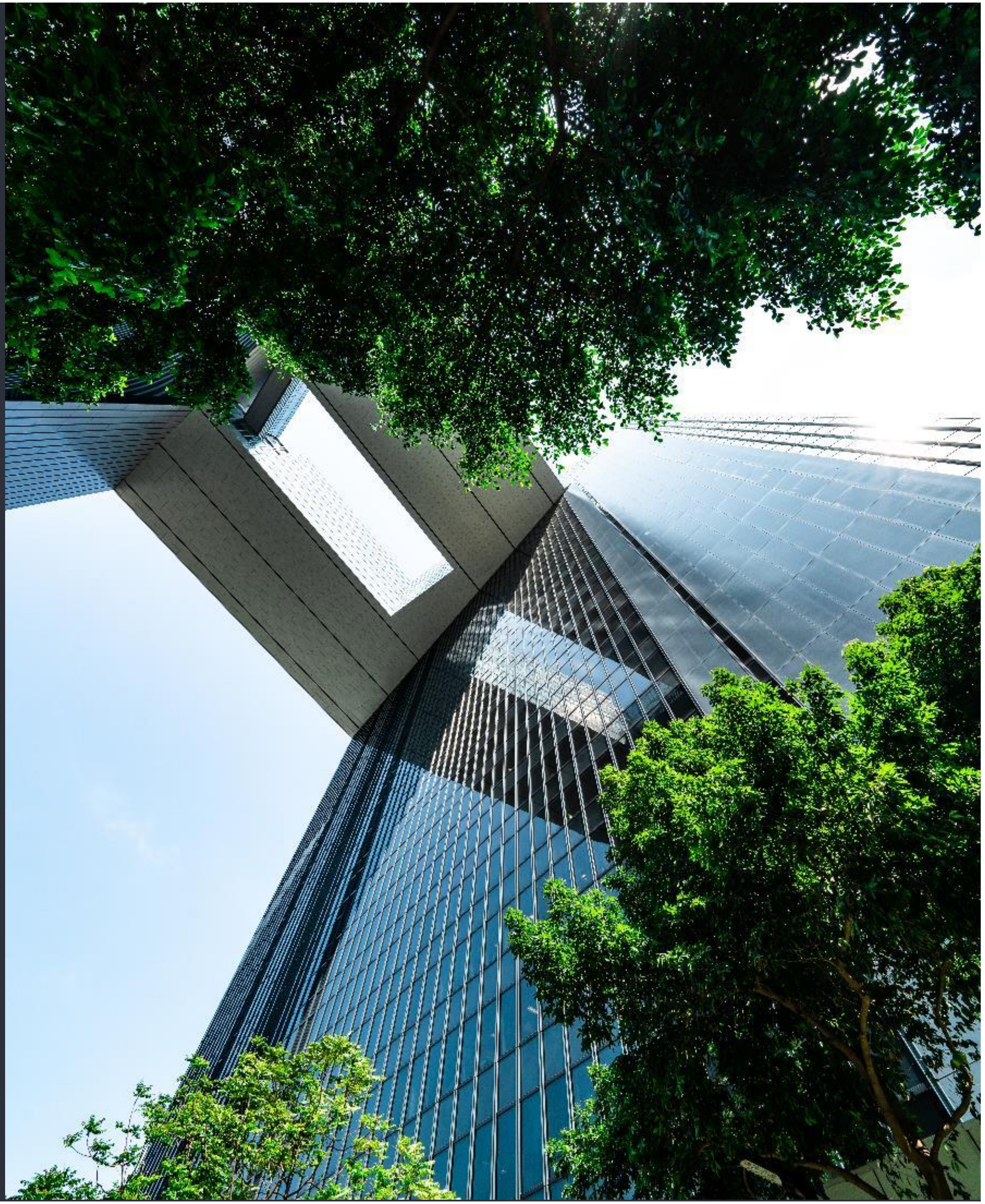
- ESG – confident of this if not signed up for PPT? Penalties and non-compliance for a specific environmental tax.
- Importing into the UK. Consider polystyrene foam used in transport and packaging. Clear plastic film to protect products.
- Fixtures and fittings (lighting, taps, shower units, glassware)
- Glazing and PVC doors and windows
- White goods
- Air Con units
- Furniture
- Polystyrene foam does not usually contain enough recycled plastic and quickly builds up towards 10MT threshold.
- Be aware of projects carried out in Spain and Italy as imports into those countries may trigger a liability there.
- German PPT is focused on the food sector. Be aware it could change as they expand the scope. Other EU jurisdictions will follow.

VAT and the DRC – is it a risk for your business

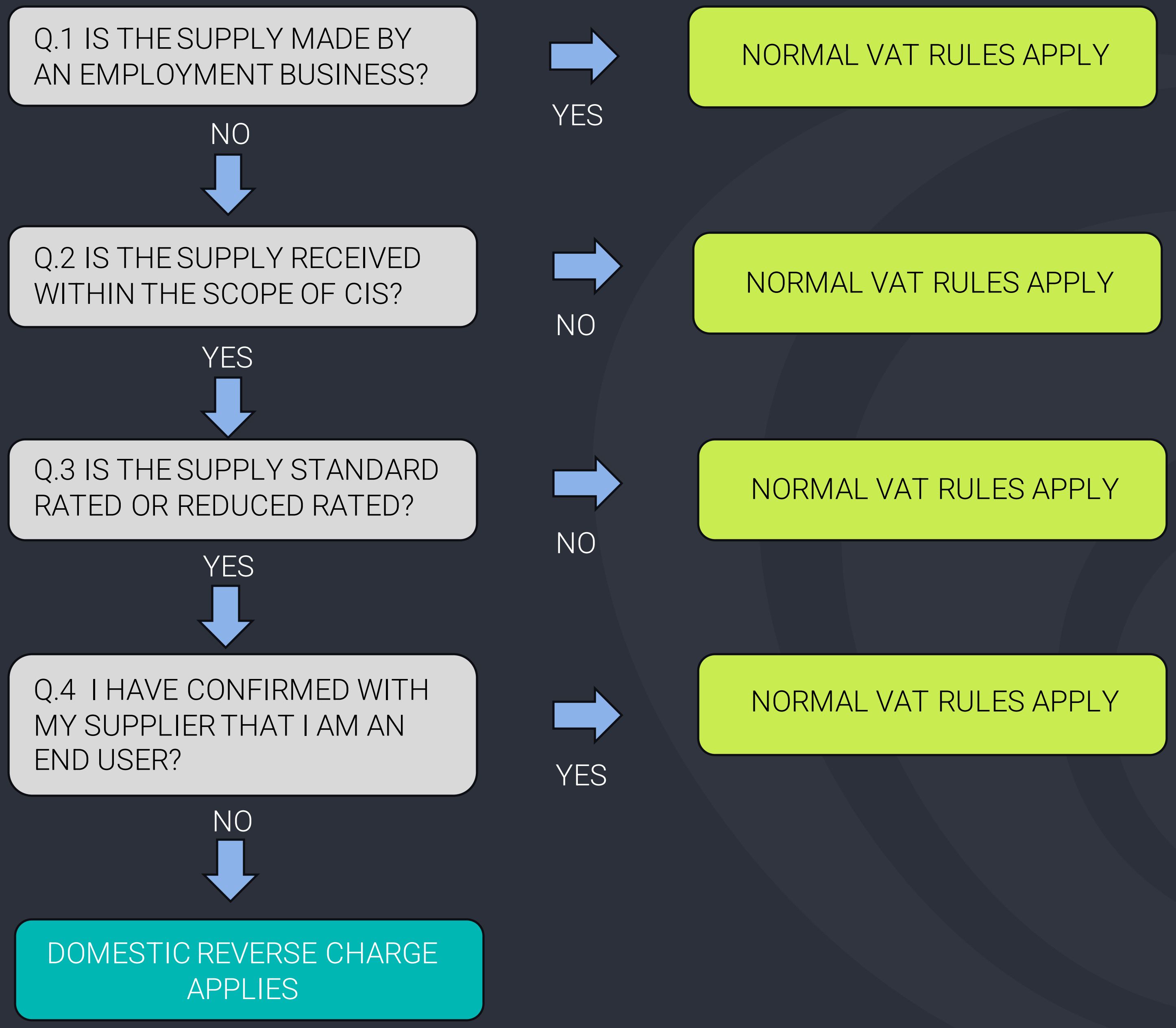
- Initial roll out March 2021 – light touch
- Now heavy approach with easy assessments where DRC should have been applied or VAT recovered when it shouldn't
- DRC and CIS so closely linked but need more integration

DRC – a reminder

- The Domestic Reverse Charge introduced March 2021
- VAT is not charged on supplies within the contractor chain
- VAT is self-accounted for by the recipient
- The services have to be within the CIS scheme
- The supplier and recipient must be VAT registered and CIS registered
- It does not apply to zero rated supplies such as new resi builds
- It meant that invoices and accounting systems need to be changed
- Where a main contractor is supplying a end user need confirmation of status
- VAT is charged when a customer says they are an end user
- If a customer is VAT and CIS registered and does not confirm end user then DRC applies



DRC diagram



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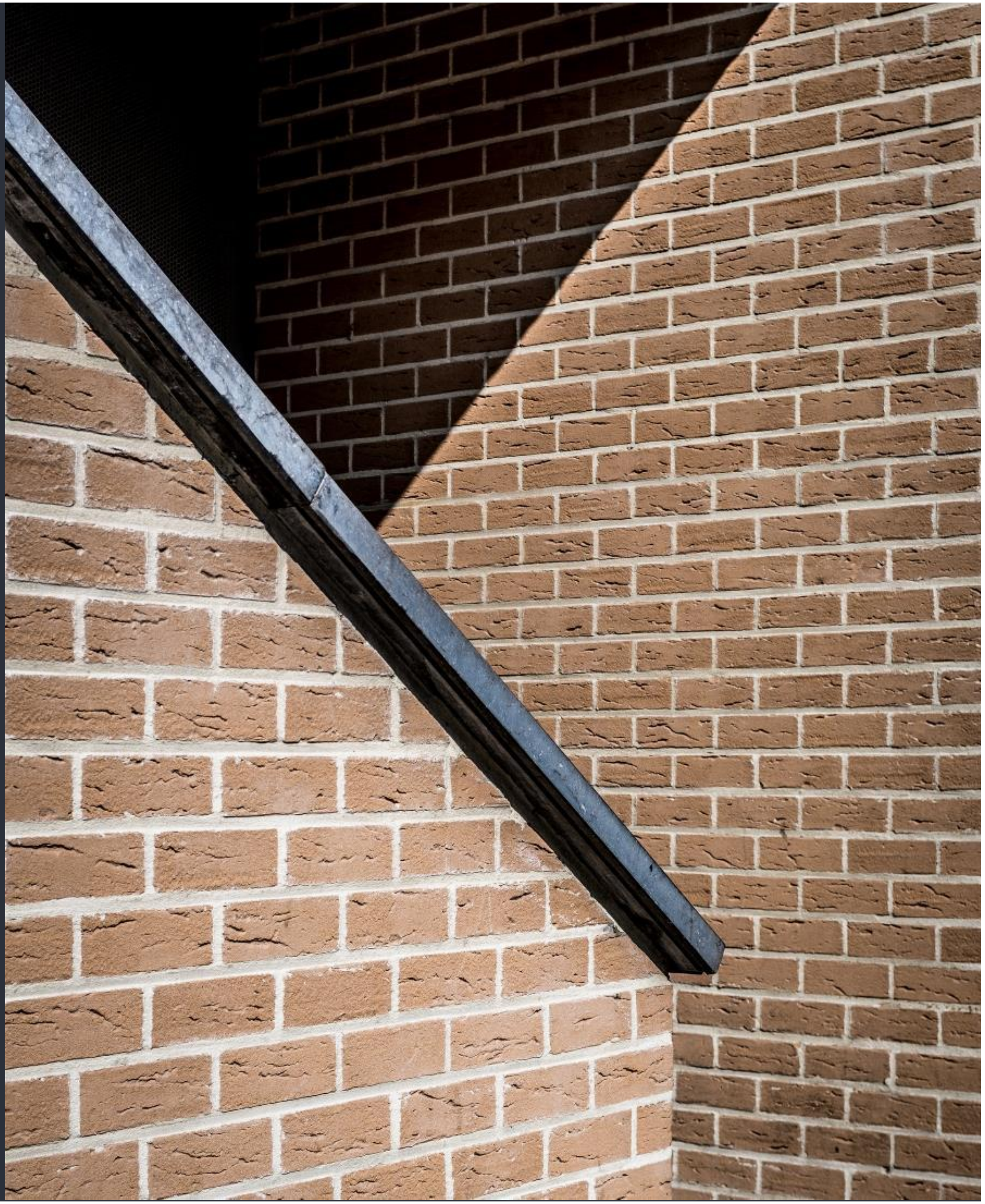
CIS operations

- Repair
- Extension
- Demolition
- Alteration
- Construction
- Installation
- Dismantling
- Painting and decorating
- Preparation and other services integral to the above.

