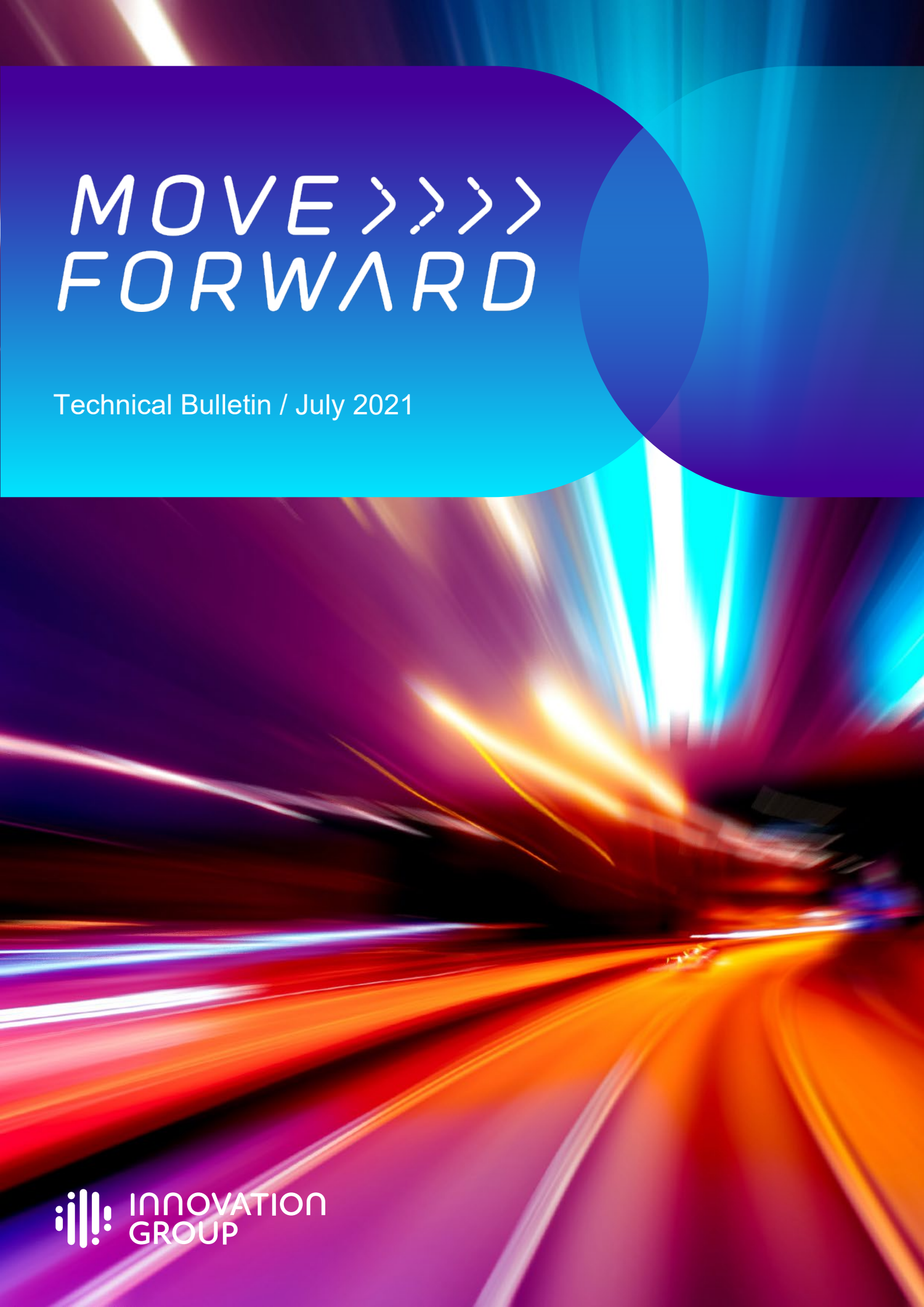
MOVE FORWARD

Technical Bulletin / July 2021



INNOVATION GROUP

Contents

Introduction

This year marks the 50th Anniversary of the addition of the subsidence peril to the buildings section of the home insurance policy. Some of the developments over that period are outlined below.

