Review of Economic Risk of Flat Safety Defects

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Format

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Background to the Fire Safety Crisis

- The Grenfell fire in 2017 resulted in government intervention in relation to external wall systems of both new and existing buildings. The Grenfell Inquiry has to date uncovered evidence that tests of some of these materials (particularly cladding) were falsified deliberately by manufacturers. As a result, certain test certificates and products have already been withdrawn from the market.
- Following the Grenfell Tower fire, the Ministry of Housing, Communities and Local Government ("MHCLG") formed an Independent Advisory Panel which met for the first time on 30 June 2017.
- The Independent Advisory Panel has adopted a conservative "rip and replace" solution requiring the removal of cladding, insultation and other materials from external walls. The process of inspection in preparation for these works has has revealed serious internal defects (defective compartmentation, malfunctioning fire alarms, missing or inadequate fire stopping and fire breaks) which are separate from the problems in the external walls. This is a nationwide problem affecting tens of thousands of apartment buildings.
- The issue with the Advice Notes is that for buildings above 18 metres tall the Advice Notes impose a "limited combustibility" requirement that was not explicit in the Building Regulations prior to 21 December 2018. For buildings less than 18 metres the Advice Notes go beyond what is required by the current Building Regulations, even after the 21 December 2018 revisions. In neither case has any effort been made to estimate the risk of a façade fire against the high cost of the works entailed by "rip and replace".
- Compounding the retrospective effect of the Advice Notes, interpretation has been left to building owners and managing agents who have vested interests. Building Owners are looking to reduce or eliminate their legal risks using leaseholders' money. Managing Agents generate fees of as a much as 20% of the cost of works and are also looking to generate fee income whilst reducing or eliminating any legal risk to their businesses.
- MHCLG took no steps to identify the number of buildings affected, to define an acceptable level of safety, to conduct cost-benefit analysis of the proposed solution or to identify whether leaseholders had any legal recourse before issuing the Advice Notes. This is in stark contrast to the approach adopted in New South Wales and Victoria, Australia. Scotland will follow the Australian example.
- The estimated cost of this intervention is unknown, but the Housing, Communities and Local Government Select Committee puts it at around £15 billion. The Association of Residential Managing Agents (ARMA) estimates the costs of external wall remediation at £2 million per block with an additional £2 million per block for internal fire safety defects.
- Even taking account the government's promised limited taxpayer support, leaseholders are looking at covering at least two-thirds (£10 billion) of this £15 billion estimated cost. The total cost is currently still unknown and may be even higher. The taxpayer support offered to date is limited to cladding removal only. Support is only being offered to buildings above 11 metres (buildings 11-18 metres will be forced to take loans and buildings above 18 metres will be offered grants). No taxpayer funding will be made available unless leaseholders can find all of the money necessary to remediate non-cladding defects at the same time.
- The issue extends beyond residential lending. There is approximately £1 billion of commercial lending secured against portfolios of freehold/ground rent investors.

