

The STAR Scheme

Introduction

In a previous article¹, we discussed the current State initiatives that aim to deliver social and affordable housing in Ireland. In this update, we put one of these initiatives under the spotlight: the Secure Tenancy Affordable Rental Scheme (the "STAR Scheme"), the purpose of which is to offer long-term stability and affordability for lower income renters that fall outside the income eligibility criteria for social housing.

Main Characteristics

The STAR Scheme is operated by the Housing Agency (the "HA") and is open to all potential housing developers. It aims to make available up to 4,000 cost rental homes in the private rental sector to assist eligible households experiencing rent affordability pressures². It does this through an equity investment to developers for the acquisition and development of residential schemes on condition that the residential units are then designated as cost rental homes. Up to €750 million of State funds have been made available for investment in the STAR Scheme.

The STAR Scheme has been open to proposers to submit expressions of interest ("EOI") to the HA since August 2023. Successful EOIs will be awarded until all the available funding has been fully allocated, or until the HA and Department of Housing, Local Government and Heritage announce the

closure of the STAR Scheme, currently scheduled for December 2027.

Cost Rental

Residential units under the STAR Scheme will be available for renting at an initial rent at least 25% below market value in high demand areas and must be designated as cost rental homes for at least 50 years. The 25% figure is set by the Department of Housing, Local Government and Heritage, and is not a legislative requirement.

The requirement for rents to be at least 25% below market rent applies only to the initial rent. Any subsequent rent increases must comply with the terms of the Affordable Housing Act 2021 (the "AHA Act") and any regulations made thereunder. The rents for residential units designated as cost rental homes under the STAR Scheme may only be reviewed once a year and any increases must be tacked to the rate of inflation³.

In accordance with Section 29(1) and (4) of the AHA Act, the minimum cost rental period for a residential unit so designated cannot be less than the cost calculation period. The minimum cost calculation period under the AHA Act is 40 years, with no upper limit, so the current 50-year cost calculation period specified under the STAR Scheme is a policy decision.

¹ <https://maples.com/en/knowledge-centre/2024/02/social-and-affordable-housing-current-initiatives>

² Cost Rental can be defined as: a long-term, sustainable home-rental scheme aimed at middle-income households with incomes above the social housing limits. Rents are based on the cost of building, managing and maintaining the properties only and are expected to be at least 25% below market rents. Homes are

provided by Approved Housing Bodies, the Land Development Agency and local authorities.

³ Section 33 of the AHA Act and S.I. No. 756/2021 sets out how rent reviews for Cost Rental tenancies should be undertaken. Any increase must be tied to the rate of inflation in the Harmonised Index of Consumer Prices.

Units

A minimum of ten (10) residential units must be proposed in an EOI, and they must either: (i) have not commenced construction; (ii) be under construction; or (iii) be recently completed and not yet rented. Where construction is not underway, it must commence by a date agreed with the HA. Proposals involving adaptive re-use of non-residential buildings for use as residential units will also be considered if the buildings have not previously been used for residential purposes. EOIs must include 2-bed units together with another type of unit such as 1-bed or 3-bed units.

The level of funding available will depend on the costs and revenues outlined in each proposal, with maximum funding of €170,000 per unit available for Dublin and €150,000 for the rest of the country. An additional uplift of €25,000 is available subject to certain sustainability criteria - set out at paragraphs 7.12-13 of the STAR Scheme explanatory document - being met.⁴ The proposer is entitled to make a "reasonable profit". Surprisingly, there is no formula for assessing what a reasonable profit is so this is likely to be interpreted by reference to EU Law's prescribing reasonable profit as "*the rate of return on capital that would be required by a typical undertaking considering whether or not to provide the service... for the whole period of entrustment [50 years], taking account of the level of risk*".

All residential units in receipt of investment from the STAR Scheme must be built and fully completed within 2 years of the commencement date or 31 December 2027, whichever is earlier.

Tenants

Prospective Cost Rental tenants must meet net income limits to be eligible. These are set

periodically. As of 1 August 2023, an income level of €66,000 net applies for properties in Dublin and €59,000 net for the rest of the country.

Three-Stage Process

The approval process for the scheme comprises three stages:

1. Submission of the EOI⁵;
2. Due Diligence Assessment by the HA; and
3. Entry into the Equity Participation Agreement ("EPA").

Stage 1: EOI

The EOI Application Form is a four-page Word document with a Declaration of Eligibility appended.

Proposers must provide their details, including contact details and VAT number, and confirm their agreement in principle to the designation of the proposed residential units as cost rental homes for a period of 50 years. A high-level summary of the proposer's track record in delivering and managing rental accommodation is also required.

Proposers must provide details of the proposal, the proposed delivery timeline and the proposed average delivery cost per dwelling. A description of the proposed dwellings is given by selecting from tick-box options and a proposed cost rent must be supplied. Proposers must also specify the proposed average STAR Scheme investment per unit and for the proposal in full.

