Autumn 2013 ASTBERRYS Newsletter

BLOCK MANAGEMENT AND INSURANCE. DO YOU HAVE TO INSURE AGAINST TERRORISM? DO YOU NEED DAY 1 COVER?

One of the areas of great concern to both freeholders and flat owners is the cost and scope of building insurance. In our Autumn 2009 and Spring 2012 Newsletters we examined the important and often misunderstood impact of insurance on water leaks from one flat to another, please go to **www.astberrys.co.uk** and click on the Newsletters for October/November 2009 and Spring 2012. In this issue we look at the scope of insurance in practice in two aspects.

Terrorism Insurance. Must a building have this cover?

The cost of terrorism insurance varies but on average it is in the region of 0.4% of the sum insured, which frequently equates to around 25% of the annual premium paid by a block of flats. To take a simple example, a Victorian block converted into 10 flats in W8 or SW5 might be insured for around £3M. The annual premium might be around £4,300 without terrorism insurance. With terrorism insurance the figure would rise to around £5,500. The extra cost of such insurance would be around £1,200.

Do you have to be covered for terrorism? The starting point is to look at the leases of the flats in the block. All leases are likely to oblige the freeholder to take out building insurance and charge the cost to the flat owners via the service charges. However, since the prospect of a terrorist attack is fairly recent and most leases are old you are unlikely to find a specific stipulation, that the freeholder must insure against terrorism. The exact wording of the covenant to insure needs to be looked at carefully to see if the freeholder may at his discretion insure against terrorism. We have never yet seen a clause requiring the freeholder to do so, but doubtless such clauses will appear in time.

Here is an example of a clause which would probably allow the freeholder to insure against terrorism, if he wanted to ".... the landlord will at all times insure and keep insured the building against loss or damage by fire **and such other risks as the landlord thinks fit**".

Here is an example of a clause which is ambiguous "... the landlord will keep the building **comprehensively insured** with a company of repute .... **against the usual risks**" another common variation might be "... such other risks as are **normally covered by a comprehensive policy of insurance**".

Here is an example of a clause which would probably make it hard for a freeholder to insure against terrorism".... the landlord will keep the building comprehensively insured against loss or damage from **fire, flood, storm, lightening, aircraft, civil commotion, malicious damage or road vehicles to the full reinstatement value**".

If a freeholder is permitted to insure against terrorism, as in the first example above, on what grounds should he decide to do so? And can his decision be challenged by flat owners, who think such insurance unnecessary? The answer to both questions is quite unclear. Surprisingly there is no case law, which gives any guidance on this point. Although there soon may be, as a case on just this point is soon to be reported. For the moment the following factors should be borne in mind by any freeholder:

- If a building is close to an obvious terrorist target, such as a major public building or transport hub, then it might be easier to justify paying for terrorism insurance and it might be harder for any flat owner to challenge the extra cost in the Leasehold Valuation Tribunal ["LVT"].

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CAMPDEN HILL GARDENS, W8

COURTFIELD GARDENS, SW5

EARLS COURT SQUARE, SW5

HOLLAND PARK AVENUE, W11

LEXHAM GARDENS, W8

NEVERN SQUARE, SW5

- Even if not close to an obvious terrorist target it may still be appropriate to insure against the effects that the explosion of a “dirty bomb” might have on any block, rendering it uninhabitable for even a short period of time.

- In a large block of flats it might be worth commissioning a report from a security expert who could provide advice on risk and the consequences of different types of attack.

- If in doubt, a freeholder of a block in central London should probably take out insurance. It might not be appropriate in Highgate or even Hampstead, but Kensington and Chelsea is right in the heart of the capital and at risk of fall out from almost any terrorist attack of any type in central London.

- When balancing the risk it might help to remember that the consequences of failing to insure, if the freeholder should have, might be catastrophic. Any flat he owned in the building might be uninhabitable for years yet his liability to pay any mortgage would continue. On top of this he might face a claim from other flat owners, suffering similar losses, on the grounds that he failed to properly insure the block. Against this there is the risk that a flat owner refuses to pay his share of terrorism insurance and succeeds [by no means any easy task] in persuading the LVT that he was right. In such a case the freeholder might have to make a refund of a few hundred pounds at most. So the balance may often be in favour of insuring against terrorism.

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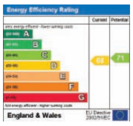
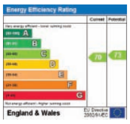
PROPERTIES RECENTLY LET IN SW5 AND W8

Penywern Road, SW5



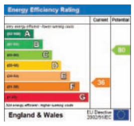
1 bedroom flat
92 m²
£636 per week

Hogarth Road, SW5



1 bedroom flat
23 m²
£295 per week

Holland Street, W8



1 bedroom flat
43 m²
£460 per week

To talk to us about letting and managing your property please telephone us on 0207 370 0123 or email us at business@astberrys.co.uk

Day 1 cover. Must a building have this cover?

What is "Day 1 cover"? It is the sum for which the building is insured right at the end of the period of insurance covered by the premium. In effect it covers the risk of an increase in construction costs over the 365 days of policy.