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EWS1 Form

- The EWS1 form was created by RICS, UK Finance and the Building Societies Association so banks could assess whether buildings with external wall systems of the types covered by the MHCLG Advice Notes were good security for mortgage lending.
- EWS1 was introduced December 2019 and revised from April 2021.
- The ratings system applies a grade A1, A2, A3 or B1 or B2. "A" grades are used where there is no combustible material in the external wall. "B" grades are used where there is combustible material in the external wall. Grades A3 and B2 are classed as "fail" because the surveyor requires the building to undertake remedial works.
- The EWS process has been implemented poorly. Forms with "B" grades were supposed to be signed by Chartered Engineers of the Institute of Fire Engineers or equivalent. There is widespread evidence that forms have been signed by unqualified individuals (e.g. reporting by LBC). Some EWS1 forms have been completed fraudulently, particularly in Wales.
- The EWS process has extended beyond assessment of external walls and has been interpreted as requiring intrusive surveys of both external walls and internal walls. This has tended to reveal other non-cladding related fire safety defects.
- According to a survey by the Leasehold Knowledge Partnership, 89%-90% of buildings surveyed receive the worst grading possible, a B2. B2 grades may be awarded for non-cladding related defects, such as defective compartmentation, missing fire breaks, inadequate fire stopping, malfunctioning fire alarms and so on.
- A B2 grade means no mortgage lender will lend against it. This means mortgagees cannot remortgage and flats can only be sold to a cash buyer who is willing to take on uncapped remediation costs.
- A B2 or A3 grade is typically reported to the local Fire and Rescue Service. In 40% of cases, a waking watch (a 24 hour patrol to support a policy of simultaneous evacuation in the event of a fire) is required. This figure is rising, as insurance companies are now requiring waking watches even in cases where the Fire Brigade does not. As a condition of cover, insurers are also requiring buildings to meet higher standards than those set out in the Advice Notes and Building Regulations, further increasing the number of buildings in scope and the costs of the works required.
- A failing grade typically results in large increases to building insurance premiums. In some cases insurers are declining cover altogether, but this appears to be in cases where buildings are not insured as part of a portfolio/block policy. ARMA estimates that the average insurance increase in affected buildings is around 400%, with some cases in excess of 1,000%.
- Collapse of agreed sales rose by 64% in 2020 from 2019; EWS1 forms and cladding costs are viewed as a primary contributing factor to this increase.

MHCLG Funding is Inadequate

- MHCLG has offered a series of different taxpayer support to affected buildings. To date this has amounted to:
  - £1.6 billion to remove ACM and non-ACM cladding from buildings 18 metres tall or taller;
  - A further £3.5 billion was announced on 10 February 2021, again limited to removal of cladding only on buildings 18 metres or taller.
  - MHCLG also announced on 10 February 2021 a system of "forced loans" to be imposed on buildings 11-18 metres tall. This funding will cover the removal of cladding only. Payments are expected to be capped at £50 per leaseholder per month. Details are unclear but the scheme is expected to offer a loan to each building, which appears to mean the freeholder.
- The funding offered to date totals £5.1 billion, or around one-third of £15 billion estimated cost of addressing the issues. The remaining two-thirds of the £15 billion is expected to come from leaseholders, albeit that some leaseholders are expected to be forced to take loans to cover the costs of cladding works.
- Leaving aside the £10 billion funding gap, the other difficulty is that work to remediate non-cladding defects (for example, missing fire breaks and other defective compartmentation) must be performed at the same time as the cladding works. Works will not go ahead unless all funding is available. Leaseholders are the only source of funds for the non-cladding works. As indicated earlier, those works may cost £2 million per block. Government grants/loans will not be made available unless the money to perform other work is also made available. Affected buildings eligible for grants or for loans may not be able to access the money if leaseholders cannot fund the non-cladding works often required to be performed at the same time.
- MHCLG's own estimate is that there are approximately 88,000 buildings standing 11 metres and above in England. 54% of these buildings are assumed to require cladding remediation works, so approximately 47,500 buildings. If the cladding works do cost around £2 million per building that would imply a cost of £94 billion for cladding works alone. Assuming £2 million per building in addition for non-cladding defects may result in expenditure of a further £94 billion.
- There is no reliable estimate of the number of buildings affected or the costs of implementing the government's preferred "rip and replace" solution. There is a significant divergence between the government's estimates and the ARMA estimates. The ARMA estimates are likely to be more accurate because they are gathered from managing agents charged with implementing the works in question.
- It is not just residential mortgage lenders affected. The forced loan scheme may also run up against commercial loan terms covering around £1.1 billion of commercial debt. Terms in those loans may prohibit new security or new debt, for instance as a result of financial covenants including interest cover and leverage ratios or as a result of negative pledge covenants in the loan agreements and security documents. Examples of this type of financing include the loans made by Rothesay Life to two private freehold investors: E&J/James Tuttiett (around £376 million as at December 2019) and Proxima GR/Fairhold/Vincent Tchenguiz (around £747 million at December 2019). Large freeholder property unit trusts such as ARC Time Freehold Income and the Ground Rent Investment Trust also have secured loans (around £60 million) with negative pledges and financial covenants in place. It may not be possible for these freeholders to borrow from the government's proposed 11-18 metre forced loans scheme. Forcing new loans on these borrowers may impair the quality of the debt.

