EVERYTHING YOU EVER WANTED TO KNOW ABOUT REINSTATEMENT COST ASSESSMENTS BUT WERE AFRAID TO ASK

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The only thing worse than reading an article about insurance is being asked to write one about it. While I would omit this remark to an audience of insurance executives, I'm sure most property professionals would agree with the sentiment.

But rather than debate whether insurance is boring, let's put aside the question of whether it really is deadly dull and see if interesting people like property managers can work their way to the end of this article.

PROPERTY MANAGERS AND REINSTATEMENT COST ASSESSMENTS

(RCAs — formerly known as Building Reinstatement Valuations)

All ARMA Accredited Managing Agents have obligations, assuming they are authorised under the FCA rules or in their capacity as Company Secretary, when dealing with insurance which include:

- Ensuring that the appropriate cover is in place and that it meets the requirements set out in the lease — ARMA Standard 4.5 (a)

- At renewal, ensuring the extent of cover, sum insured and the level of premiums are reviewed — ARMA Standard 4.5(b) & RICS Residential Management Code 15.13.

The RICS Management Code also stipulates that:

- Valuations for insurance purposes should be considered on a regular basis and instructed conveniently before renewals
- Valuations must be carried out by qualified valuers with appropriate skill and experience in the type of properties being assessed, with their fees normally being regarded as a service charge item where allowed.

DECLARED VALUE

The insurer/broker requires a Declared Value upon which the premium is based although an additional figure, known as the Sum Insured, is provided by the broker/insurer which is increased to allow for inflation over the period of a potential claim. This is commonly an addition of between 15%–50%.

Declared Value is defined by the RICS as:

The cost of rebuilding and associated on-costs on the basis of a total loss or of such substantial damage that the entire building will require demolition and rebuilding, at the level of costs applying at the commencement of the insurance period without any provision for inflation. This is also known as a 'Day One reinstatement' figure. The figure should be the equivalent of a fixed price, lump sum, competitive tender submitted by a suitable and competent contractor for works to commence on site on the first day of the period of insurance, together with appropriate allowances for demolition and other costs and all associated professional and other statutory fees (with VAT on fees only).

The starting point is to identify where the existing declared value came from. The property may have been professionally valued in the past, the figure may have been provided by the developer or maybe no one knows. Care should be taken when it has been provided by a developer since there are instances where the figure has been based on the sales prices of the flats (which of course have nothing to do with construction costs) and can be significantly inflated. Alternatively, they may be based on the developer's own build cost which may well prove to be under assessed when compared with the cost of reinstatement.

The frequency of revaluations is not stated in the advice provided by the RICS — however it is likely that the insurance policy will include a statement which is related to what is known as the Condition of Average.

The Condition of Average

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is where a declared value is deemed to be under assessed and the claim amount is reduced by the same ratio. For example, where a building is insured for say £1M but the declared value should be £2M, then the amount paid under a claim is limited to 50%. Not surprisingly the reverse does not occur.

Many policies have a waiver of the Condition of Average where the property has been professionally valued in, for example, the last three years. In such cases it is clearly beneficial to have the property revalued following this cycle. As a guide, it is generally considered reasonable to commission a full reinstatement valuation every 10 years with intermediate desk top re-assessments every three years, subject of course to there being no material changes to the building. Such assessments to be provided by qualified surveyors/valuers.

When instructing a valuer it is important to check that they are suitably qualified and have adequate Professional Indemnity Insurance cover for the level of a potentially negligent valuation. They will also need to have such cover for the "life" of the valuation.

It is also worth confirming how the valuation is being assessed. The RICS have a subscription Cost Assessment service for valuers called BCIS which has a calculation function. This however is limited to buildings of five storeys of traditional construction. Where buildings are taller and have more complex construction and amenities an Elemental Cost Assessment should, in my view, be carried out. However, the availability of suitable comparison costs is limited and hence there is increased subjective opinion and risk. Ultimately the surveyor may have to explain/justify their assessment to the loss adjuster in the event of a claim.

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DEFINITION OF VAT

We then have the contentious issue of VAT.

The definition of declared value excludes VAT (except on professional fees) since the assessment is based on a complete destruction and re-instatement. HM Revenue and Customs VAT Notice 708 (October 2013) states that a zero-rated dwelling(s) building "is built from scratch, and before work starts, any pre-existing building is demolished completely to ground level (cellars, basements and the slab at the ground level may be retained)".

In the majority of insurance claims, the building is not rebuilt from scratch and as such VAT is likely to be payable unless the insured is able to reclaim it. This issue of whether the additional VAT (VAT on fees is already included) should be added to the Declared Value was recently considered by the FTT in a case where I gave evidence. The answer boils down to the insurers conditions as to whether the VAT element has to be insured.

A typical example is that the client has taken "all reasonable precautions to include Your Value Added Tax liability within the Building Sums Insured at the inception of this insurance and at each subsequent renewal Date." In such a case if the VAT had not been added to the Declared Value and therefore the Sum Insured, the client would run the risk of being averaged on any partial claim.

Having looked into five insurers' conditions, four included similar clauses and one included cover for VAT but did not require it to be added to the Building Sum Insured. It is interesting to note that the underwriters for the insurer that did not require VAT to be added, are quite uncomfortable about it as they potentially have 17.6% (the approx. additional VAT element) more exposure than they think they have as the insurers do not ask whether VAT is included when quoting. It is likely that their wording will change with future revisions.

The FTT held that it was reasonable to include VAT in the sum insured.

Managing Agents should therefore make sure that the position of VAT is considered at renewal to avoid the client/insured being under-insured and then seeking recompense from the Managing Agent for not advising them correctly.

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