Exclusions from DRC

- Employment providers
- Supplies not within CIS contracts
- Supplies to end users or intermediaries
- Zero rated supplies
- If the parties are not CIS or VAT registered.



Construction services

- Drilling
- Extraction
- Manufacture
- Art
- Signwriting
- Seating
- Security

On their own they are not caught but if the contract includes any of the previous services then they are all caught by CIS and DRC

Where are the risks

Financial loss to HMRC

- Assessments on a business which should have charged VAT.

- Denying input tax recovery on a business that has wrongly claimed back VAT, when the DRC should have applied.

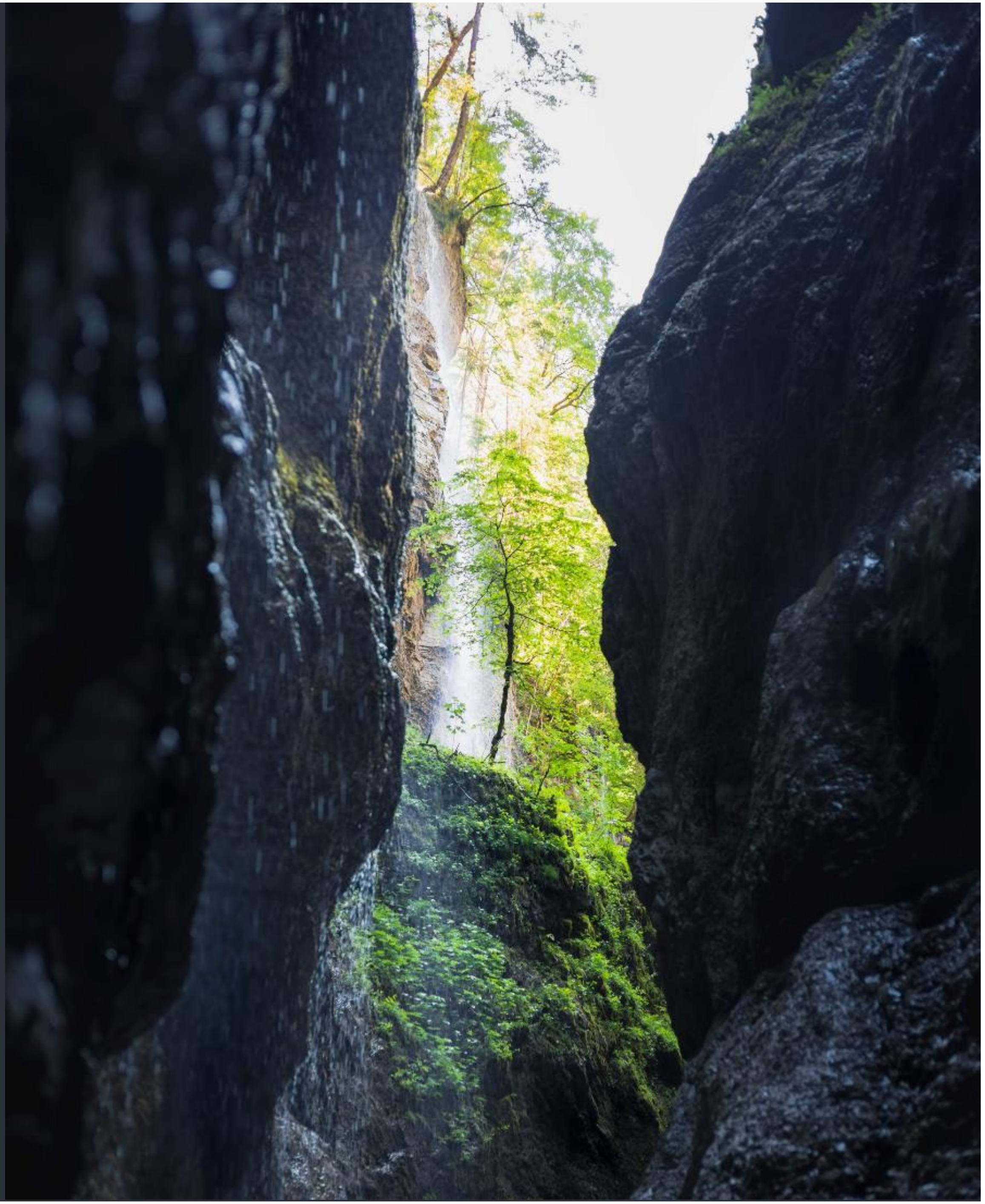
Penalties and Interest on the above.

Harm to the reputation of the business

- Ensuring the DRC process and invoicing has been carried out properly.
- CIS and VAT registration confirmation, updating and review processes established.
- Build in sub contractor and customer on-boarding to establish good practice and compliance.
- End user notifications drafted into contracts.
- Warranties in contracts to protect position on VAT and CIS as well as change to end user notification.
- Large business with a CCM and business risk review from HMRC – could push into higher risk category.

Key Takeaways

- If you are importing materials be aware of PPT
- If you are trading in the EU be aware of PPT developments and also VAT liability issues in each country
- Ensure PPT is on your risk register and it does not harm your ESG credentials
- Have robust processes in place to demonstrate good DRC compliance
- Training for finance staff and surveyors to deal with DRC and CIS
- Review processes to maintain VAT and CIS register for sub-contractors
- Attention to contracts and end user notifications and other protective warranties and vice versa



Finance Directors Forum

Break

Audit, Accounts and Financial Standards

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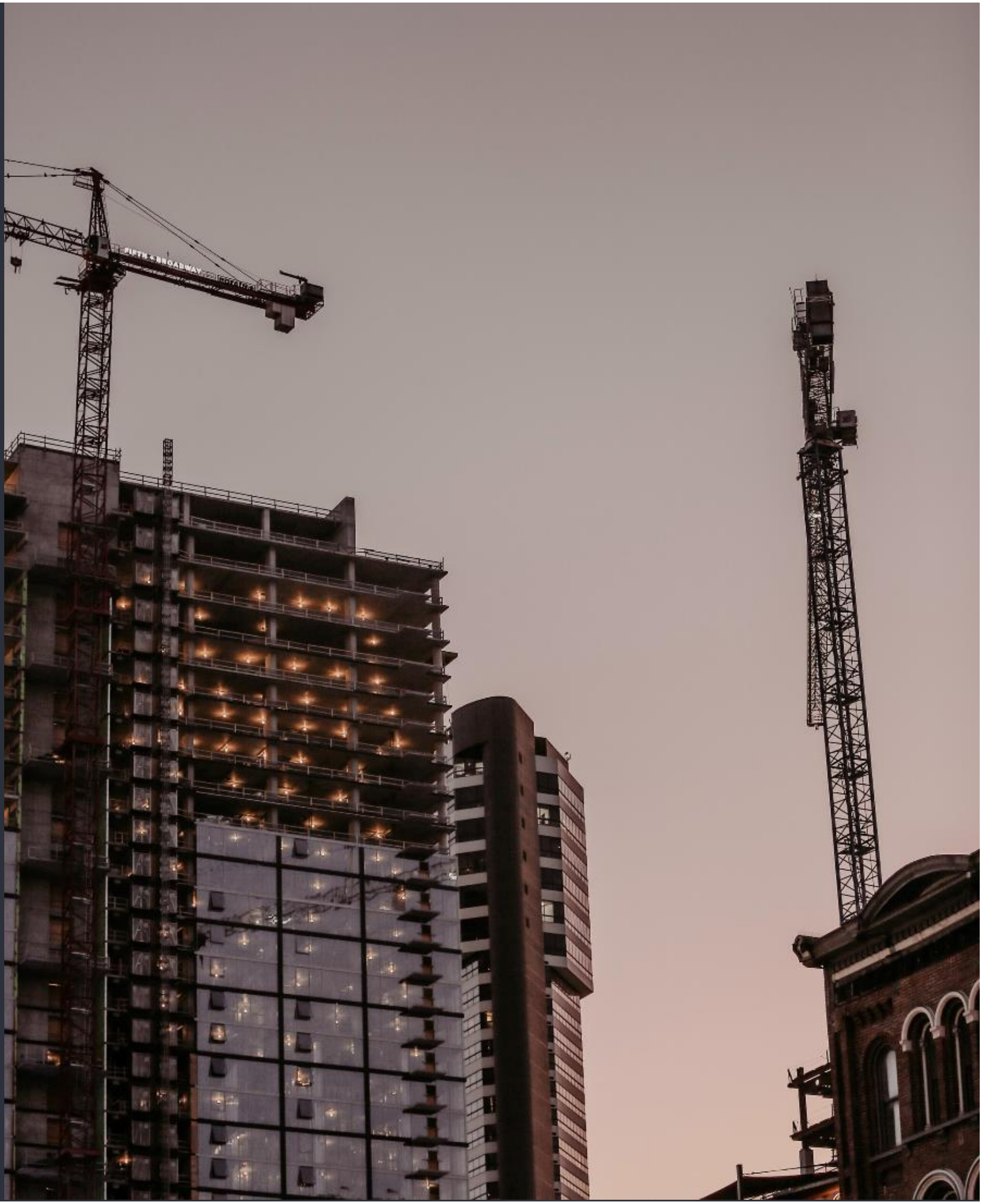
Audit, Accounts and Financial Standards

FRED 82 - Overview

The 5- step approach revisited

Right of use assets and lease liabilities

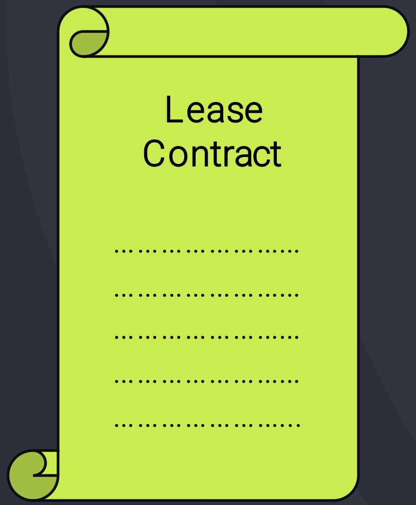
An update on UK audit reform



FRED 82 Overview

All change!

- FRED 82 issued for consultation on 15 December 2022
- Proposed some significant changes to major elements of UK GAAP



- Modifications to make the standard more useable for smaller entities
- Other modifications to increase convergence with IFRS

Other modifications

More clarity on the disclosures for small co.

Alignment of Section 2 with IASB's conceptual framework

IFRS 13 requirements on Fair value new Section 2A

Setting stage for removal of IAS 39 Option

IFRS 15s 5-step approach revisited

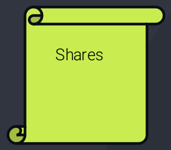
FRS 102 current model

- Dependent on the nature of the transaction:

Substantially all risks and rewards have been transferred

Construction Contracts

Percentage completion



DIVIDENDS

Right to receive payment established

SERVICES

Percentage completion

ROYALTIES

Accruals basis

FRS 102 5 - Step Model

Step 1 – Identify the contract with the customer

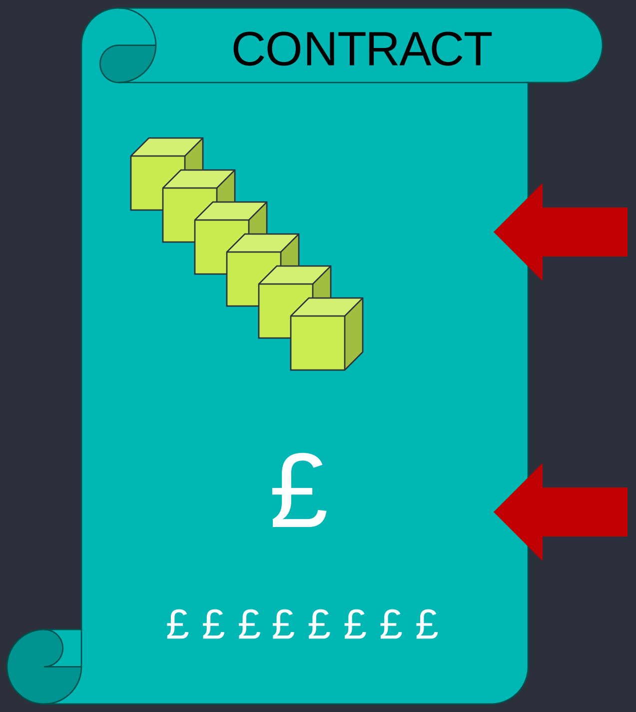
Step 2 – Identify the separate performance obligations in the contract