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Leaseholders Have No Viable Legal Recourse

- Leaseholders in most cases have no viable legal route of recovery against the developer or any professional involved in the design, construction or sale of the property. Strict imitation periods and bars on recovering certain types of loss prevent legal action. Even where viable legal claims exist, legal costs will easily reach tens of thousands per claim, with particularly hard fought cases reaching hundreds of thousands to millions per claim.
- The most likely claim that will enable leaseholders to recover the money to remediate buildings is under section 1 of the Defective Premises Act 1972. Claims under that Act are statute barred six years after the building is completed, whether the defect in question is known or not.
- There are longer limitation periods for a claim in negligence (up to 15 years from the date of the negligent act). However, current law prohibits the recovery of economic losses in defective construction cases. Economic losses are the types of losses being sustained by leaseholders.
- Only purchasers who bought off plan will have a contract with the developer. Claims for breach of contract are deemed to have accrued on the date contracts were exchanged between developer and purchaser, meaning many such claims will be statute barred. A limitation period of 6 years applies for claims for breach of contract. The 6 year time limit runs whether the defects are known or not.
- The professionals involved in design and construction (architects, surveyors, engineers, building inspectors) are unlikely to have any contract with an affected leaseholder. As the law currently stands, it is unlikely that a court would impose a duty of care on any of these professionals to avoid causing economic loss to leaseholders.
- In most cases, leaseholders are simply out of time and/or precluded from recovering their losses as a result of legal bars to recovery.
- Warranty schemes (NHBC BuildMark being the largest) are also limited to 10 years from the date a property is completed. The NHBC is currently subject to legal action because it is refusing to pay for cladding defects. There may be a legal challenge to NHBC's refusal to pay out on the basis that it did not conduct the building control work, which is a common excuse for refusing to pay.
- Zurich was previously a large latent defect insurance provider. Zurich sold its portfolio to East West Insurance in 2018. East West entered administration in October 2020 following a Court of Appeal ruling that it was liable to pay under the Zurich policies in more cases than it anticipated. East West's Administrator estimates creditors are owed approximately £210 million on those policies, which may be covered under the Financial Services Compensation Scheme.
- The general legal position outlined above is compounded by the nature of the leasehold system. Leaseholders have few rights to challenge freeholders and managing agents regarding the costs being incurred for remediation. Modern leases typically transfer all risk in the building, including in relation to structural defects, to the leaseholders. Modern leases also contain clauses requiring leaseholders to pay costs arising from orders or directions of any competent authority (e.g. requiring a waking watch). Challenges at Citiscape (Croydon) and Green Quarter (Manchester) have seen the First-Tier Tribunal find that leases containing such clauses do require leaseholders to pay for the costs of remediation and waking watches.
- The government has imposed a substantial financial burden on leaseholders via its Advice Notes. The Advice Notes are retrospective changes to the standards of external walls for buildings. There is a moral argument that the taxpayer should pay for such retrospective changes. This argument is currently not accepted by the government.

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Key Statistics

- Average per flat fire safety defect remediation bill (incl non cladding): £47,500 - £51,000 per flat (ARMA and one of the largest Housing Associations).
- Average monthly waking watch cost per flat: £499 (London); £179 (England excl London). (MHCLG)
- Average insurance rise: 400%. £1,087 average increase per flat. (ARMA)
- Average alarm cost installation: £100,000 per block (ARMA)
- Study commissioned by The Telegraph found 870,000 cladding-hit properties are in buildings above 18m (eligible for funding for cladding remediation only) and 3.7 million problem homes are in blocks between 11m and 18m (eligible for low interest loans for cladding remediation only). It is unknown how many flats are in buildings below 11m (ineligible for loans and/or funding for any remediation).
- Estimated length of time to remediate buildings based on current labour supply and availability of materials. 5-10 years (IRPM).
- LKP random sample of 110 buildings with known fire safety defects found that at least 57% of buildings had flats registered for auction auction post December 2019.
- Significant discrepancy between industry figures and MHCLG assumptions.
- Average remediation costs account for *approximately 300%* of total average household disposable income in cities analysed by LKP (Sheffield, Manchester, Liverpool and Birmingham).

