December 17 2020

OUTLINE OF LKP PROPOSAL TO SECURE PRIVATE SECTOR FUNDING FOR CLADDING & ASSOCIATED FIRE SAFETY DEFECT REMEDIATION

Summary

This briefing paper outlines a potential financial and legal solution providing for affected buildings to be remediated quickly; to be financed from the private sector; and to allow flexibility/expansion. The Leasehold Knowledge Partnership (LKP) proposal prevents the financial burden from falling on leaseholders and the taxpayer. The proposal is in line with the stated view of Prime Ministers,[1] Ministers and the Communities Select Committee that the cladding bill should not fall on the leaseholders.

Current Challenge

While there is no exact data, current government estimates suggest 3 million leaseholders[1] in approximately 13,000 buildings are affected by cladding and associated fire defects, with a potential remediation cost of around £15 billion.[2] The Fire Protection Association reports that thousands are facing impending bankruptcy and homelessness.[3]

This situation is rapidly becoming more acute, as leaseholders are served with section 20 notices this month for upcoming cladding remediation costs, in line with the Building Safety Fund schedule.

Proposal by LKP

1. A single special purpose vehicle to provide about £12 billion of funding for remediation upfront, or to be drawn down over a period of time up to the maximum, with a 50 year maturity at a fixed coupon attractive to pension firms (suggested rate of approximately 0.6%, dependent on the market). Initial feedback from the fixed income market indicates a strong demand for this structure.
2. Managed centrally to minimise administrative costs
3. A 'window' where affected buildings would apply, similar to or connected to the Building Safety Fund
4. Costs to be recovered by a series of levies.

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[1] Boris Johnson (PMQs 12 Dec 2020), Theresa May (PMQs Jan 2019).

[2] Building, "Hackitt reveals government is working on changes to Building Safety Bill." November 2020. https://www.building.co.uk/news/hackitt-reveals-government-is-working-on-changes-to-building-safety-bill/5109172.article

[3] "Bankruptcy and Homelessness Concerns Over Cladding Crisis," Fire Protection Association. October 2020. https://www.thefpa.co.uk/news/bankruptcy-and-homelessness-concerns-over-cladding-crisis

- The contributors to the levy to be decided, but our paper proposes developers and freeholders first and foremost, possibly others such as non-domiciled foreign buyers, and cladding manufacturers.[5]

5. Costs to be assessed against acceptable risk to life and property.
6. Excess costs, if any, to be recovered by reinsurance arrangement.

The vehicle would be established on a statutory basis, as follows.

a) The managing board to be set up under Act of Parliament, giving the board the power to collect a levy.
b) The factors to be considered in setting the levy to be set out in the Act, supplemented with a statutory instrument.
c) With board power to make rules to collect the levy in accordance with the Act and that statutory instrument.
d) The board to set the levy rules annually, in consultation with the industry and any other relevant stakeholders.
e) The board subject to both ministerial oversight and Parliamentary oversight.
f) The relevant minister to appoint board members, with the board reporting annually to Parliament.
g) In addition to making the Act, Parliament would also review any statutory instrument regarding the matters to be considered in the setting of the levy.
h) Last but not least, the board should be subject to judicial review if anyone affected by its levy rules argues that these are not within the board's power to make.

Thus:

- The SPV would be the mechanism by which costs are recovered in the long term.
- Its statutory powers would impose levy on those who can afford to pay.
- Present value zero or positive, no cost to taxpayer.
- Create a funding model to address the problem of long-term financing for pensions.

Indicative Levy Sources and Revenues:

Levy	**Details**	**Annual Revenue**	**Duration**	**Present Value**
New Build	1% of sale price	425m	10 years	4.25bn
Ground Rent	10% of ground rent	30m	50 years	1.5bn