Step 3 – Determine the transaction price

Step 4 – Allocate price to each performance obligation

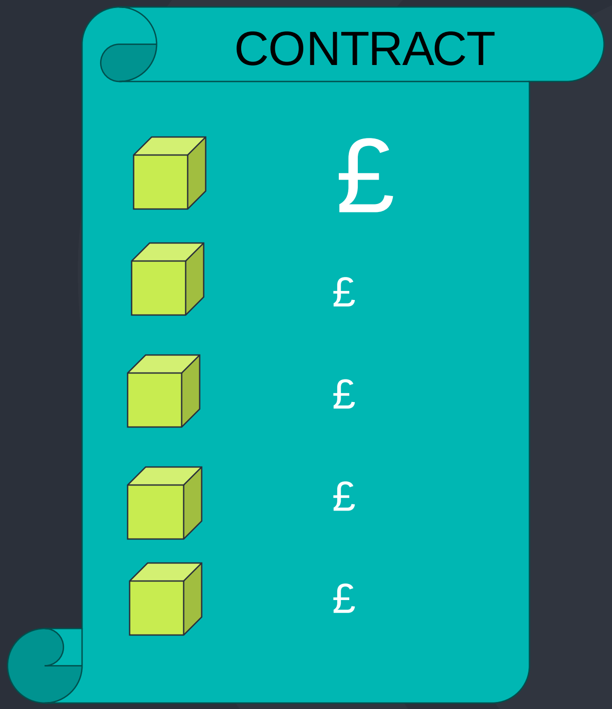
Step 5 – Recognise revenue when an entity satisfies a performance obligation

Revenue



Performance obligations

Transaction price



Performance obligations

Are matched with consideration received for performance

Revenue

- IFRS 15 <u>is not</u> a 'Revenue Recognition Standard'
- IFRS 15 is a 'Contracts Recognition Standard'
  - Contract Assets
  - Contract liabilities
  - Contract Expenses
- Lessons learned from implementation of IFRS 15
  - Who is the customer and what is the performance obligation can be tricky
  - Changes to timing of revenue recognition and the associated expenses
  - May require changes to processes and procedures
  - Fees and commissions can add complexity
- Entire industries have had to revise the way they operate in order to effectively comply with these requirements.

Right of use assets and lease liabilities

Leasing for lessees

- FRS 102’s rules for leasing by lessees is also changing
- Will converge with the IFRS 16 approach
- Another long overdue change
- Will add more complexity to the financial statements
- A new class of ‘Right of Use’ asset

A comparison

- FRS 102 Current approach

	Lessor		Lessee	
	Operating	Finance	Operating	Finance
Asset	On B/S	None	Off B/S	On B/S
Depreciation	YES	No	NO	YES
Receivable	NO	YES	N/A	N/A
Liability	N/A	N/A	NO	YES
Expense	NO	NO	YES	NO
Impairment	YES	NO	NO	YES

A comparison

- IFRS 16 / Future FRS 102 Approach

	Lessor		Lessee
	Operating	Finance	All leases
Asset	On B/S	None	On B/S
Depreciation	YES	No	YES
Receivable	NO	YES	N/A
Liability	N/A	N/A	YES
Expense	NO	NO	NO
Impairment	YES	NO	YES

What is a ROU Asset

- The right to use any asset whether
  - Land and / or Buildings
  - Investment property
  - Plant and Machinery
  - Motor Vehicles
  - Intangible Assets

- If you can access it via a rental / leasing contract then it can be a ROU.

- Need to separate ROU Assets in the financial statements so the user understands there are different rights associated with those assets.

- Amortised through profit and loss over the useful life of the asset.

Lessee's right to use the underlying asset for the lease term

- **Lease liability**
- **Lease payments/ incentives (received)**
- **Initial direct costs**
- **Decamp. costs**

Components of the Lease Liability

Fixed lease payments

(Less any incentives **receivable)**

Variable lease payments (based on index at commencement)

Additional residual value payments

Exercise price of a purchase option

Penalties for early termination

Discount using Implicit rate

OR

Incremental borrowing rate

= PV

IFRS 16 lessons

- Identification of lease contracts can be difficult especially for leases embedded within other service contracts
- When is the lease term not the lease term
- Sale and leaseback accounting can be challenging
- Modification of leases can have surprising results
  - Significant remeasurement of existing lease assets and liabilities or
  - Recognition of an entirely new lease
- Initial implementation can be time consuming and resource intensive
- If you have a complex leasing portfolio then don’t try to manage in Excel invest in software
- Finance should have input into when agreeing future leases or modifying existing ones.

An update on Audit reform

The case for Audit reform

KPMG to be fined £14m for forging documents over Carillion audit The Guardian May 2022

BDO and Mazars slammed for 'unacceptab audits accountingweb July 2022

EY and Wirecard: anatomy of a flawed audit Financial Times October 2021

Grant Thornton fined £2.3m for Patis Valerie scandal BBC September 2021

Deloitte fined record £15m for failings in Autonomy audits The Guardian September 2020

KPMG faces investigation over Conviviality audit THE GUARDIAN July 2018

PwC bosses to face questions from MPs over Thomas Cook Accountancy Age October 2019

Reviews and recommendations

- Independent Review of the Financial Reporting Council – December 2018

  - FRC to be replaced as soon as possible with a new regulator ARGA with clear statutory powers and objectives
  - Changes to the definition of PIE and stronger regulation of PIEs by new regulator
  - Improvements to the enforcement regime including more public scrutiny of enforcement decision.
  - Regulator to be give power to require changes to accounts it considers misleading

- Competition and markets Authority study - April 2019

  - Mandated joint Audits and peer review
  - Operational split between audit and non-audit services
  - Legislation to implement Brydon recommendations for replacement of the FRC with new audit regulator

- The quality and effectiveness of audit (Brydon review) – December 2019

  - >68 separate recommendation for how the operation of the audit industry and the audit process could be improved.
  - Increased powers and objectives for ARGA
  - Improving the work of audit committees
  - Additional reporting responsibilities for auditors

Paved with good intentions…

- Initial flurry of activity.

- Since initial engagement governments agenda for change has been somewhat sidetracked
  - Brexit
  - Negotiations on relationship with Europe and the rest of the world
  - The Trump presidency
  - Three different prime ministers with at times very different visions

- The world of financial reporting has not been standing still
  - FRC preparing for change. More aggressive approach to regulation of the profession
  - New UK endorsement board for UK standards
  - Continuing issues with audit quality

Where to next?

“Overdue reform of auditors is set to be delayed again

Failures such as that of Carillion have increased the focus on the auditing industry
DANIEL SORABJI/AFP VIA GETTY IMAGES

“UK government set to omit audit reform from legislative plans

Overhaul of accounting regulation and corporate governance is facing fresh delay

Where to next?

Audit reform omission shows it is ‘not a priority’ for government

The accounting industry is disappointed but ultimately “not surprised” at the news that UK government officials are likely to postpone the scheduled restructuring of the UK’s audit and governance regime, senior market participants have argued.   1st Sep 2023

- Anyone's guess really!
- Urgent need for leadership and direction on this issue
- Uncertainty not good for business and certainly not good for the auditing profession.

Where to next?

FT FINANCIAL TIMES

Anne Kiem
Chief Executive

Chartered Institute
of Internal Auditors,
London SW4, UK

Letter: The UK has no excuse to further delay audit reform

5 September 2023

It would be deeply concerning if the much-needed overhaul of audit and corporate governance regulation were further delayed, following the report that it is to be omitted from the King's Speech ("Audit reform set for further delay", Report, August 31). It has now been over five years since the collapse of the construction company Carillion, over four years since Sir John Kingman delivered the final report of the Independent Review into the Financial Reporting Council, over three years since Sir Donald Brydon delivered the final report of the Independent Review into the Quality and Effectiveness of Audit and over two years since the government published the Restoring Trust in Audit and Corporate Governance white paper. So, if not now, when exactly? The fact is that reform of audit has already been delayed for far too long and it is time the government delivered these reforms by publishing the audit reform bill it promised in the Queen's Speech over a year ago.

ESG Audit Considerations

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Partner

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About Us

A *new* perspective on sustainability and ESG

Our guiding principle: *‘Purpose, with Profit’*

Corporate sustainability doesn’t have to come at the cost of corporate profitability.

Mark J Lumsdon-Taylor. MHA Sustainability Partner

ESOS and SECR

Energy Savings Opportunity Scheme (ESOS)

Phase 3 effective 31 December 2022

Scope

- >250 employees
- Turnover >£42.5 million
- Balance sheet >£36.5 million

Requirements

- Measurement of energy use
- On-site energy audit
- Identification of cost-effective energy efficiency recommendations
- Compliance report, submitted to the Environmental Agency

Action

Multiple routes to compliance:

- Commissioning ESOS energy audits through approved ESOS assessors
- ISO 50001 certification
- Display Energy Certificates (DECs) and accompanying recommendation reports
- Green Deal Assessments

Streamlined Energy and Carbon Reporting (SECR)

Effective since 2019, often missed by expanding companies

Scope

- All UK-incorporated companies listed on LSE main market, NYSE/NASDAQ or EEA exchange
- Unquoted large companies preparing directors report under Part 15 of Companies Act 2006
- Large LLPs (as per existing 'large' definition)
- Turnover >£36 million
- Balance sheet >£18 million
- >250 employees
- Unquoted companies / LLPs exempt where annual consumption <40 MWh

Requirements

- Annual energy use (kWh) & greenhouse gas emissions (scope 1 & 2)
- Emissions intensity ratio, using a metric selected by the company
- Methodologies used to calculate the required information
- Narrative on how the company is improving energy efficiency
- Prior year figures for comparison, if available

Action

- Ensure internal controls over reporting are robust
- Consider external assurance / internal audit

ESOS best practice

Identify ‘consumed’ and ‘unconsumed’ supplies:

- ‘Unconsumed’ supplies – supplies you do not consume but provide to a third party (e.g. as property landlord). To be deducted from total consumption, data **must** be verifiable
- Consumed supplies – all other energy supplied to and consumed across all assets and activities, either from an energy supplier or from energy generated by your activities

Potential sources of energy consumption:

Buildings
- Electricity (kWh)
- Combined Heat & Power (CHP) (lighting, air conditioning, electrical equipment)
- Gas (kWh)
- Heating systems / boilers

Industrial Processes
- Electricity (kWh)
- Combined Heat & Power (CHP) (refrigeration, motors & drives)
- Gas (kWh)
- Natural gas for heating / cooling processes
- Waste Heat for fuel (kWh)
- Process Waste for fuel (kWh)

Transportation
- Business Fuel (litres)
- Petrol, diesel, bio-fuels, aviation and shipping fuel

SECR best practice

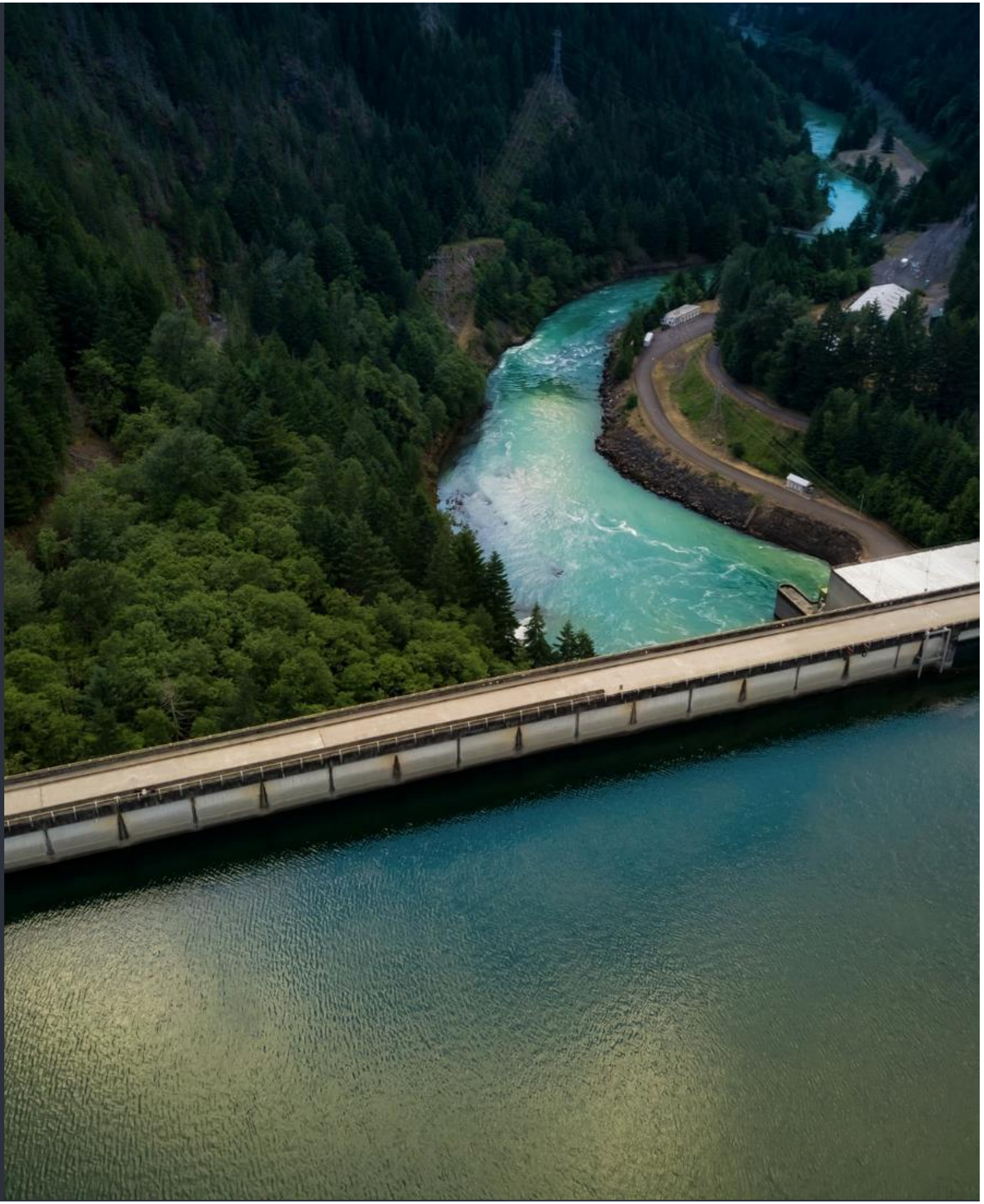
- Identify the appropriate factor for the intensity ratio:
    - FTEs – may be appropriate where emissions directly related to use of equipment or usage hours (e.g. heavy construction)
    - Headcount – may be appropriate where emissions directly related to number of unique individuals working (e.g. IT services)
    - Production units – may be appropriate where emissions directly related to number of units produced (e.g. food and agribusiness, manufacturing)
    - Expenditure – more likely to be a stable representation of activity year on year
    - Revenue – less appropriate than other factors, may be appropriate where income directly relates to emissions-generating activity