On a different topic, just how successful has the Intervention Technique been? Our patented method of resolving root induced clay shrinkage claims with the aim of retaining the offending tree was introduced by Innovation Group some years ago and our Head of Engineering, Dr Allan Tew, has been keeping an eye on sites that have been treated – more on page 9.

Next month, in addition to the usual guidance on Best Practice based on Financial Ombudsman Service decisions, we look at the work being carried out by the British Geological Survey relating to the risk of subsidence associated with climate warming – something that the Clay Research Group, of which we are the biggest sponsor, have also been working on. On the topic of predicting the future relating to climate change, Plymouth University have published a paper outlining a model to forecast coastal changes.

Richard Rollit delivered a webinar on 8 July at the invitation of Azur Group entitled 'Subsidence to Sinkholes' which was well received and still available to view at https://broker-iq.azuruw.com/s/. The organiser reported *"excellent feedback and high levels of engagement make your presentation one of the best we have ever had".* Our senior management team also have a webinar that can be accessed on YouTube at https://www.youtube.com/watch?v=W81kYdZC98I where they are joined by Sarah Dodd, Head of Subsidence at Eversheds.

Richard Rollit
Technical Director

M 447764627151
E richard.rollit@innovation.group
W innovation.group

50th Anniversary - or where has £8.3bn gone?

It's been 50 years since subsidence was added to the domestic building policy and how times have changed. The initial process involved insurers appointing adjusters who then appointed an engineer who reported to back the adjuster who sought instructions from the insurer etc. It was a lengthy process. Now, most adjusting practices handling subsidence claims employ engineers/surveyors direct and often work under Delegated Authority, reducing the number of visits and claim costs.

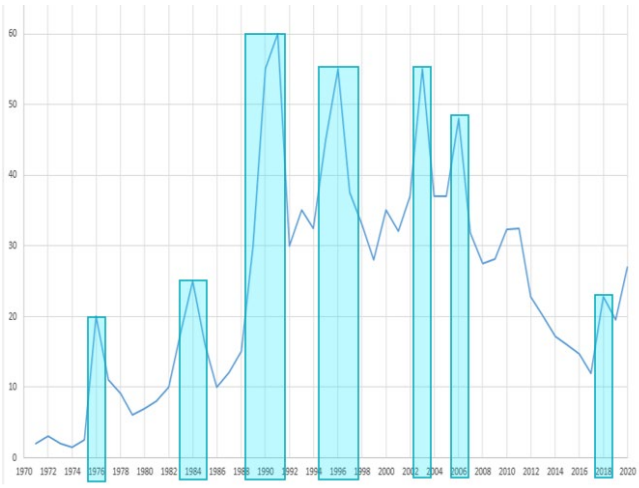
In the early days, around 50% of claims received were underpinned. It was as if 'subsidence = underpinning'. When cracks appeared, it was a brave engineer who would suggest repairing the drains/removing a tree and carrying out crack repairs, omitting foundation strengthening.

Now underpinning is carried out on around 2% of claims, resulting in a huge saving for insurers. The suggestions by the building community that this reduction in underpinning would lead to many claims being re-opened proved to be pessimistic in the extreme. This change in technical approach was largely based on the excellent work of the Building Research Establishment. It is also a function of improvements in soil testing and monitoring techniques. More next month.

So, what's happened over the last 50 years? Insurers have spent nearly £8.3billion dealing with claims on 1.3m properties - around 7% of the privately owned UK housing stock.

- Subsidence cover introduced as a standard peril following pressure from building societies and mortgage lenders.
- Relatively low claim numbers until the drought year of 1976.
- Generally, the response was to underpin, and many underpinning contractors would offer a 'free survey'.
- Costs for the peril escalated and it is thought to be one of the reasons for the failure of Municipal Mutual Insurance in 1993.
- As we have moved away from underpinning so the average claim cost (adjusted for inflation) has fallen from about £13k in the 1990's to around £6k now.