Number of Cladded Flats Built From 2013 – Estimated 90% of Cladding is Flammable

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Authority	Private flats	Social flats	People potentially affected
Hammersmith and Fulham	2,771	0	5,985
Manchester	1,599	250	3,994
Salford	1,510	347	4,011
Croydon	1,459	82	3,329
Greenwich	1,404	485	4,080
Southwark	1,229	401	3,521
Tower Hamlets	1,210	268	3,192
Wokingham	1,160	0	2,506
Cheshire East	1,154	53	2,607
Cornwall	1,122	246	2,95[illegible]

'People potentially affected' is based on 90% of cladded flats being dangerous, and 2.4 people living in [illegible]

Table: The Sunday Times • Source: Glenigan

Interim Fire Safety Costs

- Cost of Waking Watch: £499 per month per flat in London. National average is £331; £179 excluding London. (MHCLG) Costs are as high as £1,500 per month per flat. (Huffington Post).
- According to a Huffington Post FOI request, there has been an 85% increase in number of buildings requiring a waking watch within a year. As of February 3, there are 794 buildings with a waking watch. Note that this is expected to increase, as according to an Association of Residential Managing Agents (ARMA) report, insurers are now requiring them even where they are not required by the Fire Brigade.
- Alarm costs are averaging £100,000 per building (ARMA).
- Insurance Costs: In a survey of 100 buildings, ARMA found an average increase of 400%. ARMA sees an average annual bill of £1,447 per flat from £363 previously per flat. This is the lowest percentage rise of surveys conducted by Which and the UK Cladding Action Group.

Risk Concern Summary

1. DEFAULT
2. HOUSING MARKET
3. SYSTEMIC RISK

Risk Concern: Default, Forfeiture and Repossession

- MHCLG funding applies only to a small subset of costs – HPL and ACM cladding remediation above 18m. No funding is awarded for defects such as timber cladding, missing fire breaks, missing cavity barriers, flammable insulation, etc.
- Interim fire safety measures (insurance increase + waking watch charge) take up 19%-24% of disposable household income.
- Negative equity – the interim fire safety costs and the remediation costs plus the inability to sell to non-cash buyers/ remortgage/let the flat has a significant negative impact on price. This is illustrated by the number of flats being listed at auction, particularly in the last quarter.
- Fire safety defect remediation is unaffordable. Lenders are unlikely to lend due to negative equity and may be prevented from additional lending due to FCA affordability and/or other lending criteria (eg pensioners).
- Remediation may not take place for up to ten years given labour and materials availability (ARMA and IRPM estimate). This is a very long time to sustain these types of costs.
- If leaseholders default, they risk forfeiture, repossession and bankruptcy. For many, their flat is their only asset.
- Analysis of sample of 124 buildings with known fire safety defects found that at least 59 buildings had flats put up for auction since Dec 2019, with most being listed for auction in the last quarter.
- Government assumptions re costings have been challenged by industry and leaseholder groups. MHCLG assumptions appear to significantly understate costs such as average remediation bill and insurance costs.
- Help to Buy: Help to Buy loans are now required to be repaid an 'unaffected market value.' 49,918 flats have been purchased through Help to Buy since its inception in 2013. (Inside Housing)
- Leaseholders of shared ownership flats are required to pay the *entire* cost of remediation (excluding any funding awarded by Building Safety Fund) despite owning only a percentage share of the flat. Sales and lets of shared ownership are heavily restricted, typically requiring sales or lettings to be made to key workers, individuals on income support, etc. Lettings are unlikely due to the inability to switch to a buy-to-let mortgage.
- WeBuyAnyHome (the UK's largest cash home buyer) has reported a spike in requests since January, being contacted regarding a potential purchase of 2-5 flats per day with EWS1 issues. (The Telegraph, Feb 28 2021)

