

Underinsurance – are you covered?

Although not a new phenomenon, underinsurance remains an ongoing concern in the insurance market. The hardening attitudes of underwriters is seeing claims settled in strict accordance with policy wordings.

There has also been a rapid and significant increase in the cost of building materials (and labour in certain parts of the UK) and Policyholders may not realise that underinsurance may impact on payments in the event of a property damage claim.

So, what impact can underinsurance have for you?

If a claim payment does not cover the full property repair/rebuild cost or reinstatement, it could mean funds may not be available to complete the rebuild.

This may result in:

- Negative impact on service delivery to your customers
- Extended negotiations with insurers delaying rebuild
- Borrowing against potentially stretched budgets
- Potential legal action from lenders and leaseholders
- Reputational damage to your organisation

How does a building become underinsured?

Underinsurance can become an issue, as a result of several factors:

- Reinstatement Cost Assessment was completed many years ago
- No professional valuation or Rebuild Cost Assessment ever undertaken
- Sums insured are based on a notional market value
- Incorrect estimation based on historical information
- No account has been made for structural changes
- No allowance for fluctuating costs of raw materials and labour
- Developer's costs are adopted instead of the true reinstatement cost

Buildings are constantly changing value and there is always a risk that if you place insurance without examining how things have changed you may have an underinsurance risk.

Implications of underinsurance

The 'Average Clause' is a standard policy condition in UK property insurance policies, allowing an insurer to reduce a claim payment by the amount of underinsurance present at the time of loss.

Example

Fire damages a building with a sum insured of £7.2M. Loss adjusters are appointed by Insurers, and they calculate the true rebuilding cost of the property to be £9 million (i.e., underinsured by 20%). The cost of the repairs is £5 million, but once Insurers apply the average clause, the claim is reduced by the amount of underinsurance (20%) leaving the policyholder £1 million short of the full repair costs.

A regular Reinstatement Cost Assessment would have identified the underinsurance on which the policyholder could have acted.

Reinstatement costs will typically include:

- The main structure including foundations
- Half of the cost of party walls/protecting adjoining structures
- The peripheral features that form part of the development
- The cost of demolition of the above
- The cost of debris removal
- The cost of professional fees

New build or newly built properties

Unfortunately, in most cases development costs do not compare well with the costs of reinstatement. Some of the factors which make reinstatement costs higher include:

- The need to commence works urgently
- Demolition costs
- Professional fees
- Changed surroundings due to the passage of time
- Post-development additional features
- Additional site access costs
- The need to protect undamaged sections of a building and prop adjacent buildings
- Less efficient work programming requirements
- The scale of scaffolding and other access costs
- Developer's costs being set on fixed price tenders
- Economies of scale for developers buying materials in bulk
- Zero-rating for VAT for dwellings

What should you do?

We would only ever advise clients to engage a surveyor certificated by the Royal Institution of Chartered Surveyors (RICS) to perform a Reinstatement Cost Assessment in respect of your buildings.

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