- Disclosing scope 3 emissions other than employee vehicles
- Business travel by train or air
- Supply and treatment of water
- Disposal of waste
- Use of hotels
- Disclosing scope 1 emissions other than gas including heating oil and wood fuel
- Making a distinction between energy usage from renewables and non-renewables
- Reporting of location-based and market-based emissions – although this needs to be clearly explained to avoid being confusing. Explanation of the difference and linking to the above separation of renewable and non-renewable energy usage may help
- Reporting well-to-tank energy consumption rather than reporting purely based on energy bills
- Disclosing usage of sustainable materials
- Reporting on waste management and recycling
- Reporting multi-year trends in carbon emissions

CSRD and ESRS

Corporate Sustainability Reporting Directive

European Sustainability Reporting Standards



CSRD and ESRS

Corporate Sustainability Reporting Directive

effective 1 Jan 2024

- ‘Large’ entities meet two of following:
  - Balance sheet total >€20 million
  - Net turnover >€40 million
  - Average employees in year >250
- Non-EU groups:
  - EU-based turnover >€150m **and**
  - EU subsidiary or branch with net turnover >€40m
- First set of ESRSs finalised July 2023:

Environmental	Social	Governance
Climate change	Own workers	Business conduct
Water & Marine resources	Workers in value chain	
Biodiversity & Ecosystems	Affected communities	
Resource use & Circular economy	Consumers & End-users	

- ESRSs take a ‘double materiality’ approach:
  - ‘Outside-in’ – effect of climate change and other ESG impacts on the business (typically investor perspective)
  - ‘Inside-out’ – effect of the business’ activities, supply chain and distribution channels on its material stakeholders, viewed from the stakeholders’ perspective

CSRD and ESRS

2025 (on 2024 data)

Entities already subject to NFDD (‘large’ listed entities, banks and insurance entities with >500 employees)

‘Large’ non-EU listed with >500 employees

2026 (on 2025 data)
‘Large’ entities not subject to NFDD

2027 (on 2026 data)
Listed SMEs and non-EU listed SMEs

2028 (on 2027 data)

Listed SMEs and non-EU listed SMEs

EU subsidiaries and branches of non-EU parents (standalone **and** group-level impact)

CSRD and ESRS

Best Practice

Start from 'first principles'

- Working backwards from the reporting standards is the easiest way to waste time and money; and may not result in compliance!
- Consider how your business identifies, measures and responds to ESG risks and opportunities
- Focus on your value chain – where are ESG impacts most likely to be present, e.g. raw materials extraction, manual labour in countries with human rights abuses or health and safety concerns, use of water / land
- Assess the circularity of your products – e.g. can they be re-used, recycled, re-deployed
- Determine who your material stakeholders are, including those without a voice (e.g. the climate) – and which issues are material to them
- SASB and GRI sector-specific standards are helpful to identify material issues for your industry and appropriate ESG metrics

Value chain

- Do you know who your suppliers' suppliers are? Less than 2% of companies can currently see beyond the second tier of their supply chain – the further up the chain you go, the more impacts you will identify
- Mandate sharing of ESG data through your supplier / distributor contracts
- Understand whether your suppliers obtain any assurance/verification on their ESG data
- Assess your reporting boundary and how far upstream / downstream you need to go before impacts are no longer material to your stakeholders

TCFD and UK Climate-Related Financial Disclosure (CFD) Requirements

TCFD scope expanded to larger private companies and LLPs

- Public Interest Entities, premium listed groups and financial services entities already in scope of TCFD under the FCA Listing Rules

- Companies Act 2006 amended last year, expanding UK CFD scope to:
  - Subsidiaries with >£500 million turnover and >500 employees
  - Parent entities (at any time in financial year) where group turnover >£500 million and >500 employees
  - AIM-listed groups with >500 employees

- New UK CFD scope applies for accounting periods starting on/after 6 April 2022

- Responsibility for TCFD recommendations has now passed to the ISSB, which incorporates TCFD into IFRS S2 *Climate-related Disclosures*

- Additional 'supplemental guidance' (= requirements) for high-intensity sectors:
  - Financial services
  - Energy – including oil, gas, coal, electric utilities
  - Transportation – including air freight, passenger air, maritime transportation, rail, trucking services, automobiles
  - Materials and buildings – including metals, mining, chemicals, construction materials, capital goods, real estate management and development
  - Agriculture, food and forests – including beverages, packaged foods and meats, agriculture, paper and forest products

Governance

How the Board / Executive Team steward climate risks and opportunities

Strategy

The business' strategy towards climate risks and opportunities, e.g. financial / operational planning

Risk Management

How the business identifies, assesses and manages climate-related risks

Metrics & Targets

Metrics and targets used to assess and manage climate-related risks

2 Years In – Identification of TCFD Developments

With the FCA promising to follow up on its findings, and the FRC (through its Corporate Reporting Review Team) already including issues with climate reporting in its letters, we believe that every company should look again at their TCFD reporting.

Some companies are also starting to make significant strategic decisions, including where to allocate capital, based on information disclosed as part of the TCFD requirements. This is when dealing with the TCFD requirements becomes part of core business decision-making, as well as a priority for regulators and other stakeholders.

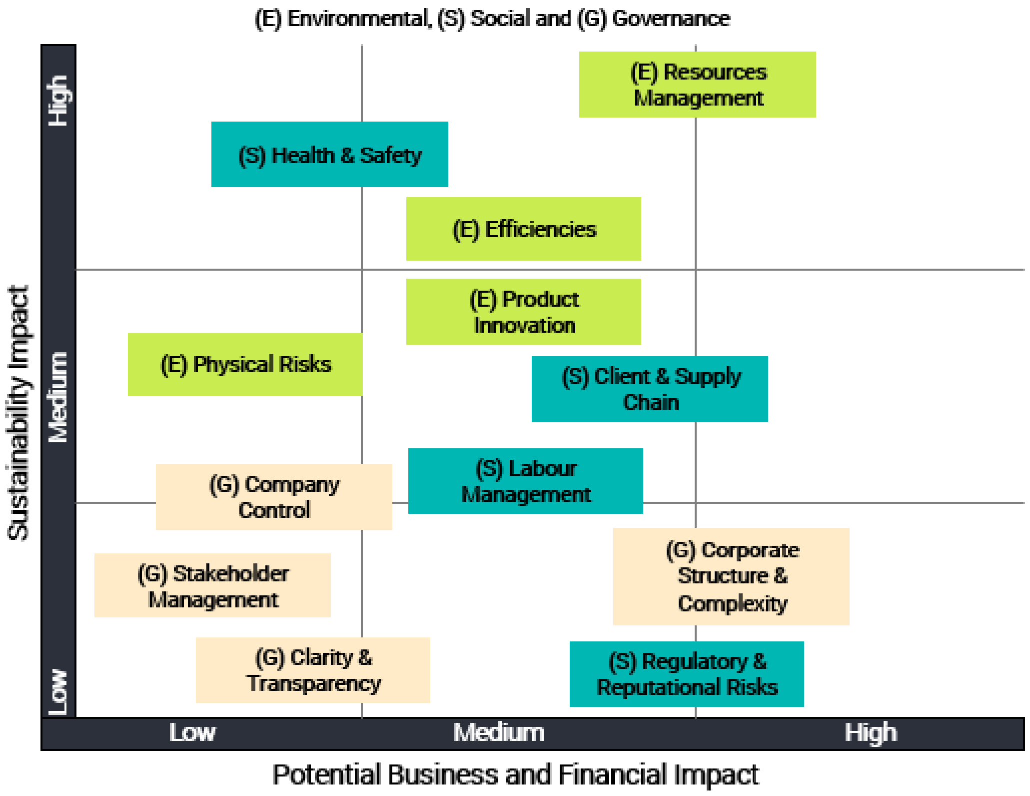
There are a number of specific high-level recommendations and specific areas to consider:

- **Recommendation 1 –** There needs to be a solid basis for the judgements that are made on the relevance and impact of climate change, which should also be reflected in reporting. (Documentation; Proportionate; materiality assessment)
- **Recommendation 2 –** The relevant regulated Listing Rule reporting requirements all need to be appropriately implemented. (Not breaching key LR Guidance. If a business cannot disclosure: **LR 9.8.6 (8) (b)**) – need to provide explanation)
- **Recommendation 3 –** The two most common areas where the regulators found companies to be inconsistent with the TCFD framework particularly need to be looked at again.

  (Scenario Analysis & Metrics – not always CRM…)
- **Recommendation 4 –** Companies need to remember that the TCFD framework is looking for climate-Related *financial* disclosures. Specifically, about quantifiable risk.
- FRC Thematic, page 47: *"We expect companies to provide discussion and,* ***where practical****, quantification of the expected impact of climate-related risks and opportunities on operating costs and revenues, capital expenditures and capital allocation, acquisitions or divestments, and access to capital."*
- ISSB: *"At a minimum an entity would need to undertake the qualitative form of scenario analysis as a basis for its resilience analysis."*

Materiality of ESG Factors on the Construction and Construction Materials Industry

Our Dynamic ESG framework includes various broader categories related to environmental, social and governance factors. We differentiate between the impact these factors have on sustainability and on the company’s credit profile (business and financial risk). Not all ESG factors influence creditworthiness to the same extent.



TCFD & UK CFD Best Practice

> *The most useful disclosures clearly stated the company's climate-related metrics and targets, explained which metrics are used to measure and manage climate-related risks and opportunities, and explained which are used to assess progress against targets."*
>
> FRC Thematic Review, July 2023

- Materiality – identify which topics and information are material for your stakeholders. If an issue is identified but assessed as not material, be prepared to justify this if challenged
- Describe the process the business undertook to determine which information to include/exclude and assess materiality
- Use infographics to communicate complex information
- Consider location of disclosures – UK CFD requires disclosures in the 'Non-Financial and Sustainability Information Statement' of the Strategic Report, TCFD agnostic
- Assess signposting within the annual report and highlight critical impacts
- Companies subject to TCFD under the FCA Listing Rules **must** provide a clear statement on the extent of compliance with TCFD – approx. 5% did not provide a statement, 45% were partially compliant with TCFD, 50% fully compliant
- Explain reporting boundaries and data limitations, with clear actions on how you will improve data quality / completeness
- Explain where there have been changes to previously-reported metrics, e.g. due to updated definitions or corrections of errors
- Provide information on your transition plan to a lower carbon economy
- Explain what is meant by 'carbon neutral', 'net zero'
- Highlight areas of uncertainty, particularly in regard to scope 3 emissions

FRC – CRR Thematic Review of Climate-Related Metrics & Targets

TCFD – July 2023

Improvements Identified:

- the definition and reporting of company-specific metrics and targets, beyond headline 'net zero' statements;
- better linkage between companies' climate-related metrics and targets and the risks and opportunities to which they relate;
- the explanation of year-on-year movements in metrics and performance against targets;
- transparency about internal carbon prices, where used by companies to incentivise emission reduction; and
- better linkage between climate-related targets reported in TCFD disclosures and ESG targets disclosed in the Directors' Remuneration Report

Specifically, Energy (response sample):

'Most companies disclosed net zero targets.

