Underinsurance and the importance of accurate building replacement valuations

The Underinsurance Scourge

Underinsurance happens when the value of a policyholder's property is underestimated, leading to inadequate insurance cover in the event of a loss. This makes accurate property valuations an essential step that help to ensure proper insurance coverage for a broker's clients.

Inaccurate building replacement valuations happen when regular valuations are not done on a property or when brokers and policyholders don't review sums insured in their policies at renewal time.

Other common reasons for underinsurance include renovating or demolishing part of a property, which also affects a property's replacement value.

"Failing to update the property's value in the insurance policy to reflect these changes can lead to a coverage gap. This is where the important role of accurate property valuations comes into play," says Scott Robertson, director of Robertson and Robertson Consulting Valuers.

Ensuring Building Replacement values are accurate

An accurate building replacement valuation is an assessment of a property's true worth, taking into account factors such as location, size, condition, features and current market conditions.

Insurers rely on accurate property valuations to assess the level of risk associated with a property and to determine the appropriate premium. Underestimated property values can lead to improperly priced premiums, potentially affecting an insurer's ability to cover claims adequately and sustainably.

"In the event of a fire or natural disaster, an underinsured property owner can face substantial financial losses, as their insurance coverage won't be enough to fully repair or replace the damaged property," says Robertson.

Additionally, many insurance policies include an underinsurance clause, which means the amount paid out by the insurer is proportionally reduced by the level of underinsurance.

The example on the right demonstrates how the underinsurance clause may be applied to a loss at settlement:

Underinsurance is a growing problem for property owners in an environment in which real estate values keep rising and building costs are escalating.

EXAMPLE:

Let's assume the sum insured for a building is declared by the insured at: $1,500,000.

But the actual total replacement value for the building is actually: $2,000,000.

The building suffers a partial fire damage for: $500,000.

For the purpose of underinsurance calculation 85% of $2,000,000 equates to: $1,700,000.

$500,000 x ($1,500,000 ÷ 1,700,000) = Insurer Pay Out.

Insurer will pay out: $441,176.

Leaving the insured to pay: $58,824.

The basic principle is the greater the underinsurance, the more the policyholder shares in the loss.

Building costs surge boosts underinsurance risks

Source: 'Building costs surge boosts underinsurance risks' article – Insurance News.com.au

A surge in construction costs ... has put homeowners at "extreme risk" of underinsurance, MCG Quantity Surveyors has warned.

MCG Director Marty Sadlier says the firm estimates the cost of building an average home in capital cities such as Sydney, Brisbane and Melbourne has risen more than 10% in the past six months, translating into an increase of $48,500 based given a median construction cost of $485,000.

Mr Sadlier says many properties in inner-city suburbs have construction costs of more than $1 million, while material and trade shortages are also increasing real costs by about 15% in many cities and towns.

"Property owners could be left hundreds of thousands out of pocket should an unfortunate event have them calling their insurance provider," he said today. "Unfortunately, most will only discover they are woefully underinsured when it's too late."

Mr Sadlier says the average construction program on sites has increased by as much as 16 weeks due to material and trade shortages, and cost increases will worsen an existing underinsurance problem that may have seen more than 80% of property investors underinsured before the pandemic.

"Given the recent hikes in materials and labour costs, I'd be surprised if we weren't closer to 100% of owners at risk," he said.

Additional outlays such as professional fees, council charges and emergency accommodation, all add to the end amount that needs to be covered, Mr Sadlier says.

Building sector stimulus programs, natural catastrophes and supply chain issues affected by the coronavirus have contributed to shortages of materials and trades.

Homeowners should update their property insurance value at least every year, not rely on online insurance calculators to assess property replacement costs and shop around for insurance options, MCG Quantity Surveyors says.

How can we help?

Sorting out your insurance cover often drops to the bottom of your never ending to-do list. That's where we can help. We do the hard work of reviewing your insurance strategy, adapting your cover and giving you peace of mind that your business is properly insured.

How do you know if you are underinsured?

You are at risk of being underinsured if:

- You haven't updated your insurance cover to reflect the growth of your business.
- Your insurance is based on an outdated replacement cost of your business assets.
- You are covered for damage to your business premises but have not considered other forms of financial loss such as business interruption and management liability.

Contact us today

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