

Built to last?

Cladding and fire risk in the property sector

Why did we engage on this issue?

The Grenfell disaster in London¹ in 2017 claimed the lives of 72 people and left an entire community in dismay. Occurrences of similar fire incidents have raised many concerns over fire safety management from residential and commercial buildings alike. In order to implement Grenfell Tower Inquiry² recommendations the UK government has issued a consultation on Fire Safety on 20 July 2020³. Ahead of government's consultation RLAM was already engaging with 19 building companies about their fire risk management strategies.

The Government has continued to put further pressure to those responsible for buildings where ACM combustible cladding is yet to be removed. The building market has had to adopt costly measures in removing cladding, with leaseholder and householders sharing the responsibility of paying retrofits to make blocks safe⁴. An expected 2,000 defective buildings nationwide will require remediation. Replacing unsafe cladding in London alone has been estimated to cost about £4 billion.

Furthermore, the fire at the student accommodation The Cube in Bolton in November 2019 exposed the risk to fire of high-pressure laminate (HPL) cladding when combined with certain types of combustible insulation. This was a distinct type of cladding from the Aluminium Composite Material (ACM) which was used at Grenfell Tower. The risk of this type of cladding in fuelling fire had not explicitly been identified before and was not in scope of the remediation requirements. We decided to request further information to understand how RLAM's portfolios may be exposed to this risk.

Who did we identify as being at risk?

Tenants and house builders, face high risks to the threat of fire safety. Our fixed income sterling funds invest in secured debt issued by social housing organisations, for example, where the additional security may be physical property. We also

hold some exposure to UK property companies in our equity funds. Danger to human safety and the cost of remediation compromise the sustainability of our lending position. Furthermore, the loss of human lives, failure to comply with safety standards and implement appropriate risk assessments and management, will put companies' reputation at risk. We selected a final list of 19 companies, based on their likelihood of having high-rise properties with HPL cladding and the exposure of RLAM funds to these companies.

Engagement process and outcome

During Q1 2020, we received answers from 17 of the 19 property companies likely to have high-rise properties with high-pressure laminate (HPL) cladding. We observed different thoroughness in the responses received, with four holding responses, based on those companies' ongoing surveys.

Responses in Q1 informed the second phase of engagement which started in May 2020. This phase aimed to go beyond the assessment of risk exposure to cladding but to ensure that appropriate fire safety standards were in place. We received 11 responses to this second outreach, with updates on surveys conducted on HPL cladding. These responses included details on companies' disclosure of their fire safety policy, the scope and breadth of their risk management strategy. They also covered whether the companies had remediation or repair policies, and if they had conducted external audits to their fire safety risk management.

Formulaic and legalistic responses on cladding

Some of the companies' responses to our phase one attempt to evaluate their exposure to HPL or other cladding risks were ambiguous. They followed legalistic formulae and left space for interpretation. The second round of questions provided some clarification.

Best practice on fire risk management

All companies confirmed they have fire risk management strategies and checks as required by regulation, but some responses to the engagement highlighted best practice.

Some companies mentioned having a 'golden thread' of fire safety information, and a fire logbook or online platforms. The latter covered all aspects and checks/ inspections carried out on all the elements of fire safety and required reparation or mitigation response within the property. An important feature displayed in some responses, was incorporating residents behavioural aspects; regular communications with tenants and resident engagement, fire drills and prevention activities, beyond just signalling fire exists were part of the best practices. All companies conducted the mandatory Fire Risk Assessments, but a few had independent Health and Safety consultants whose reports are 'peer-reviewed' periodically. Others partnered with a local fire brigade to conduct these assessments.

One company, in particular, mentioned a detailed process for fire risk and inspection schedules, involving insurers' inspections, local authority fire brigade partners and quarterly reviews of the process by the company's board. Four companies disclose online their Health and Safety Risk Management which includes Fire Risk Management.

Cladding removal costs and responsibility for fire risk

Companies also commented on how material this risk was to them. The cost for one of the companies in our study was £4.3m to address façade risks on five buildings and £8m improving fire stopping. Another company spent £13.9m in costs for work related to replace the cladding. Some companies revealed that in 2020, they continued removing ACM, Grenfell-type cladding.

Differences in the control of and access to buildings in different asset types, means the fire risk management responsibilities vary. Some companies in our engagement programme confirmed that as developers they could be held responsible for cladding removal, but once sold they were no longer responsible for managing fire risks. Commercial warehouses or office rented spaces with a single occupier do not have control of fire risk management. Companies with assets such as shopping centres, residential or student housing are more likely to be involved in the day to day management of the building. We also found the outsourcing of building management to a third party to be a common practice.