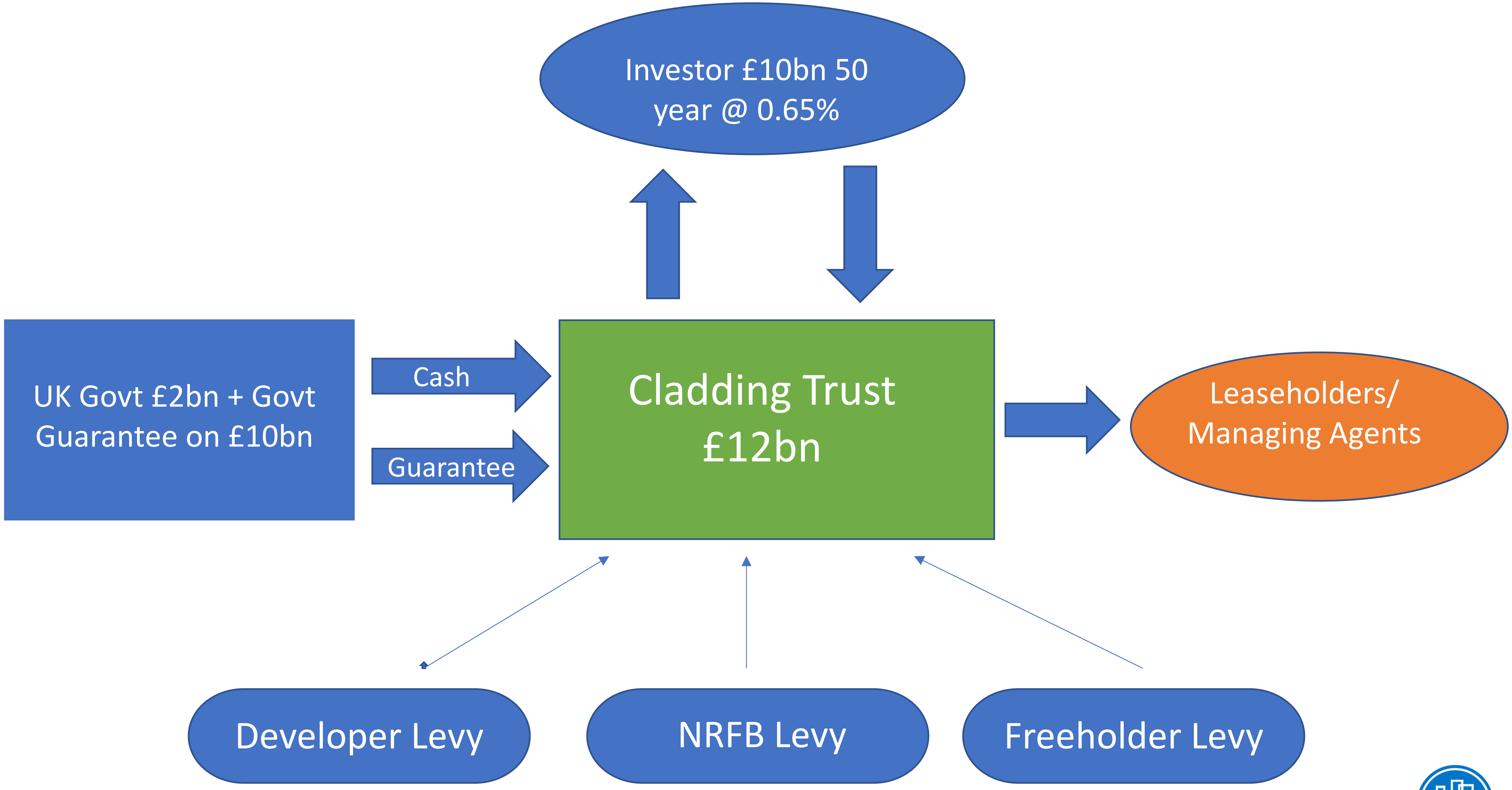
[5] Such a levy – on new buildings, though oddly not ground rents, was proposed by Long Harbour (a £2 billion ground rent fund). It was submitted in May 2020 to the MHCLG select committee when it held an enquiry into the progress of cladding remediation. https://committees.parliament.uk/writtenevidence/5232/pdf

Non-Resident Foreign Buyer	Extra 3% of sale price + removal of first time buyer exemption	375m	10 years	3.75bn
Manufacturer				1.5bn
VAT rebate	Remediation works zero-rated			3bn *(dependent on works)*
Government Contribution	Building Safety Fund			1.6bn *(Building Safety Fund)*

<u>Conclusion</u>

The proposal detailed above is transparent and accountable, and works. It solves a contentious political issue in a just and proportionate way. It enables people to move on with their lives. We underscore that it does not require a 'magic money tree,' as financing could be provided by pension funds and other long term investors and repaid by private sector levies. Further, it has the potential benefit of helping to stabilise the insurance market - specifically with regard to professional indemnity cover and buildings insurance. It may also bring more certainty to the sales market, reducing risk to the valuer and the conveyancer, and avoiding what appears to be an emerging collapse in the market.

LKP welcomes the opportunity for more detailed discussions.


Investor £10bn 50 year @ 0.65%
UK Govt £2bn + Govt Guarantee on £10bn
Cash
Guarantee
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Leaseholders/ Managing Agents
Developer Levy
NRFB Levy
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