Number of Subsidence Claims, 000s (1971-2020)



Removal of Cover Following a Cash Settlement

When a claim is settled by a cash payment, insurers want to protect themselves against the risk of further claims for the same damaged area that they've already settled.

If the damage is minor e.g. decorations only, most insurers take no action. What's the position if there's another incident before repairs have been carried out? Insurers rely on the fact that the adjustment of the second claim should be the cost of repairs less the amount paid in settlement of the first claim (but not yet spent) - and less the second excess. However, some insurers will specifically endorse the policy to exclude damage to the same area until repairs have been completed.

The same principle above applies when there is damage caused by one peril but a payment hasn't yet been made, followed by damage caused by another peril. We've had a couple of instances recently. We were dealing with subsidence damage and had quantified the cost of repair. However, no payment had been made. In one case there was fire damage, in another it was escape of water that caused damage to the same part of the building. In both cases, our argument was accepted: that the value of the fire and escape of water claims was the full cost of repairs less the notional cost of the subsidence repair.

More usually, insurers will remove subsidence cover from buildings until repairs have been completed. The policyholder needs to apply to the insurer's customer services for cover to be reinstated once repairs are completed. Particularly for major repairs, they might well need to provide evidence from a supervising engineer or surveyor about the repair. Occasionally insurers will remove all buildings cover until the damage has been repaired. Most insurers ask at policy inception whether a property is in a good state of repair and won't offer cover if it isn't. A subsidence-damaged property is at greater risk of damage through other perils e.g. water ingress through cracks or through an ill-fitting roof.

If we are cash settling structural damage, our standard practice is to warn the policyholder that subsidence cover will likely be temporarily removed. If the client doesn't remove cover – and some don't always do so – that's a bonus for the policyholder. If all cover is removed, there will be a reason. Whatever the decision, it is, of course, a matter for the insurer.
The Financial Ombudsman Service considered the subject recently. Following subsidence damage to a garage. Insurers offered to instruct repairs, but policyholder wanted cash. A settlement of £11,560 was agreed. Insurers said that, upon payment, the buildings and contents cover for the garage would be removed until repairs had been completed. FOS said that was fair. '*I don't accept that the increased risk is limited to further subsidence. For instance, a building with structural issues will likely be more susceptible to other insured events too, such as storm or accidental damage*.' It was also fair to remove contents cover. '*I can't reasonably decide it needs to continue to cover contents in the garage whilst repairs remain outstanding. I say this for the same reasons I gave above, in respect of the buildings cover*.' DRN-2775531.

Removing all cover is unusual but can be fair in certain circumstances. In this case, it was a garage rather than the main house that went uninsured. Also, insurers had some doubts as to whether repairs would be carried out.

Proportionate Response

Proportionate isn't a word that appears in most insurance policies. The closest is 'proportion' when referring to average and underinsurance, or contribution when more than one policy covers a loss. In each case, the policy pays a rateable proportion of a claim.

Although the word proportionate doesn't appear, it's a fundamental concept of the law in all sorts of areas including insurance contracts. In laws of warfare, a country's response to unlawful aggression

should be proportionate to the aggression, mainly to protect civilians. In criminal law, proportionality of the sentence to the crime is fundamental.

The overriding objective of the Civil Procedure Rules of 1998, an expanded version of which is still in force today, required courts to deal with cases justly and at proportionate cost, in ways that are proportionate to: the amount of money involved; the importance of the case; the complexity of the issues; and the financial position of each party. Having said which, a lawyer's idea of what are proportionate legal costs to incur in a dispute seem to vary considerably from what the man-in-the-street might think was reasonable.

In insurance claims, the cost of resources that an insurer applies to a claim is proportionate to the amount claimed. A claim of, say, £75 from a policyholder might get very little scrutiny; it's uneconomic. And there's little point spending £2,000 to investigate a contents claim for £2,500 that might well be the correct sum due under the policy. The exception is if fraud is suspected. In those cases, insurers will spend what it takes to establish the facts. It will be interesting to see how the continued introduction of artificial intelligence into claims handling changes the economics.

