

Prepare for deep waters

Flood insurance for UK property, both commercial and domestic, will change materially in 2013 and possibly sooner. This is the response by the UK insurance industry to the decision by the Government to reduce planned spending on flood defences. The underlying message is that insurers think the flood risk is getting worse.

Bill Gloyn, Partner, European Real Estate of international insurance broker, JLT Specialty Limited (JLT), warns that the government cuts in planned spending on flood defences have important, potentially catastrophic implications for commercial property owners and managers. They can include:

- the probability of more frequent and possibly more severe flooding
- limited or more expensive insurance or both
- potential breach of contract for properties where insurance isn't available
- reduction in availability of property loans
- claims from neighbouring property owners affected by flood prevention measures

The United Kingdom is unusual; flood insurance is widely available for most domestic and commercial properties. This isn't the case elsewhere in Europe. But UK insurers fear that climate change will increase the number and possibly

the severity of floods, and they have already seen claims increase by 200% in real terms during the last decade.

Following the 2007 summer floods, which cost them about £3 billion in claims, members of the Association of British Insurers (ABI) revised their commitment to continuity of flood insurance agreed with the UK Government. This agreement – the Statement of Principles – affects the whole of the market even though it covers only domestic and small commercial property built before 2009.

This agreement expires in June 2013, and it contains a number of conditions, the most important of which is that the Government maintains and improves flood defences. With the cuts in planned spending announced in October 2010 in the comprehensive spending review, insurers do not expect to renew the agreement – at least not in its current form.

Speaking at a conference organised by the British Property Federation and the City Property Association in December,

David Williams, Claims Director of Axa Insurance, said: “2013 will see an end to flood insurance as we know it and it is not just householders who need to be concerned. The Statement of Principles keeps things ticking over. If the agreement with the government is not renewed, it will have a huge impact on the market.” The ending of the agreement would see, he said: “Much higher rates for some properties and a complete absence of insurance for others.”

Hazards

The most severe UK hazard is storm surge: the combination of a high tide and severe windstorm like the East Coast floods that killed more than 300 people in 1953. It's also possible, however, that the cumulative effect of serious, although not catastrophic, losses plus the probability of more to come as a result of climate change, will cause insurers to retrench when the agreement expires. Even the events in Australia, although on the other side of the world, have an effect on the global



insurance market and may well influence reinsurers to consider their continuing support of the existing arrangements.

Three events in the last four years have shown that groundwater flooding, where drainage systems cannot cope with heavy rainfall or melting snow, can also cause major losses. According to Environmental Agency Chief Executive Paul Leinster, our knowledge of this hazard lags 10-15 years behind that of other types of flood. He called for more research on surface water flooding in his talk to the property associations' seminar.

Fuelled by the experience of the summer of 2007, the number of properties estimated by the Environment Agency to be at risk has risen substantially over the past few years, mainly because of the realisation that the surface water exposure is now higher than previously understood. Some 3.8 million properties are believed to be at risk of surface water inundation compared to 2.4 million exposed to river and coastal flood. Within those figures are some 1 million exposed to both.

The ABI agreement can also be reviewed in case of external shock, such as a material change to the availability of reinsurance. Bill Gloyn, who is also chairman of the BPF insurance committee and immediate past-president of the City Property Association, pointed out at the seminar that reinsurance support is critical to the continuation of flood insurance but that abrupt changes are possible.

"Anyone thinking that the insurance market would not withdraw cover on a widespread rather than selective scale only needs to remember that there is clear precedent for that to happen. It did for terrorism – first, for fire and explosion, following the City of London bombs of the early 1990s and did again, for all cover, following the atrocities of 9/11."

Property market repercussions

Gloyn said the repercussions could go far beyond dearer property insurance. He pointed out that insurance against flood damage is critical to a whole range of contracts in the real estate business – construction contracts, leases and funding agreements. "If cover is not available – and that is already the case in some areas of the United Kingdom – the consequences are almost too catastrophic to contemplate. Widespread breaches of contract will lead to chaos and a potential collapse of the property market – both commercial and residential."

The latest valuation guidelines from the Royal Institution of Chartered Surveyors (RICS) make it clear, seemingly for the first time, that flood and other sustainability risks must be taken into account, added Gloyn. "It would be an unwise valuer who didn't also consider if insurance was available before settling on a value.

He continued: "It is worth recalling the response given by the Council of Mortgage Lenders to the Pitt Review following the summer 2007 floods – in summary, without insurance there is no mortgage. Without mortgages, there is no property market!"

Whatever happens after 2013, JLT believes that insurers will push to link premiums more closely to specific risks. Some businesses can gain. They should be able to reduce the cost of their insurance by improving the flood resistance of their properties and the resilience of their buildings. As brokers, said Gloyn, we will be able to use our skills to negotiate rates that really do take account of improvements that owners have made.

There is, however, a caution when it comes to making property less likely to flood: the water has to go somewhere. If one property owner protects his property by diverting water away, he may

face a claim from another owner who's suffered more flooding as a result. The sensible approach may be for them to work together, for example, to devise a sustainable urban drainage system.