Average household income of impacted leaseholders

Based on responses to Inside Housing survey of 1,324 leaseholders conducted in February 2021

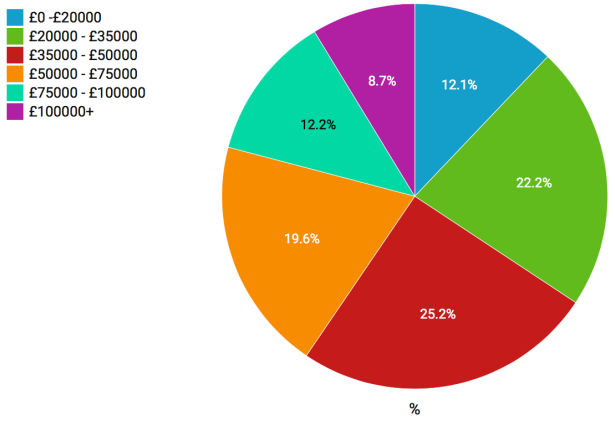

Chart: Peter Apps • Source: Inside Housing • Get the data • Created with Datawrapper

Remediation costs set to be passed to leaseholders

Based on Inside Housing survey of 1,324 leaseholders carried out in February 2021

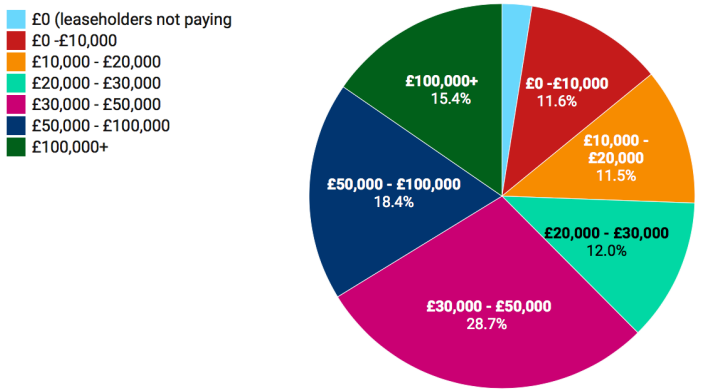

Chart: Peter Apps • Source: Inside Housing • Get the data • Created with Datawrapper

Average Flat Prices By Region and Projected Impact on Value

Region	Average Flat Price (2019, ONS)	Average Hhld Disposable Income 2018 (ONS)	Remediation Cost (ARMA & Housing Association data)	Average Insurance Cost *Rise* (ARMA)	Average Waking Watch Cost (MHCLG)	Predicted Impact on Value
North-East	£93,500	£16,995	£49,500	£1,084	£2,148	-63%
North-West	£128,000	£18,362	£49,500	£1,084	£2,148	-46%
W Midlands	£130,000	£18,222	£49,500	£1,084	£2,148	-46%
London	£428,000	£29,362	£49,500	£1,084	£5,988	-17%
Yorkshire & Humber	£112,500	£17,665	£49,500	£1,084	£2,148	-53%

- Assumes a three year (low) time horizon to remediate flat.
- Based on a discount rate of 2%.

Study of Auction Rate of Affected Flats

- LKP analysed a random sample of 110 buildings impacted by fire safety defect issues.
- Study reviewed flats from Manchester, Liverpool, Sheffield and Birmingham. Study purposely did not look at what were likely to be the statistical outliers, such as London, Newcastle, and Sunderland.
- Study analysed auction data provided by the Essential Information Group of flats registered for auction from December 2019 onwards.
- Study analysed the following data: date registered for auction, guide price, original purchase price, whether the flat sold at auction and sale price.

LKP Auction Study Findings

- 57% of affected buildings had flats registered at auction.
- 15% of flats went unsold at auction. This number is expected to be much higher due delay in confirmation of sales.
- Percentage registered January 1 – April 20th: 47%
- * Percentage selling above guide price: 4.2%
- * Percentage selling above original purchase price: 6.3%. These flats were purchased in 2003, 2009 and 2010.