In the 1970s when inflation was very high some freeholders found themselves out of pocket, because of the effects of inflation on building costs. If a building burnt down or suffered major damage in one year it might not be possible to start reconstruction until right at the end of that year or possibly only in subsequent years. The building may have been properly insured for full reinstatement costs at the time of taking out or renewing the policy. However, such a sum could prove inadequate 12 months or more later on. It was to guard against such an eventuality that Day1 cover was offered.

Rather confusingly Day 1 cover is sometimes called in the alternative "Sum Insured" or "Current Sum Insured". To most people this would suggest the sum for which the building is actually insured. However this is not the case where Day 1 or Sum Insured cover is in place. In such cases the sum in which the building is insured at the start of the period of insurance is usually called "Declared Value". Where there is no Day 1 or Sum Insured cover, then there is no Declared Value and the expression Sum Insured usually relates to the sum for the whole of the insurance period [with no inflation protection].

If a building has a Declared Value of £3M it might have a Day 1 value of £3.6M which might also be called the Sum Insured or Current Sum Insured. However, if a building is insured for £3M with no Day 1 cover then the Sum Insured is £3M and no reference will normally be made to Declared Value or Day 1 value. Typically Day 1 cover is for about 20% more than the Declared Value and costs around 4% of the premium which would be charged without such cover. Using the figures in our example above without Day 1 cover you might expect to pay a premium of around £4,300 for simple cover of £3M. With Day 1 cover the premium would increase by some £172.

Do you have to take out Day 1 cover? Again this will depend on the drafting of the clause in the lease relating to building insurance. Most leases will allow for Day 1 cover. Again there is no helpful guidance from any Tribunal or Court.

The following are matters to consider. The cost of Day 1 cover is usually relatively low, but then in times of low inflation so is the risk. In any case many insurers will build into a policy without Day 1 cover an automatic element of inflation, typically 5%. This may not be sufficient because in any year building cost inflation is often higher than the CPI or RPI. Nevertheless, insurers sometimes offer a degree of inflation protection at no extra cost.

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The whole question of building insurance and its interplay with the covenants in the lease is one which will vary from building to building. The examples above are illustrative only and should not be relied on. At Astberrys we are experts in block management and the interpretation of leases. One of our directors is a lawyer and we have excellent contacts with building surveyors and insurance brokers. To talk to us about building insurance and block management generally please email us at business@astberrys.co.uk or telephone 0207 370 0123.

MARKET UPDATE

SALES

Following the financial crisis of Autumn 2008, prices for central London prime property fell by around 17%. The volume of sales transactions had already dropped by around 40% in the 12 months leading up to the crisis. Volumes began to improve in 2008/9 as buyers moved in, attracted by lower prices and a weak pound. **By early 2009 prices were starting to rise again. Since then prices have risen by around 60% and have now passed their pre crisis peak. The influx of cash foreign buyers shows no signs of abating. In the second quarter of 2013 over half of all purchases in Kensington and Chelsea were made without mortgage. Will this upward trend continue?** While foreign money continues to flow in, the answer must be yes. A rise in interest rates is unlikely to make much difference if you have no mortgage and in any event the markets are not pricing in significant rises in the foreseeable future. Investors are chasing very low yields. A gross yield of less than 3% is quite normal for the bigger properties within the Borough, but this does not appear to worry cash purchasers. **The only dark cloud on the horizon is the prospect of a left wing government in 2015 with a possible mansion tax and an anti rich agenda.** However, beware fashion is fickle. At the moment prime London is seen as the place to invest. This may change and if so prices will fall. When net yields are at or near to negative and the world and his wife talk of buying in London you can be sure that a bubble has formed. Who knows when or if it will pop. There is some evidence that right at the top the market is slowing. According to Savills values of £10M plus houses fell by 0.3 in the second quarter of this year.

RENTALS

The poor yields offered by central London property may not bother the Asian purchasers, who continue to buy. However, they **are a cause for concern for any new buy to let investor in the Borough. It is simply impossible to cover anything more than the most modest amount of finance from net rental income.** For those without mortgages or long established landlords the oversupply of rental property continues to keep rents at a lower level than 12 months ago. **Rents remain up to 20% down on the same property between 12 to 18 months earlier. The larger flats have suffered the greatest downturn. Good quality small units remain in high demand and rents are stable.** The student flat market, increasingly one to which investors are turning, is also showing a modest oversupply. There are more large, but tired properties on the market than 12 months ago. A drawing room can so easily become a fourth bedroom and a kitchen adapted to create a communal area. Rents for this type of dowdy, but centrally located flat are falling as well. Although, not by very much - on average around 5% over the same rental 12 months earlier. The demand for zone 1 student accommodation remains high and if it is clean and modern it will rent very quickly. **To talk to us about the student letting market, at which we are experts and generally about letting and managing your rental properties please contact us at business@astberrys.co.uk or telephone 0207 370 0123.**

ARLA
Association of Residential Letting Agents

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The Property Ombudsman