All companies reported some Scope 3 emissions, but it was not always clear what these related to and whether they were included in the net zero targets.

Most companies reported some relevant sector-specific and cross-sector metrics, but could improve the linkage with risks and opportunities.

The larger companies in the sample provided helpful explanations of the assessment of climate on the financial statements.'

ISAE 3000

Reminder

Assurance for external corporate reports, ensuring their financial and non-financial key-performance indicators reported are aligned with strategies (under defined parameters)

Providing assurance on financial and non-financial metrics and processes (ISAE 3000).

Assurance services related to corporate reporting of sustainability or environmental, social, and governance (ESG) information.

Corporate reporting:

- Corporate report evaluation, gap assessments and strategic roadmap(s)
- Alignment of corporate reports to new reporting frameworks
- External reporting development (e.g., Annual report, Integrated report)

Performance measurement:

- KPI evaluation, gap assessments, and strategic roadmaps
- KPI mapping and process documentation
- Automation of KPI reporting

Assurance over KPIs:

- ISAE 3000 (Revised) – Assurance Engagements Other than Audits or Reviews of Historical Financial Information
- ISAE 3400 – The examination of prospective financial information
- ISAE 3402 – Assurance Reports on Controls at a Service Organisation
- ISAE 3410 – Assurance Engagements on Greenhouse Gas Statements

New Approach to ISAE3000 – The ISSA International Standard on Sustainability Assurance

ISSA 5000 will serve as a comprehensive, stand-alone standard suitable for limited and reasonable sustainability assurance engagements. It will apply to sustainability information reported across any sustainability topic and prepared under multiple frameworks.

Key areas of focus in developing the standard:

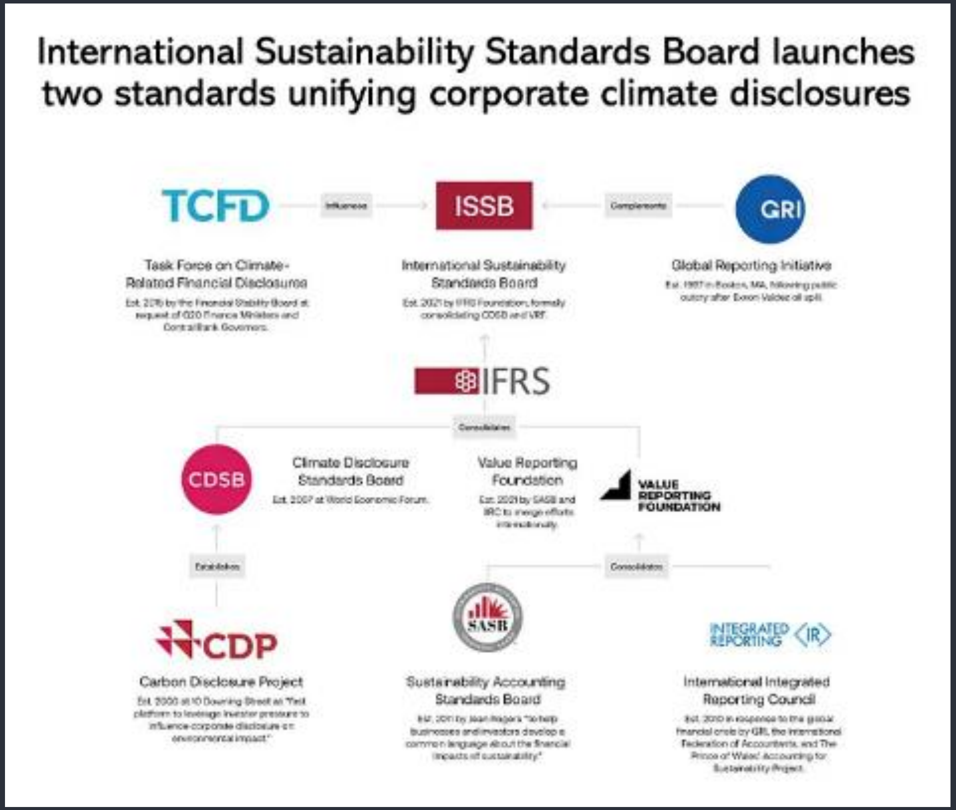
The standard will address the conduct of an assurance engagement in its entirety. However, the IAASB will specifically consider the requirements and application material for the following six priority areas

1. difference in work effort between limited and reasonable assurance;
2. suitability of reporting criteria;
3. the scope of the engagement;
4. obtaining and evaluating evidence;
5. the entity's system of internal control;
6. and materiality. (IAAB 2022B:9)

Set to supersede ISAE3410, ISAE3000.

IFRS S1 and S2

Accounting Standards – IFRS S1 & S2



IFRS S1 introduces a comprehensive range of disclosure requirements designed to provide investors with a more nuanced understanding of a company's short, medium, and long-term exposure to sustainability-related risks and opportunities. (Excludes the double materiality principle, which requires considering the impact of corporate activities on the environment)

The **IFRS S2** provides a detailed and standardized framework for reporting climate-related risks and opportunities, ensuring that investors have access to crucial information to assess a company's preparedness, resilience, and potential impact in a changing climate landscape.

Effective – JANUARY 2024.

ISQM – International Standard on Quality Management

Important note **after 15th December 2022** – assurance engagements:

Note:
For assurance engagements beginning on or after 15 December 2022, the assurance report needs to include a statement that the firm of which the practitioner is a member applies ISQM 1 (or other professional requirements, or requirements in law or regulation, that are at least as demanding as ISQM 1).

Auditing Climate Risk

Clarity in Understanding audit risk.

Climate-related Risk

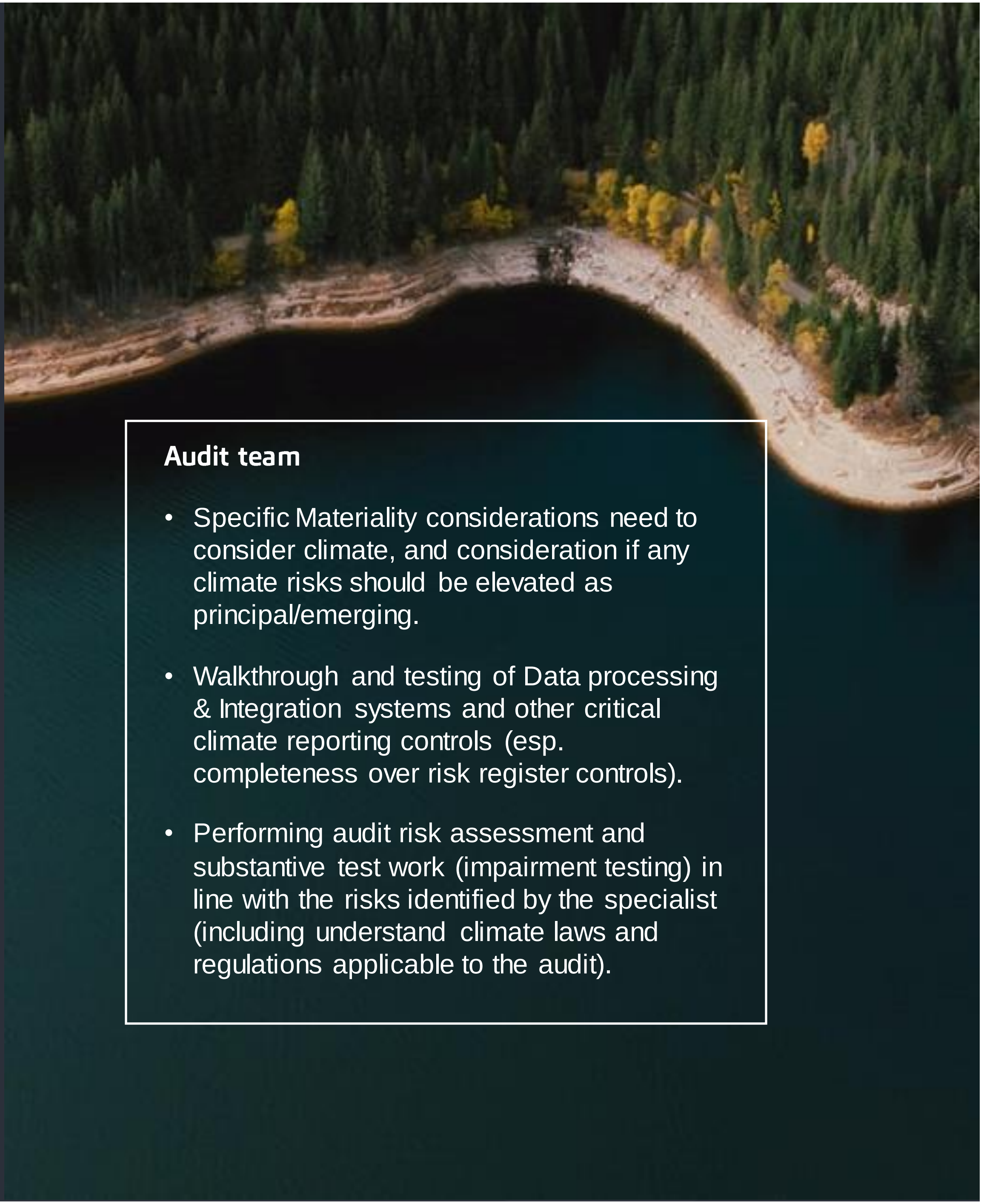
1. **Physical risks** - These are risks associated with disruption to business activities arising from climate change. Physical risks are further categorised into acute risk and chronic risk.

2. **Transition risks** - These are the risks associated with a global commitment to move to a low carbon economy. Transition risks are further categorised into policy and legal risks, technology risks, market risks and reputation risks.

Risks Identified in key sectors

1. Financial sector – banks, insurance groups, asset owners, asset managers

2. Non-financial sector – energy, transportation, material and buildings and agriculture, foods and forest products, Oil + Gas, Mining & Heavy Industrial



Audit team

- Specific Materiality considerations need to consider climate, and consideration if any climate risks should be elevated as principal/emerging.
- Walkthrough and testing of Data processing & Integration systems and other critical climate reporting controls (esp. completeness over risk register controls).
- Performing audit risk assessment and substantive test work (impairment testing) in line with the risks identified by the specialist (including understand climate laws and regulations applicable to the audit).

Risks and Opportunities
Climate Change

Clarity in Understanding audit risk.

1 Climate-related Risk - Physical

Physical risks
These are risks associated with disruption to business activities arising from climate change. Physical risks are further categorised into acute risk and chronic risk:

Acute risk
Acute risks include one off disruptions such as hurricanes, floods and fire

Chronic risk
Chronic risks are more gradual changes such as changing rain patterns and rising sea levels

2 Climate related Risk - Transitional

Policy & Legal Risks
Government; regulation; carbon pricing & capping.

Technology Risk
Technology will allow existing products and services to be replaced with ones that are more energy efficient and deliver lower emissions.

Market Risk
here is a significant change in consumer behaviour and expectations with consumers looking for low carbon goods and services.

Reputational Risk
Stakeholders have higher expectations of how businesses respond to climate change issues.

Risks and Opportunities
Climate Change

Specific financial statement considerations

Going concern
Are there any material uncertainties over the business' sector, operating environment, suppliers or customers, lenders, arising from climate risk?

Impairment risk – goodwill, other intangibles, property, plant and equipment
Are the cash flows and economic benefits generated by the CGU / assets sufficient to justify their valuation? Are assets at risk of obsolescence from emerging technology?

Impairment risk – inventories, including work in progress
Is the valuation of stock recoverable through sales? Does an active market exist for the products? Is any inventory at risk of obsolescence from emerging technology?

Impairment risk – trade receivables
Has the credit risk profile of the customer base worsened as a result of climate risk, e.g. specific customer going concern risk / ability to pay invoices?

Valuation – financial instruments
Is the fair value affected by climate risk, e.g. interest rates, inflation risk, counterparty default risk, credit risk? Are the cash flow hierarchies / waterfall mechanisms affected by ESG performance criteria? Has the ESG risk been appropriately factored into the fair value?

Completeness – regulatory obligations / provisions
How has the business identified the legal requirements it is subject to, and how does the business stay abreast of these? Has the business complied with ESG-relevant legislation, e.g. ESOS, SECR etc?

Completeness – constructive obligations / provisions
Has the business' professional body stated the sector has a responsibility to rectify, reduce or offset its ESG impacts? Is there a current, valid expectation on the business to incur additional expenditure in relation to its carbon emissions?