Top tips for developers, commercial property owners and managers:

Planning

A regular complaint by insurers is that properties are still being given planning permission despite being in high risk areas. This improved when the Environment Agency was given stronger powers, but there is now a fear that the new focus on localism may dilute the ability of the Environment Agency to stop new schemes in the future.

Design

In areas of higher flood risk, minimum national construction standards aren't adequate. Design features to protect against flooding and minimise water damage need to be given clearer profile.

Information

Surface water flooding is extremely hard for insurers to model and quantify. The more precise, site specific detail that property owners can provide, the stronger the broker's hand in negotiating. Insurers will look for the location data at geocode and address point to fit into their models.

Cooperation

Work with other businesses and parts of the community to create sustainable urban drainage systems (SUDS), bearing in mind the need to balance these schemes with the overall economical viability of new developments. Help strengthen community resistance to flood risk by following the guidance in the ABI leaflet *Insurance Issues for New Developments*.

Research

Promote research into ground water flood and effective control measures.

A flood of claims

Figures published by the Association of British Insurers (ABI) in November 2010 showed that since 2000 insurers have paid claims of £4.5 billion to customers whose homes or businesses had been hit by flooding. Major losses include the 2007 summer floods which resulted in £3 billion in claims; the 2005 floods in Carlisle that cost £272 million and the Cumbrian floods in November 2009 costing £174 million.

According to the ABI, reasons for the rise in flood costs include increased frequency and severity of flooding and the growing problem of surface water flooding. The Environment Agency actually estimates that the total cost of the 2007 floods was nearer £4 billion, with some 65% relating to household losses. Of those, only 75% were insured compared with 90% of commercial losses.

Total cost of loss

Flood often has a long-term effect. Because of the time needed for the water to disperse and property to dry out, it can take weeks or months before things can be put back to normal. Consequential losses can, therefore, last for a very long time.

Recent data issued by Munich Re (*Topics GEO 2009*) showed that only 30% of total global losses arising from natural catastrophes are insured. Much of the balance relates to the consequential losses that flow from damage - often underestimated when cover is arranged. In many cases, businesses do not survive a major loss.

The loss of rent cover due to flood is usually restricted to the period of the rent suspension identified in the lease. However, with increasing numbers of

contracts giving a break option to the tenant if serious damage occurs, the actual period of the loss might be much longer - especially if it takes some time to find a replacement tenant after a break has exercised and the subsequent rent is lower than that originally paid.

The future funding of flood defences

The Department Environment Food & Rural Affairs (Defra) has proposed that the way in which funding is currently allocated should be changed; the 95% of costs contributed by Government in the past is seen to be far too high. In future, funding will be determined by reference to the local outcome - more effective, longer lasting measures will get a higher level of funding.

As a first step towards implementing a charge, Defra launched a consultation just before Christmas with a closing date for responses on 16th February. Implementation is then due to start on 1st April 2012. Details can be found at www.defra.gov.uk/corporate/consult/flood-coastal-erosion/index.htm

The future focus for funding will be on public infrastructure and residential property. New developments, including housing, will receive little or no financial support and there will be far less available for areas at moderate risk. Business, in particular, is expected to include flood within a general assessment of business risk and to include provisions for it accordingly. This additional burden, coming on top of existing local and national taxes, including empty rates, is something that readers may wish to comment on - before it is too late!

An important group of MPs, the cross-party Environment, Food and Rural Affairs Committee, says that the Government has shifted a burden for flood defences to local communities that they may not be able to afford.

Following publication of the committee's inquiry into Future Flood and Water Management, its chair Anne McIntosh M, who spoke at the seminar before the report was published, commented: "At a time of budgetary constraints councils must give flood protection work priority since many of them will need to increase the financial contribution they make to key local flood defence projects whilst also fulfilling their new duties to lead local flood work."

The committee called on the Government to:

- Spell out how it will deliver its pledge to focus public money for flood defence on communities at greatest risk and least able to protect themselves.
- Ensure adequate and stable funding for local authorities and other agencies given new responsibilities under the Flood and Water Management Act 2010 to plan for and respond to flood events.

The committee said in its report that there is an urgent need for the Government to reach agreement with the insurance industry on the future provision of flood insurance because of the expiry of the current Statement of Principles. "The renewed agreement should ensure that investment in flood resilience measures by householders is reflected in the insurance premiums they pay. Defra should provide the Committee with an update on progress on this within six months."

What if?

A serious flood affecting Central London would put all services under extreme pressure – possibly even to breaking point, since they are already so stretched, and businesses would suffer as a result. For instance, seven of the nine major rail terminals are situated in the area shown in the Environmental Agency flood map as at risk and numerous underground stations are in flood risk zones. Premises may be inaccessible, even if they aren't themselves flooded, or staff unable to get to work. The effect of the pre-Christmas snow demonstrates how stretched London's infrastructure is.

Two of the three emergency response hospitals, Guy's and St Thomas' are within yards of the Thames and numerous underground stations are in flood risk zones. It is not clear how well protected major public services are, but many individual buildings still have emergency back-up power generators, telecoms and critical support functions in the basement.



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