Proportionate remedies for misrepresentation were introduced for consumers in the Consumer Insurance (Disclosure & Representations) Act 2012 and for businesses in the Insurance Act 2015.

In subsidence claims, we frequently need to explain to a policyholder that a few cracks in a wall doesn't mean that the house needs to be underpinned: it's a disproportionate remedy. Although old hands will remember that during the 1970s and 1980s, soon after subsidence cover was first added to property policies, underpinning was indeed a common response by insurers – see article on page 2, Claims practice has moved on since then.

The other main subsidence claim circumstance in which we need to consider proportionality is when subsidence has been operating for a considerable period. The first step is to review the policyholder's notification of damage to the insurer. There is usually new damage that has become apparent and is the subject of the claim. The policyholder generally isn't claiming for historic distortions. Consider the notification condition; have insurers been prejudiced by late notification of old damage?

If a policyholder is wanting older damage to be repaired as part of the current claim, check the date that our client came on cover. Is it reasonable for the current insurer to be paying for damage which occurred before cover commenced? We saw an extreme example of that reported recently.

A policyholder bought a property in 2016 and took out building's insurance. In 2017, he started a conversion project which involved ground investigations. These showed that the soil was poor quality and the house had been suffering from subsidence prior to the start of the conversion. He asked the insurer to pay for the cost of dealing with the subsidence problem that had occurred prior to the conversion - which he thought should include underpinning. A second engineer instructed by the policyholder thought movement had likely been active throughout the life of the 120-year-old building. There were severe distortions in the house.

Insurers accepted that subsidence had occurred whilst they were on cover but said it wasn't reasonable for them to pay the full cost of carrying out the necessary underpinning and remedial work. They offered £2,000. FOS agreed that was fair.

'The insurer is only responsible for dealing with the damage which happened after its policy started – a time frame of up to nine months. Although its clear damage continued during that time, taking into account the engineering evidence, it's likely the majority of the damage happened prior to the policy starting. In these circumstances, I'm not persuaded it would be fair to ask the insurer to pay for underpinning. I accept the engineer's view that underpinning is needed in order to stabilise the house. But that's a remedy to a problem that's been on-going for many years or even decades prior to the insurer's policy starting. It's disproportionate to the amount of damage that's likely to have happened whilst the insurer insured the house. I'm satisfied it would be reasonable for the insurer to offer a contribution to the cost of putting right the problem, based on an estimate of how much additional damage is likely to have occurred since the policy started.' DRN-2619423.

Often FOS will say that if an insurer can't distinguish between insured and uninsured damage, the insurer should pay for the full repair. That would have been a disproportionate response in this case.

Loss of Rent: Domestic Houses

When dealing with a rented house, it's always important to get the full picture of tenancy arrangements at the outset. Often a claim for loss of rent isn't made until later during the life of a subsidence claim. At that stage, tenants have moved on and the only source of information who can be contacted is the landlord/policyholder making the claim.

Was the property tenanted when the damage was discovered and notified to insurers? Frequently damage is discovered at the end of a tenancy – either by the landlord or a managing agent – when the property is being checked. Or it's discovered by decorators sprucing up the property to make it attractive to new tenants.

Always ask at the outset for a copy of the tenancy agreement in force at the point of subsidence notification.

If the discovery is at the end of a tenancy, still ask for a copy of the expired agreement. It confirms the rent and dates. Has a new tenant been lined up? Has the new tenant signed a tenancy agreement and paid a deposit? In England, the maximum tenancy deposit amount is five weeks rent. Most landlords charge either that or a month's rent.

Until the agreement has been signed (which will include a starting date) and a substantive payment made, there isn't a legal agreement in place. Whilst a landlord might later try to persuade you that a new tenant had absolutely committed to the property, let the facts speak for themselves. Was there a legal agreement?