Indirect taxation, import & export duties, climate levies
Is the business on top of its tax obligations, e.g. plastic packaging tax?

ESG Services

MHA Dynamic ESG Advisory

Create an Integrated External Engagement Framework (IEEF)

Evaluate performance and create ESG plan (ESGP). Right Audience? Capacity? Innovation & Fresh Thinking? Actions (commitment) internal & external?

Implement IEEF & ESGP Solutions with effective ROI and communications frameworks

- We passionately believe that an ESG commitment should deliver a significant return on investment
- Whether that return comes through energy payment savings in the form of Climate Change Agreements, through efficiencies or through grants, bursaries or beneficial funding we know that every business can make sustainability pay

We call it 'Purpose with Profit'

“

Corporate sustainability doesn't have to come at the cost of Corporate profitability.

Mark J Lumsdon-Taylor
MHA Sustainability Partner

Advisory

- MHA Dynamic ESG - a complete approach to embedding ESG from companies that are taking their first ESG steps through to the operation of a fully integrated ESG programme:
- Full ESG & Net zero plan: “Create; Evaluate; Implement”
- GHG (Greenhouse Gas) emissions – collation and the journey to Net Zero and its associated reporting
- SECR* and ESOS* compliance & Reporting (Assurance & Technical)
- Advice on UKETS (UK Energy Trading Schemes), Carbon Code,GRI Reporting (Global Reporting Initiative)
- Specific Scheme support: CCAs (Climate Change Agreements), UKTI grants, VCCAs (Voluntary Climate Change Agreements)
- ISAE 3000 non-financial assurance, Green Finance Solutions & Bespoke Marketing & Communications

Assurance & Compliance

- Climate reporting & Disclosures under TCFD & S172 Legislation
- Audit assurance (Note: FRC Thematic review)

Sector insights, current issues and legislative points on the horizon

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Renters Reform Bill

> **"Safer, fairer and higher quality homes thanks to a once in a generation overhaul of housing laws"**

- Section 21 to be abolished after court system improved for handling legitimate possession cases BUT No time-line
- Grounds for repossession
  - Moving in
  - Selling
  - Superior landlord lease termination
- Fixed term tenancies to be banned
  - Student accommodation to be exempted -cyclical market- academic year
- Landlords consider all requests for pets – 42 day time limit- some exceptions
  - Pet Insurance – to cover damage
- Rent increases – annually – simple form to be used- 2 months notice
  - Tenant to appeal to First Tier Tribunal
- Illegal for blank bans on benefit claimants or families with children
- Property Portal
  - Landlords obligations
  - Tenant support for new tenancy agreements
  - Landlord and dwelling to have a unique entry
- Landlords legally obligated to Join a new Ombudsman scheme (Companies House for landlords?) should be linked to the "Privately Rented Property Portal"
  - Landlords with Managing agents – still need to register
  - Tenants only complaints to Ombudsman
- Decent Homes Standard extended to PRS
  - Social housing must be free from serious health and safety hazards – When?
- Enforcement Powers for LA's
  - Targeting criminal landlords
  - When?

Building Safety Act 2022

Technical functional requirements of building regulations are not changing

BSA provides an application process for High Risk Buildings:

- Building Safety Regulator (BSR)
  - Must approve application before work commences
  - Approve any major changes to original scope
  - Must receive a " Golden Thread " bible on completion to obtain completion certificate

Building control approval application will contain details of:

- Competence of person appointed
- The approach to meeting functional requirement (Building Regs)
- Occupation – assumptions on future management
- How the build will be managed through construction
- How change of control will be managed throughout

HSE is a statutory consultee – fire and rescue + sewage consultations

BSR will be a multi-disciplinary team – 12 weeks timeline for new build 8 weeks for existing buildings

A residential building cannot be occupied until BSR approval

Client will need to appoint a competent Designer and Principal Contractor

Duty holders will have to demonstrate to the regulator how heir building is designed , built and managed such that there legal duties are fulfilled

Mandatory Occurrence Reporting – required when there is a safety occurrence (structural or fire safety) design or in construction that may lead to occupational risk if not remedied

Completion certificate –MDT to undertake final inspection – issues certificate within 8 weeks – this allows registration of the HRB

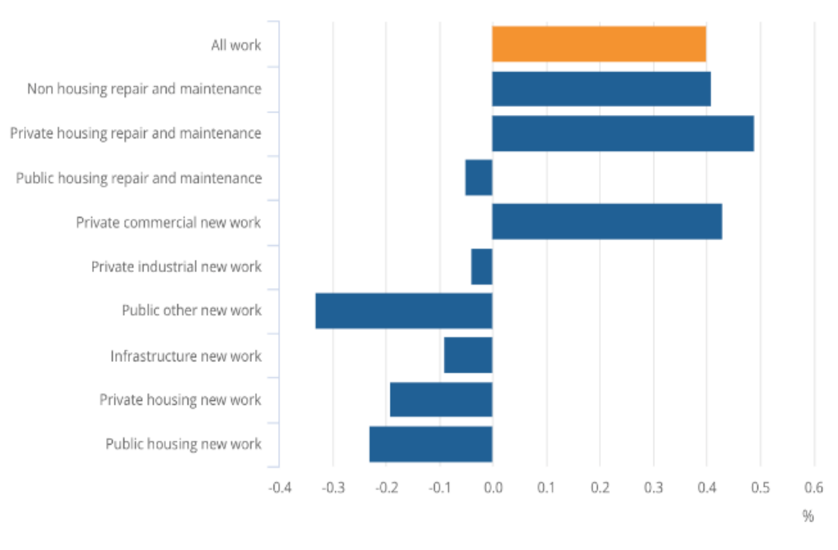
Potential issues

- Not clear at application stage how much detail required
- Cost of waiting for property to be issued for a completion certificate through non occupation
- Criminal liability for breaches of certain provisions

The Levelling Up and Regeneration Act (LURA) receives Royal ascent

- It is intended to solve the economic and social disparities across the UK. It also replaces former EU regional funding that was designed to tackle the same issues.
- The act was to some degree a political football meeting various concerns and to a certain degree there are elements of compromise.
- The issue is the government need private developers to deliver on its aims while simultaneously holding the sector to account.
- New measures in the act include raising enforcement for planning control breaches to 10 years, and the introduction of the infrastructure levy and community land auctions.
- In reality, much of the detail is yet to be enacted via secondary legislation.
- Now that the act has been passed. The government will respond to the consultation on the changes to the National Planning Policy Framework (NPPF)
- New measures include making it easier for councils to put local plans in place, setting out design codes and plans to deliver more homes. Slow build out rates from developers will now be questioned by councils.
- As regards, social housing compulsory purchase compensation rules have been changed to allow land to be bought at existing use value for schemes delivering large levels of affordable housing.
- Development of town centres and in particular retail require developers to deliver community assets alongside any schemes.

Current issues



Two consecutive months of construction output decline ended in September

The 0.4% recovery was driven by a 2% rise in repair and maintenance,

The only sector to register new work growth was commercial, which rose 3% monthly and is now 5% up on a year ago.

The annual rate of construction price inflation has now slowed to 3.9% in the 12 months to September, down from the record annual price growth in May 2022 of 10.4%.

Specific issues currently in the construction sector

Insolvencies in the year to August 23 for the construction industry reached 4,263, the highest number of any sector in England or Wales according to the Insolvency Service.

Begbies Traynor, covering the third quarter of 2023, said 5,919 construction companies across the UK were in “critical financial distress”.

Construction bodies have bemoaned a King’s Speech that confirmed landlords would not have to make home improvements to drive up energy efficiency

Insufficient qualified installers to scale up from fitting 60,000 heat pumps last year to an estimated 250,000 a year by 2025.

Currently, there are about 3,000 qualified installers but experts calculate the country will need 27,000 by 2028 to hit current government targets

Construction

- Restrictions on rooftop solar panels to be relaxed in commercial buildings
- Introduction of biodiversity planning rules delayed from October to January
- Wind power generates a quarter of UK electricity in 2022
- Schools closed due to the RAAC concrete crisis
- R&D tax recovery
- Carillion – KPMG fined £21m for audit failings + disqualification of CEO and FD

Construction

Modern Methods of Construction

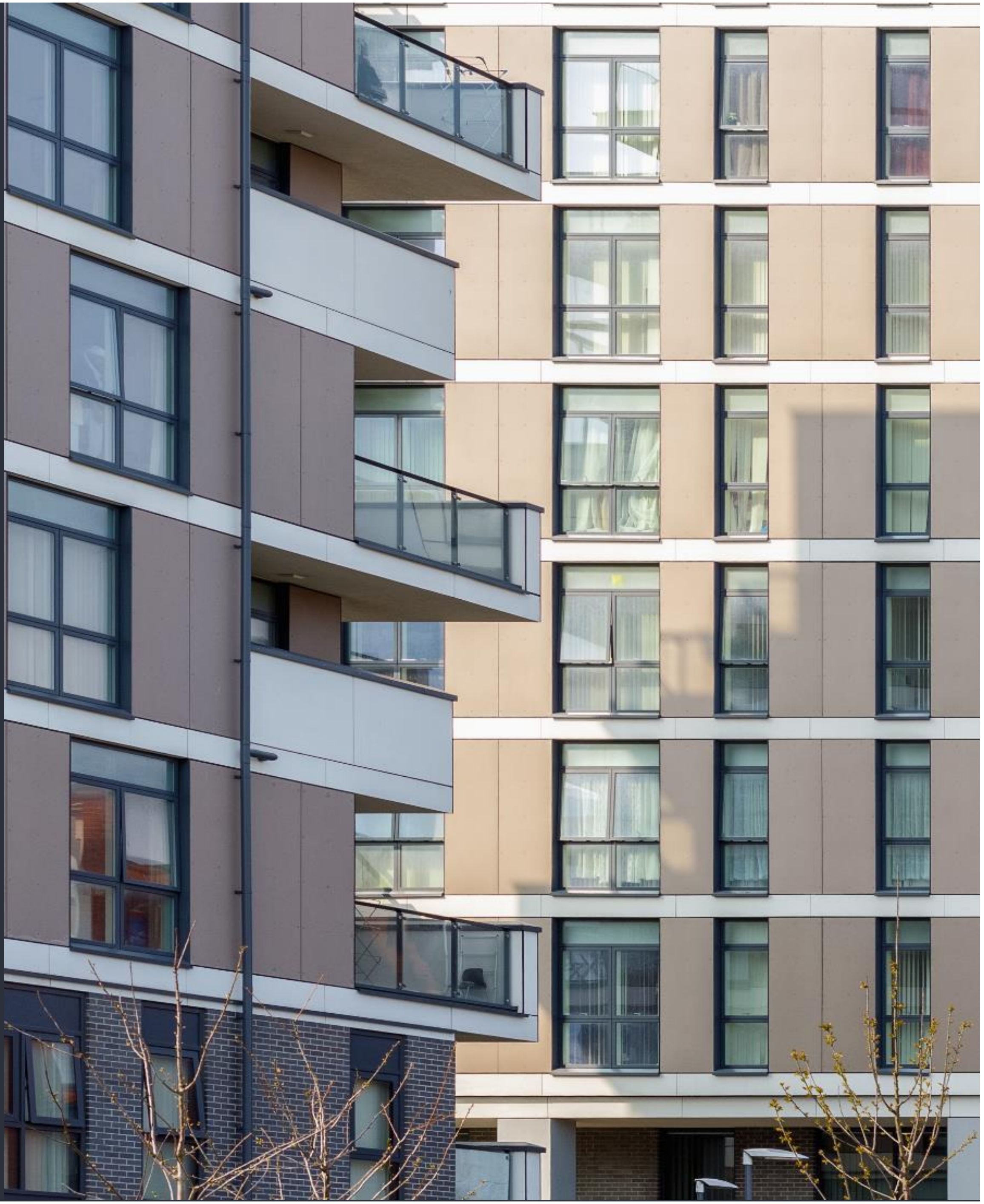
- Volumetric modular house builder TopHat saw losses increase as turnover fell last year.
- L&G's modular housing business
- Homes England is set to lose most of the £68m it is owed by collapsed modular housebuilder Ilke Homes.

In October, the House of Lords, built environment committee launched an inquiry into the future of Modern Methods of Construction

In May, the Department for Levelling Up, Housing and Communities appointed a consortium to create sector-wide standards for modular parts and buildings to remove barriers to innovation and promote the wider use of MMC in industry.