* *These figures are subject to change and based on current sales data registered.*

Auction Data Examples

	Flat A	Flat B	Flat C	Flat D	Flat E	Flat F	Flat G
City	Birmingham	Liverpool	Birmingham	Manchester	Manchester	Liverpool	Manchester
Date of Purchase	2004	2003	2004	2007	2003	2008	2007
Purchase Price	£114,200	£121,435	£240,000	£163,950	£410,000	£134,450	£120,000
Date at Auction	Feb 2021	Feb 2021	July 2020	Mar 2021	Sept 2020 * Sold prior	Feb 2020	Oct 2020
Guide Price	£90,000	£90,000	£140,000	£130,000		£38,000	£85,000
Sold/Unsold	Unsold	Unsold	No sale registered	Sold	Sold prior	Sold	No sale registered
Sold Price			No sale registered	£135,000	£270,000	£54,500	

Case Studies: Birmingham

- 36 buildings have applied to the Building Safety Fund. There will be additional buildings that will not have applied because they have not been surveyed and/or they do not meet the criteria
- Average flat price £160,000 (2019, ONS)
- Average disposable household income: £16,078 (2018, ONS)
- Waking watch cost as a percentage of disposable income: 13%
- Increased insurance cost as a percentage of disposable income: 7%
- Replacement alarm cost as a percentage of disposable income: TBD
- Loan cost as a percentage of disposable income: 4%
- Average non-cladding remediation bill as a percentage of total income: 155%
- Average cladding remediation bill as a percentage of total income: 149%
- Average cladding + fire safety defect remediation bill as a percentage of total income: 308%
- Average cladding + fire safety defect remediation bill as a percentage of flat price: 31%
- Impact on flat price: estimated deduction of 37%. Estimate subject to change based on funding and works required.

Case Studies: Birmingham

	Building A	Building B	Building C
Flat price	Flat ***, two bedrooms £170,000 in 2016	Flat ***, two bedrooms £180,000 in 2004	Flat ***, 2 bedrooms £169,000 2010
Number of flats	182	141	380
Waking Watch cost	£218,400 per year	£134,000 per year	£208,000 per year
Insurance Cost	875% increase £40,000 increased to £350,000	890% increase £36,000 increased to £321,000	TBD
Remediation Bill	£52,000 for a two bed flat	£58,156 on average	Estimated £7million. Timber cladding, flammable insulation, missing fire breaks.
Flat Sold at Auction	Flat 112 Unsold at auction for £118,000 list price	Flat 709, Sold at auction £145,000	Flat 325 unsold at auction – no bids at £190,000 guide price

Case Studies: Sheffield

- 36 buildings have applied to the Building Safety Fund. There will be additional buildings that will not have applied because they have not been surveyed and/or they do not meet the criteria.
- Average flat price: £117,500 (ONS, 2019)
- Average disposable household income: £16,541 (2018, ONS)
- Waking watch cost as a percentage of disposable income: 13%
- Increased insurance cost as a percentage of disposable income: 7%
- Replacement alarm cost as a percentage of disposable income: TBD
- Loan cost as a percentage of disposable income: 4%
- Average non-cladding remediation bill as a percentage of total income: 151%
- Average cladding remediation bill as a percentage of total income: 148%
- Average cladding + fire safety defect remediation bill as a percentage of total income: 299%
- Full remediation average cost as a percentage of flat price: 42%
- Impact on flat price: deduction of 51% depending on funding. Deduction subject to change due to funding and works required.