If there was no tenant when the damage was discovered and no tenant lined up, there aren't grounds for a loss of rent claim. This point was considered in a recent decision at the Financial Ombudsman Service. '*Mrs B's policy confirms she is covered for any lost rental income. But in this case, it doesn't apply as she didn't have any tenants in the house during this time so had no rental income to lose*'. DRN-2349501

If damage is discovered mid tenancy, always ask the tenant when they first became aware of the damage. It might well have been before cover under the current policy commenced. Until recently, landlord buildings insurance was an extremely competitive market. Many landlords switched insurer or Managing General Agent (MGA) regularly. Covid has rather dampened the market now.

In one recent case considered by the Financial Ombudsman Service, policy inception was September 2018. In early 2019, the policyholders made a claim for their tenanted property. Insurers investigated. The tenant told them that damage started in the summer of 2018. The policy excluded: 'damage … which originated before this cover cause was effective.' FOS said declinature was fair. The word 'originated' in the exclusion helped.

'*The exclusion covers damage which 'originated' before the policy was in place. I've taken that to mean damage that began before the policy started. …. I accept the report from Ageas says the damage has been getting worse since the policy started. So it's arguable that Ageas could be expected to cover any damage that happened whilst it was on cover from September 2018. But I think the exclusion, and particularly the word 'originate' means that if the damage began before the policy did, it doesn't need to cover any worsening of that damage that might have happened once the policy was in place'*. DRN4232590

If the property is tenanted, the tenancy agreement will say that the tenant should pay rent to the landlord. In what circumstances can the tenant stop paying? The Government's model tenancy

agreement says ‘Where the property is uninhabitable because of damage caused to the property by an insured risk then, unless the damage was caused by the tenant’s negligence or failure to comply with the tenant’s obligations under this agreement, the tenant shall not be required to pay rent until the property is fit for occupation and use’. So, the property needs to be uninhabitable.

Apply the same test that we do for owner-occupiers. Does the property have toilet, sleeping, heating (in winter) and cooking facilities? Many tenancy agreements take a stricter line about uninhabitability: check the exact wording. Just because the tenant is inconvenienced by damage or doesn’t like a cracked wall in their bedroom isn’t a reason for them to stop paying rent.

Tenants who want to move anyway might use damage as an excuse to move out, even though the property is habitable. If the policyholder claims for loss of rent in those circumstances, we should do more than just reject the claim. It’s sensible to work with the landlord, ensuring that he understands the tenancy agreement and takes steps to enforce it against the tenant. Pre-emptive action by a landlord against a tenant to prevent loss of income is better than legal action afterwards to try to recover the situation.

Where a landlord has a damaged property, it can be sensible of them to temporarily reduce rent. It’s better to have continuing occupation at reduced rent rather than an empty property with no rent coming in. However, be careful if giving advice on the subject. Make sure the policyholder understands that we are not saying the balance is claimable under the policy. If the property is tenanted and habitable, there’s usually no cover. For cases involving a supporting broker, some clients might occasionally be prepared to make an ex-gratia payment covering loss to a landlord through agreed rent reduction.

If a tenancy comes to its natural end during the life of a subsidence claim, a landlord might complain that the property is more difficult to let as a result of cracks, monitoring or impending repairs. Maybe so. But being a landlord is a business choice and dealing with unforeseen events involving the property and tenants is part and parcel of that business. Having said that, it’s frequently the case that we will assist by arranging to fill cracks and carry out modest cosmetic repair to make a property a more attractive rental proposition or contributing to the cost of same.

Do we ever need to pay for loss of rent from Day One? Yes. The occasional landslip or sinkhole might mean that a property is unsafe to occupy. Loss of rent is triggered immediately. Technically, where the tenants go to is not our or the landlord’s concern. In practice, we have the expertise and it is good practice to assist in resolving a homelessness problem if we can. It’s a sensible business decision if we can arrange an alternative that is the same or cheaper than the rent that the landlord was receiving: it’s a win-win. It also makes it more likely that the tenants can and will return to the property when it’s made safe and habitable.

Does the local authority have a role? Don’t be surprised if they ask what’s happening to tenants. The Housing Act 1996 places a general duty on housing authorities to assist individuals and families who are homeless or threatened with homelessness. However, as soon as they know insurance money is available, either directly or indirectly, councils naturally lose interest.

