



Taking the guesswork out of building valuations

At a glance

- Incorrectly insured assets can cause major underinsurance problems down the line
- Qualified professionals are needed to establish the accurate insured value of a building
- Customers need to make sure that building sums insured remain at the correct levels

A failure to establish the accurate insured value of some buildings is potentially creating a ticking time bomb for commercial property owners.

Getting an up-to-date accurate assessment of reinstatement costs for insurance purposes must be an absolutely essential component for securing the future of a business.

Avoiding the dreaded 'clause of average'

What if an insurer questions the adequacy of your sum insured in the event of a loss?

If your building surveyor cannot support their rate with detailed calculations, the insurer may apply the 'clause of average'.

Clause of average is a policy condition that requires the amount of a claim payment to be reduced proportionately if you have not insured your property for the full value or replacement cost.

For example – if you insure a building for £1,000,000 and the insurer insists that the true rebuild value is £2,000,000, the extent of the insurer's liability is limited to 50% of an insurable loss. A fire causing £100,000 of damage will result in a maximum payment of just £50,000 leaving you to fund the shortfall.

Significant time can also be lost while this issue is debated and additional financial costs may be incurred such as independent assessments and legal fees.

At present, a lot of property owners rely on commercial building insurance valuations that are often produced by a chartered surveyor, loss adjuster or insurance surveyor who derive a figure by applying a £ per square metre rate to the gross internal or external floor area of a property.

The valuer has historically used the latest £ per square metre rates for an average type of commercial property as provided in published cost data books and online data tools such as by the Building Cost Information Service (BCIS), which is part of RICS.

The use of £ per square metre rates to assess the reinstatement cost of a property for insurance purposes has been common practice amongst surveyors historically and indeed will still be common practice amongst many surveyors today.

This, though, has sometimes led to cases of underinsurance, as well as over-insurance.

The rebuild ranges indicated in published and online rating guides can be quite wide for some building types, by as much as £500-£2,500.

Undetected problem

It is an issue that can obviously go undetected for many years and if a building is insured for less than its full reinstatement cost, in the event of extensive damage an insurer would only pay out a percentage of the cost of repairs because of the clause of average.

There are a number of different ways and methodologies used to come up with a building valuation.

One such method of valuation is by using a quantity surveyor who can advise clients on realistic rebuilding budgets.

Ticking time bomb

Index linking, which is widely used by insurers to update the sum insured of a building from one year to the next as the policy is renewed, has run at around 1%-3% in the last few years.

However, solely relying on this over a longer period to maintain an accurate sum insured of a building may eventually lead to errors even if the rebuild figure has been correctly calculated in the first instance. The indexation applied may not accurately reflect changing regional trends and differing labour and material costs for a particular property.

We would recommend that figures are checked every three years, to make sure that building sums insured remain at the correct levels.

Other potential pitfalls for property owners trying to ascertain a correct building valuation include costs associated with the change in building regulations that have added significantly to the cost of a rebuild in recent years, the use of developer costs – especially recent developments, which could have been built at a significant discount – and using the market value of a property to establish a building sum insured.

Using the market value can result in significant levels of underinsurance depending on geographic location. This will impact on the vast majority of properties outside of London and parts of the southeast.

In the event of a total loss, the professional cost assessment must allow for the cost of reinstating the specified premises to the existing design, to a standard equal to, but no greater or better than the existing condition, in accordance with current building regulations and other statutory requirements as may be applicable.

So, like many commercial insurance contracts, the devil really is in the detail and making sure assets are insured correctly – and not by educated guesses – could save a fortune in the long run.