Case Studies: Sheffield Buildings

	Building A	Building B	Building C
Flat price	Flat ***, 2 bedroom £148,000 in 2006		Apt **, 1 bedroom £114,300 May 2008
Number of flats	113	132	111
Waking Watch cost	£730,000 per year	£780,000 per year * Has just been removed	£120,000
Insurance Cost	£60,653.31 60% increase	Uninsured for a year. Unable to get insurance until building remediated	
Remediation Bill	£2.6-6.2m *all non cladding	TBD. Cladding, compartmentation and smoke ventilation needed.	TBD. Flammable cladding, timber balconies, safety breaks and inadequate cavity barriers
Alarm cost	n/a		£100,000
Flat Sold at Auction	£103,000		£75,000

Case Studies: Manchester

- 200 buildings have applied to the Building Safety Fund. There will be additional buildings that will not have applied because they have not been surveyed and/or they do not meet the criteria.
- Average flat sale price: Manchester- £183,000; Bury - £110,000 (ONS); Salford - £160,000 (ONS, 2019); Trafford -£145,000
- Average disposable household income: £17,511 (2018, ONS)
- Waking watch cost as a percentage of disposable income: 12%
- Increased insurance cost as a percentage of disposable income: 6%
- Replacement alarm cost as a percentage of disposable income: TBD.
- Loan cost as a percentage of disposable income: 3.5%
- Average non-cladding remediation bill as a percentage of total income: 143%
- Average cladding remediation bill as a percentage of total income: 140%
- Average cladding + fire safety defect remediation bill as a percentage of total income: 283%
- Full remediation average cost as a percentage of flat price (Salford): 31%
- Impact on flat price: Manchester: -32%; Bury: -54%; Salford: 37%; Trafford: 45% Deduction may change subject to funding and works required.

Case Studies: Manchester Buildings

	Building A	Building B	Building C
Flat price	* No flats at auction	Flat 108, Britton House, 2 beds £120,000 Dec 2009	Flat 208, 9 Burton Place, 2 bedroom £159,950 2016
Number of flats	288 across two buildings	100/165	
Waking Watch cost	£262,800 per annum * This was paid for three months before alarm installation.	£240,000 per annum	
Insurance Cost	Due to renew in July.	TBD	TBD
Remediation Bill	£18m estimate Rejected from BSF £60,000 to £100,000+ per flat	At least £30,000 per flat - Flammable cladding, render and insulation - - missing fire breaks	£4,600,000 - £7,000,000 - Timber cladding, flammable insulation, missing fire barriers
Alarm cost	£60,000		
Flat Sold at Auction		Unsold at auction with guide price of £140,000. Sold post auction £131,202.	135,000 guide price. Unsold.

Case Study: Liverpool

- 53 buildings have applied to the Building Safety Fund. There will be additional buildings that will not have applied because they have not been surveyed and/or they do not meet the criteria
- Average flat price: Liverpool. - £104,950 (2019); Halton - £90,000
- Average disposable household income: £17,430 (2018, ONS)
- Waking watch cost as a percentage of disposable income: 12.5%
- Increased insurance cost as a percentage of disposable income: 6%
- Replacement alarm cost as a percentage of disposable income: TBD
- Loan cost as a percentage of disposable income: 3.5%
- Average non-cladding remediation bill as a percentage of total income: 143%
- Average cladding remediation bill as a percentage of total income: 141%
- Average cladding + fire safety defect remediation bill as a percentage of total income: 284%
- Full remediation average cost as a percentage of flat price: %
- Impact on flat price: deduction of 56%. Estimate subject to change due to funding and required works.

Case Study: 3 Liverpool Area Buildings

	Building A	Building B	Building C
Flat price	Apt 38, two bedroom £134,450 in 2008	Flat 48, two bedroom £195,000 in 2003	
Number of flats	266	200; seven blocks	109
Waking Watch cost	£291,200 (paid for by Halton Council)	£250,000 per year	£170,788 * May have changed Q3 2020 under new MA
Insurance Cost	£524,663 Only two firms willing to insure • Increase of £1,400%	700% increase * Service charge increase from £1,355 to £4,785 per flat not including remediation	TBD
Remediation Bill	3 of 6 buildings are below 18m Anticipated average bill of £30,000 per flat	£7,000,000 (estimated) 5/7 blocks are under 18m	TBD
Alarm cost	£1,000 per flat		
Flat Sold at Auction	Apt 38, sold at auction £57,500	Flat 48 Guide price at auction £165,000	