Occasionally a tenant will complain to the Local Authority that a property is unsafe. The council will do a Housing Health and Safety Rating System (HHSRS) assessment. Only if it thinks the house has serious health and safety hazards will it take action. Shelter, the housing charity, gives some examples. They are mostly not problems that arise through subsidence. http://england.shelter.org.uk/get_advice/repairs_and_bad_conditions/health_and_safety/hhsrs As always, it’s different in Scotland and Northern Ireland.

Unless a property is unsafe, we are most unlikely to be dealing with loss of rent prior to repairs. If an unusual pre-repair situation arises, discuss ideas to keep the property habitable within your team. If loss of rent is being paid, mark it in iSubs ‘important information’ so that the loss period is minimised.

Always check the indemnity period. The policy will say during which period loss of rent is covered. It’s typically two or three years after the insured event. For subsidence, by custom and practice we use the date of claim notification as the event date, partly to be consistent with the ABI Domestic Sharing Agreement. It can sometimes take a year or more to identify the cause and mitigate before we are

ready to repair. This eats into the indemnity period so the period when loss of rent can be paid is reduced.

In some cases, repairs are not ready to be started until after the indemnity period has expired. That's unfortunate. However, unless there were unreasonable delays on our part, the policy should be applied, and no loss of rent reimbursed. Note that it has to be unreasonable delay by us. Just because it was hard work and time consuming to get a local authority tree removed doesn't mean that we should waive the time-limit.

The FOS has considered a complaint where policyholder complained that delay in repairing caused them to lose rent. Subsidence damage was notified in 2013. Insurers were ready to repair in June 2016 so scoped repair then. Repairs started in January 2017. Various difficulties arose. Repairs completed in May 2018. Policyholder said he'd lost rent since 2015. However, his complaint was rejected.

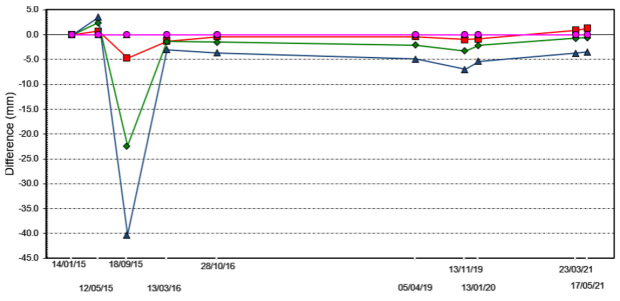
'*I accept it took nearly two years for the external works to be completed in May 2018. But having looked at the history this appears to have been due to reasons largely outside of RSA's control. The weather stopped works progressing at various points, and complications with the age and construction of the conservatory meant experts had to be consulted. …. I have noted some small gaps in the progress of the claim……But this delay itself isn't enough to make me think compensation needs to be paid …. Mr and Mrs B have said they've given their tenants reduced rent for a large period of time due to the inconvenience caused to them. I can understand why they may have wanted to do this, but I would only say that RSA need to reimburse them for this amount if it had caused unreasonable delays. And on the whole, I find it hasn't.*' DRN9924808.

For most perils – fire, storm, impact etc - the date of loss is the date the property became uninhabitable. For cases where subsidence repairs start after the indemnity period has ended, some clients are prepared to waive indemnity period limits and pay loss of rent. The logic is that delayed uninhabitability wasn't within the underwriter's contemplation when the policy was drafted

Next month we will look at loss of rent for commercial premises.

Intervention Technique

Our Head of Engineering, Dr Allan Tew, reports on a case where the Intervention Technique was used to stabilise a property damaged by root induced clay shrinkage, and good news, the building has been stabilised.



The graph, right, illustrates the movement that was taking place in the summer of 2015 – around 40mm of subsidence was recorded in September 2015.

As part of the ongoing monitoring of a selection of claims where our patented technique was used, we returned to site in the Spring of 2019 and readings were taken over a two-year term.