Real Estate

- New Housing Minister Lee Rowley – 16th since 2010
- House prices register their first monthly increase since March
- Housing market is past 'peak pain', says Savills
- Bungalows face extinction as construction hits 80-year low
- Housebuilding hits record low amidst covid crisis
- Home sales down 17% year-on-year in September
- UK’s commercial property market on the edge
- WeWork faces bankruptcy as shares suspended
- Real estate investment businesses struggle
- Super-rich pour £1.3bn into London offices
- Record-breaking rents predicted for West End office space



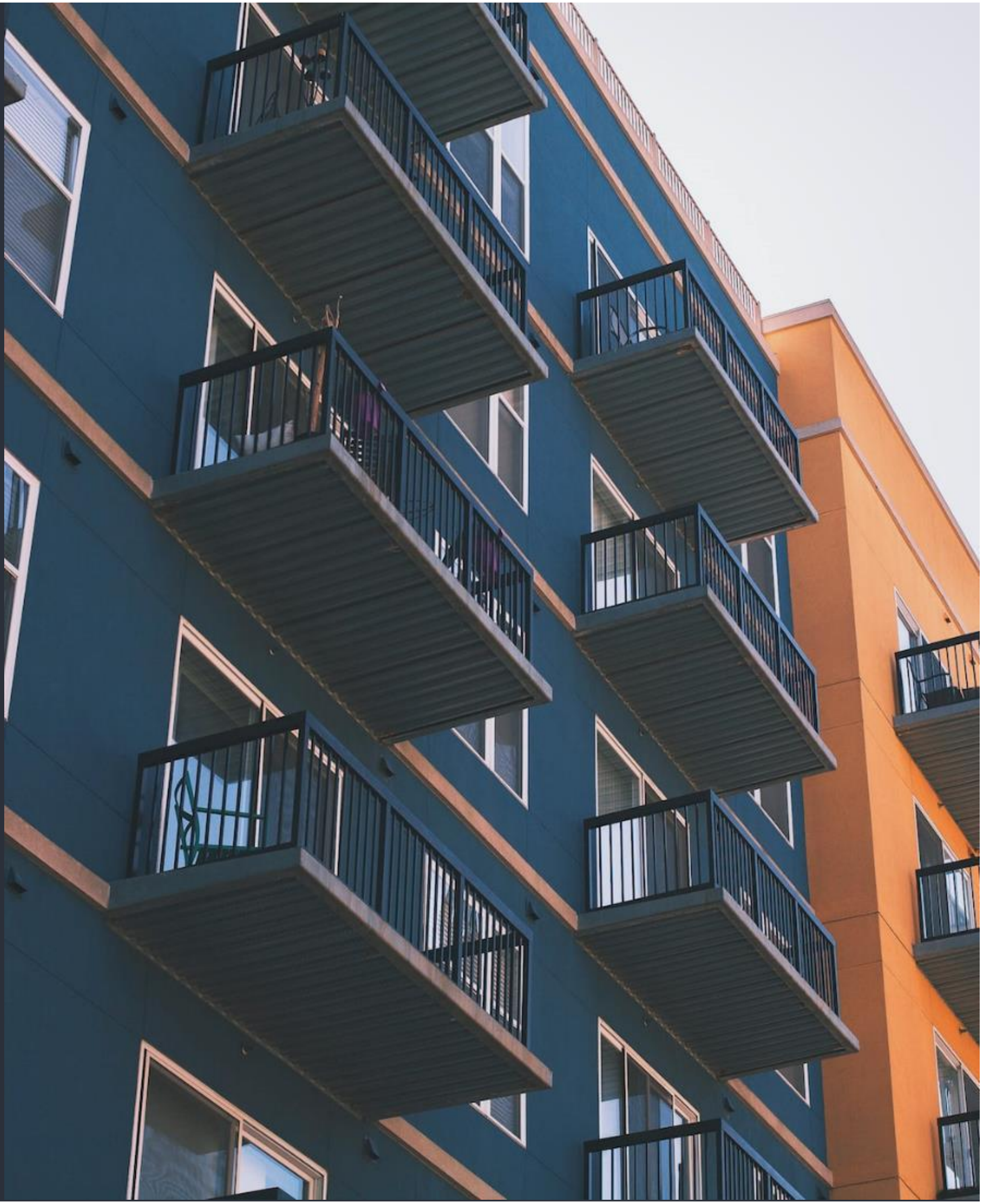
Real Estate

- US buyers account for 1 in 10 purchases in central London- Knight Frank
- 03.11.23 BoE holds rates, at 5.25% & slashes growth forecasts
- Barber shops are now fastest growing sector of the retail economy
- Knight Frank to cut up to 3% of UK workforce
- Heat pump grant boosted by 50%
- UK surpasses Hollywood with more studio space
- Green belt expands to 1.6m hectares
- Brighton and Hove council proposes 10% sales tax on beach huts
- HS2 'will not be between Manchester and Birmingham'
- Banks refuse to lend on homes with spray foam insulation

Real Estate

- Meta pays £149m to surrender office lease
- Home energy efficiency taskforce scrapped
- Fall in prices drives thousands into negative equity
- National Grid lack of capacity
- Long delays in property registrations causing frustration among homeowners
- China introduces first-time buyer mortgages to stimulate property market
- Rise of Airbnb exacerbating the housing crisis in many popular tourist areas
- Savills final October auction raised £41 million from 159 lots.

Leases to go on the balance sheet under FRS102 revisions 1.01.25?



Valuations

- Need to be proactive
- Review position before year end
- Get the right values – expert specific to you
- Can change of use/ improvements improve valuation?
- Sublet spare space
- Obtain planning advice to enhance valuation
- Liaise with auditor / accountant
- Consider impact of write downs in the accounts – discuss with interested parties

Going concern

- Practical consideration
    - Do you need to refinance within 12 months of signing accounts?
        - Bring year end forward
        - Bring audit forward
    - Terms agreed 5 years ago are unachievable in this market

Refinance

- Indicative Rates
    - Base Rate 5.25%

- Owner Occupier (good financials)
    - 5 year term, 55% LTV
    - 2.5% OBR = 7.75% high street banks
    - Specialist lenders = 8 – 10% fixed
    - Interest cover 130% to 175% - maybe 190%

Investment Property

- Standard BTL – 75% LTV

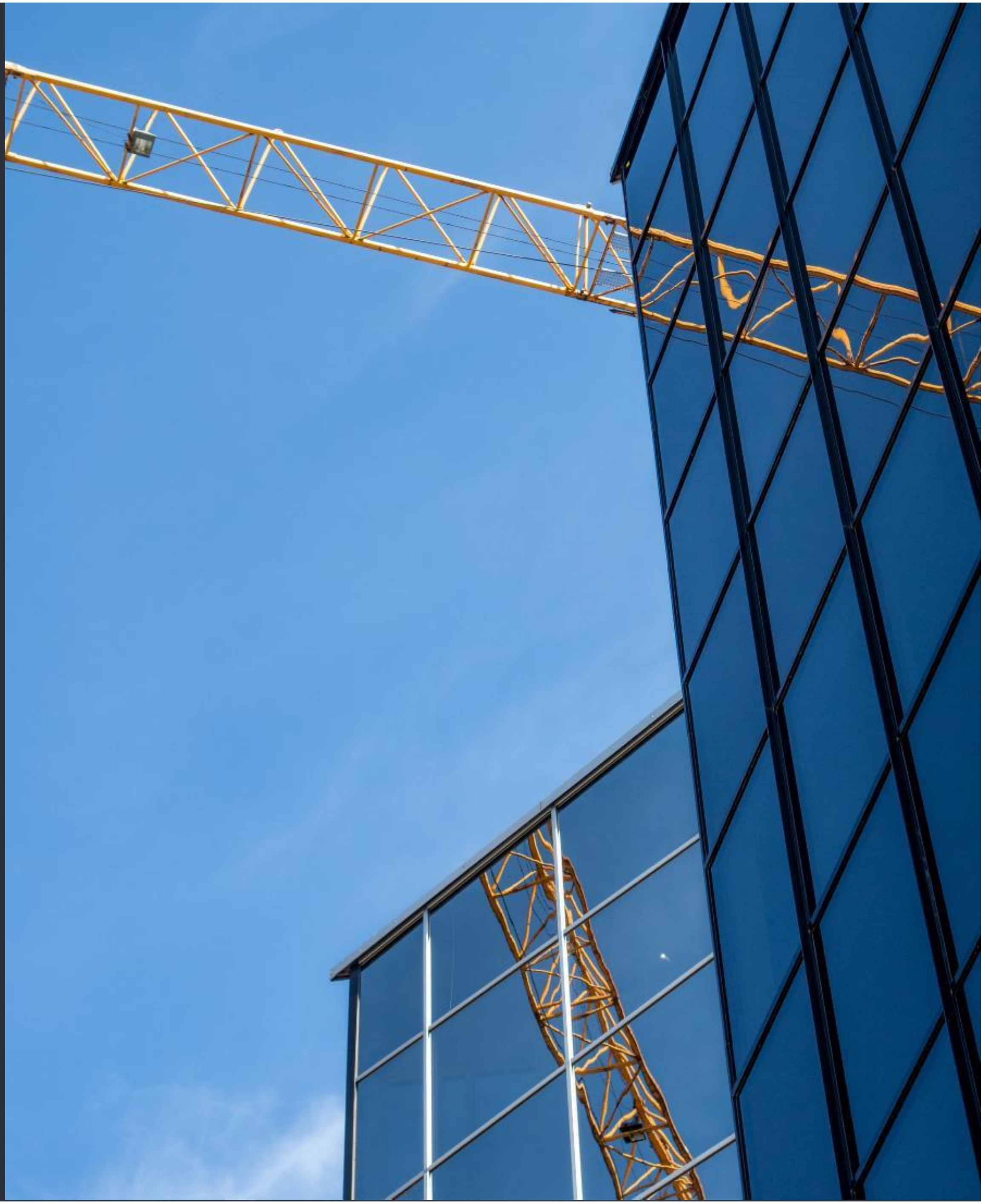
  2 years fixed
  - 7% arrangement fee
  - 4.34% but stress tested @ 6.34%

  Or:
  - 3% arrangement fee
  - 6.64% but stress tested @ 8.64%

  5 years fixed
  - 6% arrangement fee 5.25%
  - 2% arrangement fee 6.05%
  - But no stress testing

Development finance

- Really depends on strength of proposition
- 4 – 5% OBR
- 2% arrangement fee, 1% exit fee



Lets be positive

- Demand for self-storage rises, prices increase
- Lettings boom opens doors for estate agents + mergers
- UK faces shortage of laboratory space in science superpower bid
- Inflation now at 4.6%- mortgage rates are falling below 5% for five-year terms
- Rent controls as currently in force in Scotland and under consideration in Wales will not be put into effect in England, the government has made clear.
- Beds in sheds out – BTR + data centres+ student accommodation + film studios = generally positive
- Retro fitting will grow
- There is a clear shortage of residential buildings

Labour party conference

- Shadow housing secretary, Angela Rayner plans to deliver the biggest boost in social and affordable housing for a generation. Starmer said he wanted to tackle planning blockages and make use of the low-quality green belt space which he dubbed "grey belt"
- Labours shadow, chancellor, Rachel Reeves pledged to overhaul the antiquated planning system and fast track planning applications for major infrastructure projects.
- Labours pledge is to "get Britain building again" battery factories, life sciences, and 5G infrastructure would be given preferred treatment in planning
- Matthew Pennycock, shadow housing minister, said labour were not proposing rent caps, recognising that this could make things a lot worse for tenants. They will look to consider how to deal with disproportionate rent rises.
- Give more powers to local planning authorities
- Reinstate Mandatory housing targets and local plans
- Support housebuilding selectively on Green belt land
- Reform planning and land purchase rules
- Restore five-year land supply.
- Starmer referred to large-scale housing settlements that will be developed by state supporting companies using compulsory purchase orders to obtain sites.

Conservative Party Conference

Conservatives

- Renters Reform Bill was confirmed to be still on track for a second Parliamentary reading
- Housing secretary, Michael Gove, says he wanted to give local authorities a greater "degree of freedom" to adopt their own local plans, provided they were able to deliver on them
- Concern has been expressed at the low number of local authorities with adopted plans
- The Conservatives are hoping that the Levelling Up and Regeneration Bill will take a lot of the delays out of the planning system, thereby avoiding discretionary nature of planning
- They want to modernise the planning system and make it much faster for local areas to make those plans
- Build 300,000 new homes per year by mid 2020s
- Prioritise Brownfield development
- Regeneration of 23 English towns and cities
- Introduce a planning "super squad" for major housing schemes
- Consultation on extending permitted development rights
- Funding the planning skills delivery fund
- Focus on "beauty" in planning policy.

Lastly

The UK Net Zero Carbon Building Standards, is due to report later this year. It should look at technology adoption and how to use to increase carbon savings, possibly as an offshoot of the introduction of the golden thread of information that new builds must preserve.

