

McLarens' Guidance on Reinstatement Valuations

As a property owner it is crucial to ensure that your asset – including any Landlord Contents and the rental income – is adequately insured. The protection afforded will provide peace of mind and security to your asset and, in the event of a claim, the damage will be repaired and your rental income, protected.

It will likely be a requirement of any financial institution involved in providing a mortgage or other loan capital against the asset that the asset is adequately insured. It is therefore important to ensure that the sums insured are set at a correct level.

Insurance Policies typically contain an underinsurance penalty clause called 'Average', which proportionately reduces the sum payable in respect of any claim in the event that a property is inadequately insured.

Take, for example, a property insured for €200,000. Let's say the building is damaged as a result of a fire and the cost of the repairs is established to be €100,000. In the course of the Insurer's inspection, it is determined that the property is underinsured, and the correct building sum insured should be €400,000. The building is therefore insured for 50% of the what the correct value should be and therefore the claim settlement to the policyholder will be reduced by 50%, in this case, reduced from €100,000 to €50,000. A €50,000 shortfall arises payable by the policyholder and not the Insurer.

If the property is completely destroyed by fire and costs €400,000 to rebuild, the Policyholder will only recover €200,000 (the sum insured) and be left with a €200,000 shortfall.

The above example relates to buildings, but underinsurance clauses can also apply to Loss of Rent and Landlords Contents cover. Landlord's Contents (which may comprise contents of common areas and/or individual flats/apartments) should be insured for their estimated replacement value.

How should a property owner go about setting the correct building sum insured?

It is a common error on occasion to insure at the market value of the property. In the event of physical damage to the property, the loss sustained by the owner on the majority of occasions will be the cost of repairing the damage, and that is the basis on which the sum insured should be considered.

The building sum insured should reflect all costs to fully demolish and rebuild the property in full, summarised below:

- Demolition of existing building and debris removal from site. The cost of removing any asbestos content needs to be considered here
- The full cost to rebuild the property including, if insured, boundary walls, driveways, fences, outbuildings etc. Consideration should be given to any aspect of the insured asset, which is a protected structure (which will inevitably carry a higher rebuild cost)
- An allowance to comply with statutory and local authority requirements including planning requirements and up to date building regulations

- Potential inflation costs to allow for an increase in building repair costs during the period of construction (typically one year but for larger buildings the rebuild time could be considerably longer and inflation could squeeze the sum insured into an 'under-insured' value)
- Professional Fees (typically architects, surveyors and/or engineers)
- VAT liability (currently 13.5% on building costs and 23% on professional fees)

There are a number of options to assist owners of a residential property. If a financial institution provides a mortgage, they will normally arrange their own survey, which will provide an indicative cost to rebuild the property.

The Society of Chartered Surveyors Ireland (SCSI) website provides assistance in setting a minimum sum insured via this link: <https://scsi.ie/consumer/build/house-rebuild-calculator/> but this calculator/guide reflects rebuild costs for standard (estate type) single unit residential dwellings.

There has been much discussion within the construction industry about building cost inflation, which does introduce an element of uncertainty when selecting the building sum insured. Earlier this year, the SCSI has reported an Ireland-wide average 7.3% rise in the cost to rebuild domestic property in the previous 18 months, exceeding inflation.¹

There are various solutions available in the insurance industry to assist property owners in protecting themselves against unforeseeable inflation risks, without un-necessarily over-insuring. An experienced insurance broker will be able to assist/direct property owners in this regard.

Turning to insurance for Loss of Rent, this should be easier to establish, and reflect the maximum rent which could be lost during the period of cover selected, e.g. 12 months or 24 months. For example, if the property contains 4 fully occupied apartments each producing rental income of €12,000 per year and a 12-month period of cover is selected, then the sum to be insured should be €48,000. If a 24-month

period of cover is selected, then the sum insured should be €96,000. Any planned increases in rental charges should be factored when setting the sum insured. Applicable Service Charges may also be included here depending upon the policy wording. Commercial Rates may also be covered under commercial property owners' policies.

Some policies will also provide cover for additional alternative costs incurred by tenants following building damage, if not otherwise insured e.g. the reasonable cost of alternative accommodation should their dwelling be uninhabitable due to insured damage.

Property owners should consider the period of cover for Loss of Rent to reflect the worst likely scenario of serious damage happening to a property. In the majority of occasions, 12 months cover will not be adequate in the event of serious building damage. Following such damage, a property owner needs to deal with selecting and appointing a professional team of architects/surveyors and the like, obtain tenders for building repairs, deal with planning consent for the demolition and rebuilding, all before the repair period itself is factored in.

Other factors which can delay matters include asbestos removal, supply and demand of labour and lead time for materials, timescales for a tenant to remove their personal belongings/fully vacate to allow repairs to take place. It is recommended that a property owner adopts a cautious approach when setting the period of cover for Loss of Rent.

Conclusion

The examples given illustrate the importance of ensuring the correct sum insured is used so the required protection is in place for repairs to damage and/or rebuild. This should be a regular topic to review with your broker to provide peace of mind and security to your asset, however, the onus is firmly on property owners to arrive at and insure for the correct reinstatement value for their property, which in most cases is a duty under the terms and conditions of the policy.



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References

¹ SCSI (2021) House Rebuilding Costs Have Increased By Average Of 7.3% Nationally Over Last 18 Months) Available at: <https://scsi.ie/house-rebuilding-costs-have-increased-by-average-of-7-3-nationally-over-last-18-months/> (Accessed: 30 November 2021)