Proposers are required to complete a declaration confirming that the minimum proposer requirements are met. Where a consortium/joint venture is proposed, all parties must complete the declaration.

⁴<https://www.housingagency.ie/sites/default/files/2023-07/2023-07-18-STAR-INVESTMENT-SCHEME.pdf>

⁵ 2023 07 17 Application & Declaration.docx (live.com)

So, all in all, the first stage of the approval process would appear to be quite administrative in nature and easy to navigate.

The HA will give preference to an EOI which meets the following criteria:

- (a) high density proposals in urban locations;
- (b) proposals with a higher volume of units;
- (c) high density residential developments with a diverse range/mix of dwelling types;
- (d) proposals located within 1.25km of urban transport systems (such as DART or Luas) or within 1.25km of reasonably frequent urban bus services (at least every 20 minutes peak hour frequency); and
- (e) proposals which can deliver additional cost rental homes in the shortest timeframe.

Stage 2: Due Diligence Assessment

The HA will typically notify proposers within 2 to 4 weeks as to whether their EOI is considered suitable to proceed to Stage 2, which involves a full due diligence and financial assessment. This stage requires additional information to be provided for assessment by the HA and its advisors, including:

- (a) delivery costs or construction costs if appropriate;
- (b) management, operational and maintenance costs;
- (c) the proposer's funding package;
- (d) the appropriateness of financial assumptions regarding void and vacancy risk, cost inflation and rental income inflation and any other variables;
- (e) the level of investment to be provided and the cost rents that will be made available with the benefit of the investment on completion of the dwellings;
- (f) sources of funding of the proposed units including a letter of confirmation from any proposed funders;
- (g) the proposer's tax compliance; and
- (h) the location, amount and ownership of any units currently under management by the

proposer, and how long they have been under management.

It's no surprise that, as one progresses through the approval process, the level of detail and specifications becomes more onerous and demanding.

Stage 3: EPA

Subject to the successful completion of Stages 1 and 2, a form of EPA in the HA's prescribed format will then be entered into between the HA and the proposer, governing the equity investment from the STAR Scheme (the "Investment").

Under the terms of the EPA, ownership of the properties remains with the developer and the Investment is secured by way of a fixed charge. Where a commercial lender is involved in purchasing, developing, or refinancing the purchase of the property, the HA will permit a first ranking charge for that lender and take a second ranking charge subject to intercreditor arrangements.

There is no interest or return payable to the HA during the 50-year cost rental designation period. However, the EPA will include a right for the HA to receive a property realisation equity share ("PRES") from the relevant property. The PRES is calculated as a percentage of the then market value of the relevant property by reference to the aggregate of the equity share contributed to the purchase by the developer plus the Investment. The PRES is payable either:

- (a) at the end of the cost rental designation period;
- (b) if the property (or any part thereof) ceases to be used for a cost rental home for any reason during the lifetime of the EPA; or
- (c) on breach of the AHA Act or any regulations made thereunder.

Expiry

On the expiry of the EPA after the 50-year cost rental designation period, there are three options available in respect of the Investment:

1. extension for an agreed period, with the dwellings to retain their designation as cost rental homes;
2. payment to the HA of the PRES and exit from the cost rental designation; or
3. the HA may exercise an option to purchase the residential units for market value, making an allowance for the Investment.

Conclusion

The STAR Scheme offers an opportunity for private developers to contribute to the social and affordable housing sector in Ireland by endeavouring to make it more viable for them to bring cost rental homes into the market. It does this by seeking to address economic and viability issues faced by developers (rising construction costs, softening of yields and increased interest rates). To date, however, there have not been many proposals submitted by potential developers, possibly due to the complexity and duration of the approval process. In our view amendments may be required to attract potential investors and unlock senior funding.

It remains to be seen whether the STAR Scheme will be attractive to private developers who will need to balance the availability of the potential Investment against other factors. The terms of the EPA, the key governing document for the Investment, provide for increased regulation and oversight by the State in the developer's ownership of the designated property. The EPA contains various provisions regulating the use of the property, the potential sale of the participating property and the realisation of the PRES. Once a property is designated for cost rental purposes for the period of 50 years prescribed by the EPA, it cannot then be used for other purposes during that period without Ministerial consent.

The provisions of the EPA will certainly have an impact on the valuation of the property by any proposed purchaser through a combination of:

- (a) the limitation on market rents through the cost rental designation;
- (b) the requirement of the EPA that the PRES be realised at the maturity of the STAR Scheme; and
- (c) the impact of the option for the HA to acquire the property in the event of a proposed sale by the operator or on maturity of the scheme.

So, a cost beneficial analysis clearly needs to be undertaken by a developer in signing up to the Scheme. Is there a risk that the limitations imposed by the STAR Scheme outweigh the benefits?

It is our view that aspects of the template EPA stand to be further developed and clarified for more certainty to be brought to this key governing document for the STAR Scheme.

We will continue to monitor the development of the STAR Scheme and are interested in seeing whether it will attract more proposers.

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