SME house builders

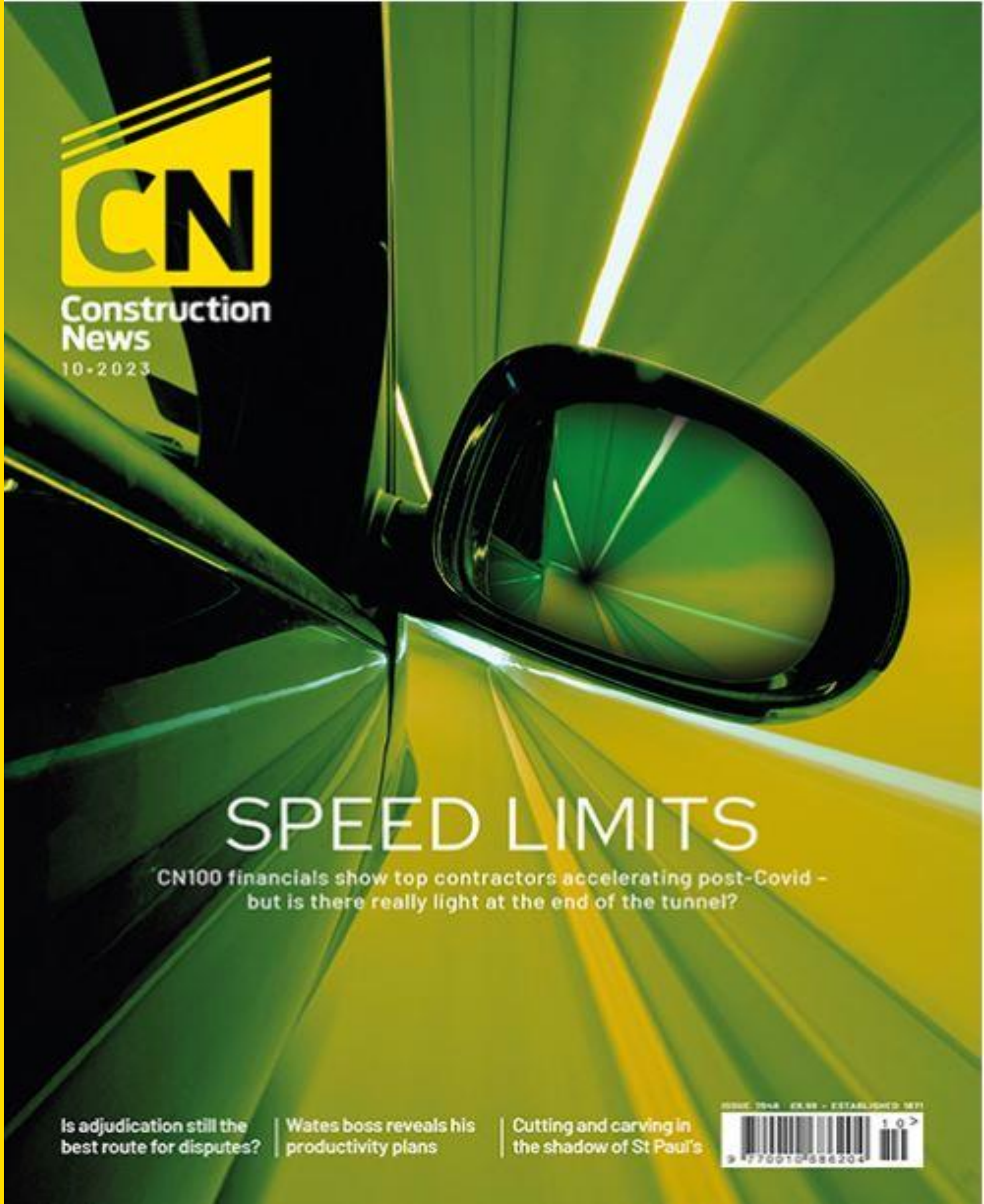
Government has been looking at the fact there are few house builders in the UK through the Competition and Markets Authority's review of the sector. Apparently, there are just 2500 operational firms across England which is 80% less than 1988.

Savile's reported in August that SME house builders were responsible for 39% of new homes in 1988, compared with just 10% for today. The climate for SME's changed radically after the recession of 2007–08 when around third of SME builders stopped trading.

CN100 2023

Key data and conclusions

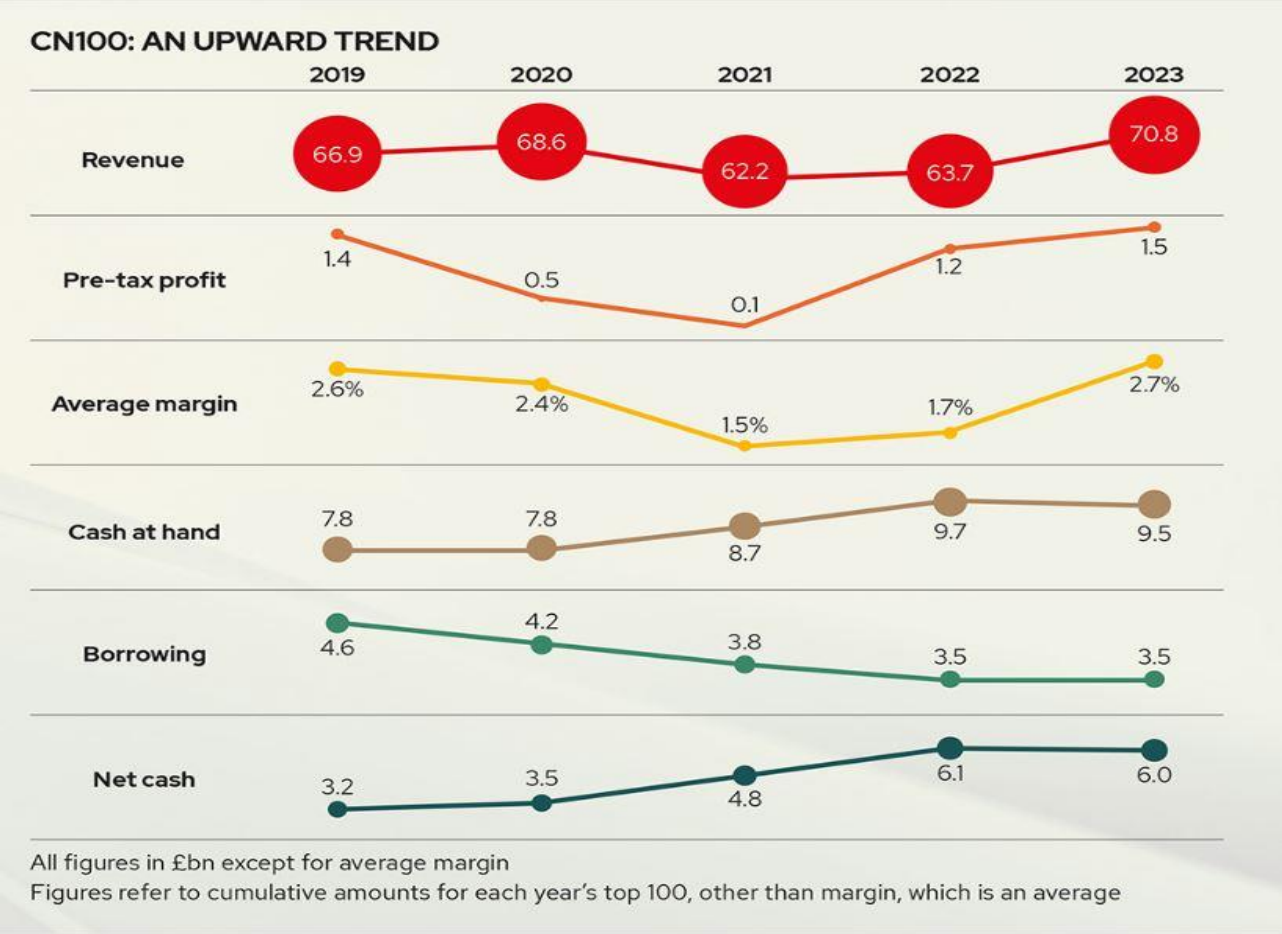
Ben Vogel, Deputy Editor, *Construction News*



What is the CN100?

- A ranking of the top 100 contractors in the UK & Northern Ireland
- Published annually by *Construction News* since 1992
- Examines audited accounts filed with Companies House and stock market announcements issued before 18 August 2023. So the period covered mainly ends in 2022
- Figures cover turnover excluding JVs
- Does **not** include specialist housebuilders eg Barratt, Persimmon, Bellway - *CN* focuses on contractors
- Reveals more than just turnover and profit: metrics also include short/long term loan debt, net cash, dividend payouts, employees/wage bill

Data overview



Turnover – all companies

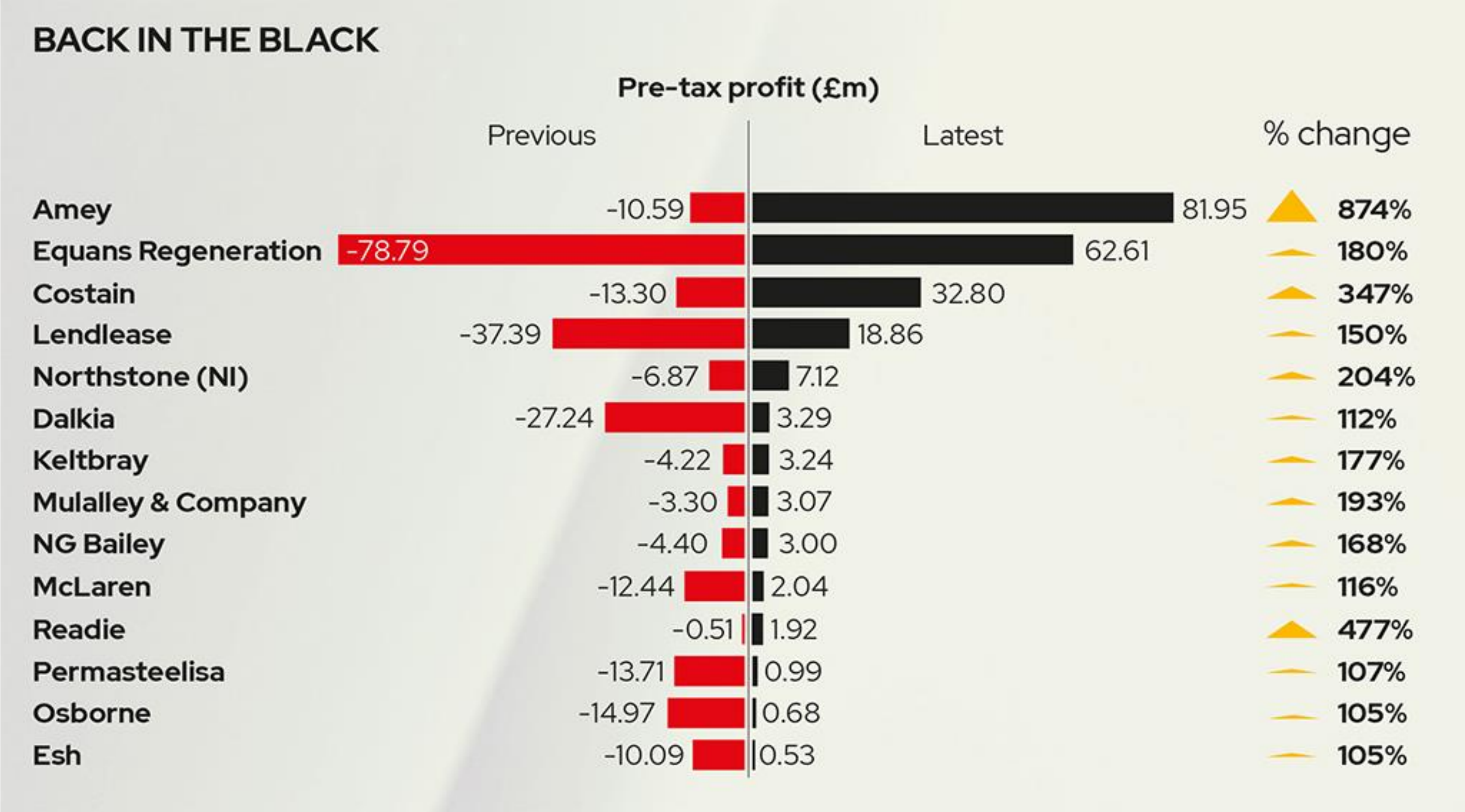
Biggest firms – headline figures

TOP 10

	CN100 2022		CN100 2023
Total revenue	27,119.3	▲	29,198.1
Total pre-tax profit	301.9	▲	568.5
Average pre-tax profit	33.2	▲	52.0
Average margin	0.8%	▲	1.5%
Total net cash	1,140.0	▼	1,064.2
Total dividend payout	75.6	▲	127.1

NB: All currency figures in £m

Profit recovery



Construction News

Top 5s

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Questions?

Seminar feedback:

www.surveymonkey.com/r/ConstructionRealEstateForum

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