RLAM's Real Estate Portfolio – our own portfolio approach

As well as being an investor in property companies within our equity and fixed income funds, RLAM is a considerable investor in physical property assets through a range of real estate funds, and has carried out a risk assessment of the entire estate. We assessed risk factors such as residential occupancy,

where construction used any form of cladding, where buildings are over 18m in height and where there were sprinklers. Only one site was at high risk, a high rise building for which the cladding is currently being replaced. We have a process in place to ensure cladding risk is minimised in all new buildings acquired for the portfolio. RLAM's managing agent JLL is subject to an internal quality review for fire risk management, and to RLAM Health and Safety auditing, conducted by Leonard Engineering. JLL is in charge of conducting regular Fire Risk Assessments (FRA) for RLAM. They are also in charge of putting in place and disclosing fire safety policies. A risk management system ensures that risks flagged in the FRA's are communicated to building managers, and that mitigating action takes place.

Conclusions and recommendations

The exposure to HPL cladding risk appears to be low and concentrated; ACM cladding seems to be more prevalent but has been and continues to be phased-out. Despite building standards and substantial regulation, companies' responses remain heterogeneous, showing this type of investor engagement brings value-add in understanding the risk.

Fire risk management is a crucial health and safety issue with clear links to insurance costs, liabilities and reputational risk. Improved public disclosure of the companies' fire risk management strategies would allow for sector peer-learning and better information for investors' exposure to risk and investment decision making.

One of our holdings in the student housing sector emerged as the company with the most overall exposure, due to their scale and the nature of their high rise assets. As long-term investors in this business we have engaged with them regularly over the past three years on cladding matters, including specific queries for this report and are satisfied with the level of fire risk management in place at all their properties. In a previous meeting with management, we were told that this was their single biggest concern within their property portfolio. Nevertheless, given the very clear risk here we will continue to monitor and engage with the company to ensure that any remaining cladding is removed in a timely manner.

The complexities of the housing market different types of leasing and ownership structures' mean that the onus of ensuring cladding retrofitting and fire safety management lies in various stakeholders. Split incentives between stakeholders' make fire safety a persistent risk hard to mitigate. As investors, we are exposed both to the inaction due to increased fire risk, which impacts lives and assets and to the costs of expensive retrofitting. We see as part of our responsibility to develop this engagement and share the findings to help drive better practices in fire risk management, supporting the implementation and going beyond the UK government regulatory efforts.

Summary table of the companies' responses

	Cladding risk Response from November and May	Fire risk management Response from May	Disclosure of fire risk policy	Real estate subsector
Company 1	Detailed response explaining no cladding defined as fire risk exposure	Best Practice	Yes	Office
Company 2	No cladding defined as fire risk	Best Practice	Yes	Retail
Company 3	Detailed response explaining no cladding defined as fire risk exposure	Good	No	Residential
Company 4	Detailed response explaining no cladding defined as fire risk exposure	Good	No	Industrial
Company 5	Detailed response explaining no cladding defined as fire risk exposure	Good	No	Homebuilding
Company 6	No cladding defined as fire risk	Did not respond	No	Residential
Company 7	No cladding defined as fire risk	Good	No	Industrial
Company 8	Detailed response explaining no cladding defined as fire risk exposure	Compliant	Yes	Office
Company 9	One development with ACM	Good	No	Homebuilding
Company 10	Some cladding but low risk	Compliant but no audit	No	Health Care
Company 11	Three developments with ACM	Compliant	Yes	Homebuilding
Company 12	Some cladding but low risk	Did not respond	No	Health Care
Company 13	Some cladding but low risk	Did not respond	Yes	Diversified
Company 14	Some cladding but low risk	Did not respond	No	Residential
Company 15	Conducting survey	Did not respond	No	Office
Company 16	Unclear response	Did not respond	No	Homebuilding
Company 17	19 properties with HPL, 3 above 18 m	Good	No	Residential
Company 18	Did not respond		No	Homebuilding
Company 19	Did not respond			Diversified

Notes

- <https://www.gov.uk/government/collections/grenfell-tower>
- <https://www.grenfelltowerinquiry.org.uk/about>
- https://www.gov.uk/government/consultations/fire-safety?utm_source=2350fb29-962b-45de-ae25-b539bd6f02da&utm_medium=email&utm_campaign=govuk-notifications&utm_content=immediate
- <https://www.ft.com/content/f30ef039-d413-438f-9abe-34de34dd7ee0?shareType=nongift>

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