Risk Concern: Housing Market

- In 2016 (pre Grenfell), there were 182,637 flats sold. In 2020, there were only 100,332 (Sept 2019-Sept 2020) flats sold. This is a drop of 45% compared to a drop of only 26% for houses (693,182 in 2016 and 509,186 in 2020). From year end Sept 2019 to year end Sept 2020 there was a 30% drop in flat sales. This is unlikely to be significantly accounted for by the pandemic given the time period. (ONS)
- 1.27m flats may be unable to be sold due to the fire safety defect crisis. (Capital Economics)
- Lenders are restricting mortgage access to purchase flats by requiring higher deposits. Nationwide and Virgin offers up to 75% mortgage for new build flats; 85% for previously owned flats. Barclays caps lending at 85% for previously owned flats valued at over £220,000. Natwest has a 75% cap on new build flats. Most houses and bungalows, by contrast, are now eligible for 95% mortgages. (The Guardian, March 21, 2021)
- According to industry experts, the fire safety defect scandal is removing the 'first rung' from the property ladder.
- Flat sales falling through impact house sales further along the sales chain.
- Collapse of agreed sales rose by 64% in 2020 from 2019; EWS1 forms and cladding costs cited as a primary contributing factor to this increase. (The Telegraph, Jan 29 2021)
- IRPM and ARMA estimate remediation could take 10 years given current availability of labour and materials.

Risk Concern: Systemic Risk

What is the impact on Tier One Capital Ratios – the RWA calculations for these mortgages? How will it impact bank lending?

How will the default risk on mortgage books impact bank stress testing?

What is the financial risk for lenders with large exposure to mortgages on flats?

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Building Insurance Premium Increases

The Grenfell tragedy exposed the vast numbers of buildings designed, built and signed off by a regulatory system which we now know was unfit for purpose. As a result, insurers now often assess an above 18-metre block with the view that the maximum loss could be the whole building rather than just a few flats. Insurers are working on the basis that the costs of fire in these buildings is significantly higher than originally thought, and that many represent an ongoing fire risk. As a result, rising insurance premiums have caused tremendous financial pressure on leaseholders.

We are also seeing that some insurers are moving the goalposts, with EWS1 B1 ratings no longer being adequate, instead requiring works to be done in order to attain an A rating, meaning leaseholders paying for works outside of the Building Safety Fund. In many cases, Waking Watches (WW) are being requested by insurers in order for them to proceed with cover, despite the local Fire Brigade being satisfied that they are not needed.

Insurance Statistics
ARMA has conducted a survey with its members in order to illustrate the current insurance landscape. Data for 143 blocks were submitted, revealing:

- Previous insurance premiums for 2019/20 totaled £7.76m.
- Renewal premiums for 2020/21 total £29.07m.
- **This represents an average premium increase of 374% per block.**

When this is worked out on a flat by flat basis, the costs are clear. The below figures represent where unit numbers are known (107 blocks):

- Total number of flats – 13,570
- Previous premiums totaled £4.92m, or £363 per flat per annum.
- Renewal premiums totaled £19.63m, or £1,447 per flat per annum.
- **This represents an average increase of 400%, or nearly £1,100 per flat.**

To date, one building in the sample remains uninsured.

13 (i.e. 10%) of the 143 blocks had increases in excess of 1,000%. The highest increase provided was 1,840% for a block of 42 flats, whereby the premium has gone from £25,000 to £460,000. To put it another way, last year each leaseholder was paying an average of £600 per annum, compared to £11,000 this year.

ARMA Insure
ARMA, in conjunction with a panel of major insurance companies, has made a proposal to MHCLG whereby any increase to building insurance premiums will be much lower in exchange for Government accepting the risk on fire related loss in excess of £250,000. The expected cost to HM Treasury is only £20m-£25m. However, at this stage there is “little appetite” for HM Treasury to take on the risk and so ARMA are asking what is the alternative solution - apart from leaving leaseholders to fend for themselves?