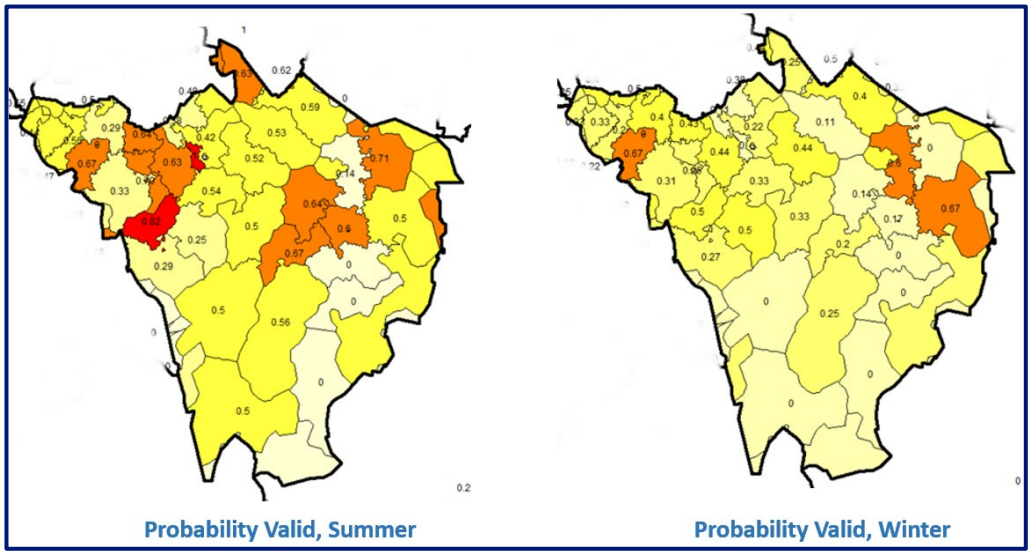
Damaging movement of 50mm recorded in September 2015 has been reduced to normal seasonal movement of around 5mm from Spring 2019 to Spring 2021.

Decisions from FOS Website

16 March 2021 DRN-2630154	Defective design DDMW, Extension	Damage to extension. Defective design declinature. FOS said NHBC not applicable. Building Regulations. '*These regulations are relevant. However, as it says the depths "may" need to be increased, I'm not satisfied that's an absolute requirement in order for building regulations to be met. And as the building work was approved by Mr W's local authority, which carried out inspections throughout the various stages of the build, including at the time the foundations were laid, I'm satisfied that the foundation depth met building regulations at the time.'*
18 March 2021 DRN-2365246	PH prejudiced investigation by repairing	Crack damage to porch. Insurers inspected and declined the claim. Damage got worse. A year later, PH got his own engineer's report. That mentioned subs. However, PH had carried out repairs so insurers couldn't investigate further. So claim stayed declined. FOS said that was fair. It was for PH to show the peril had operated. *'I accept the report suggests subsidence. But I'm not persuaded that the report on its own is conclusive evidence. Indeed, the report also explains what should happen next to help determine the cause of the damage'*. Drainage CCTV was recommended, but PH didn't have that – or any other investigations - done. He just repaired.
22 March 2021 DRN8810631	Extension. DDMW. Defective design Stability. 10mm movement.	Subs damage to an extension. Claim initially declined as DDMW. FOS rejected that argument. It had stood the test of time (30 years). NHBC wasn't the correct measure. Insurers then said property was stable. The "…levelling exercise from April 2019 to January 2020 has shown negligible movement (less than 2mm level difference) …I would consider level movement of up to 10mm to be related to common seasonal movements. Level readings are well within this tolerance." No stabilisation of foundation – as PH wanted - was required.

Probability of valid claim by Season – Bromley

Distribution of domestic subsidence risk by season.



Liability by Season – Bromley

District	valid summer clay	valid summer EoW	Repudiation Rate (summer)	valid winter clay	valid winter EoW	Repudiation Rate (winter)
Bromley	0.626	0.136	0.238	0.08	0.37	0.55

For further information or any queries, please contact:

Richard Rollit
Technical Director

M 447764627151
E richard.rollit@innovation.group
W innovation.group