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Reinstatement Cost Assessments - Frequently Asked Questions

Under-insurance remains an ongoing concern in the insurance market. With insurers' attitudes to risk changing in the first hard market that some of us have ever seen and the tragic events at Grenfell giving us all a much better appreciation of modern construction materials, poor fire stopping and a greater likelihood of larger losses.

Could you or your clients afford to have a claim payment that doesn't meet the full cost of repair or reinstatement of their property?

Cardinus conducts thousands of Reinstatement Cost Assessments every year so it's no surprise to us that over 80% of the buildings we value are underinsured. Some of the reasons for underinsurance and/or increases in values may not be obvious to you, so we have set out below a number of frequently asked questions and answers to assist you:

Q. How does a building become underinsured?

A. This can happen for a number of reasons, including:

- A professional valuation has not been carried out in the last three years or prior.
- Figures are based on the market value rather than the reinstatement costs.
- Historical figures have been rounded up, perhaps by insurer's index linking. This may not take into account any rise in material and labour costs due to the property's location.
- Relying on developer's figures. These may not include aspects such as debris removal, surveyor fees and the cost of meeting local authority requirements in the event of a rebuild or VAT.

Q. If a property is constructed of stone will this have a bearing?

A. Yes, stone is normally more expensive than brick. The range of costs for stone is quite wide and this factor needs individual consideration to ensure the correct rate to be applied. It's also likely that more specialist craftsmen will be needed to work with stone so you also need to factor any potential increased cost for specialist labour and their availability.

Q – Does the area where the property is located have an impact?

A – BCIS rates take into account regional variations. Please note that you can have areas that are within relatively close proximity, one being upmarket and one being less desirable. The costs of reinstatement will not necessarily vary between the two.

Q – What is the relationship between reinstatement cost and market value?

A – None. Reinstatement costs can be much higher than the market value, for example, in areas where land values are significantly lower than prime areas of London where land costs are high and properties are much sought after.

Q – How is reinstatement cost affected with historic buildings and those that are listed?

A – These factors can dramatically increase rates for listed buildings. The effect of a listing will directly impact the costs of materials and craftsmanship required to rebuild to the agreed timescale, thus increasing the cost. Remember that normally a listed building will have to be reinstated exactly as it was before being damaged or destroyed.

Unfortunately, there can be abnormal costs relating to the reinstatement of listed buildings. This can include unusual and highly specialist techniques in replicating items such as ornamentation, lead work and stonework and the involvement of heritage bodies leading to higher professional fees.

Q – Can I base reinstatement cost on a contractor's quote for rebuilding?

A – A contractor's quote is a snapshot of a point in time and will invariably be lower than the actual cost following serious damage or destruction.

Q - If I set my insurance cover based upon the original development cost of constructing the property will that be adequate?

A – Development costs do not compare well, if at all, with the costs of reinstatement following, for example, a serious fire. There are many factors which make reinstatement costs higher including:

- The need to commence works urgently
- The timescales involved when you have residents rendered homeless
- Demolition costs
- Changed surroundings due to the passage of time
- Additional features such as outbuildings post-development
- Additional site access costs
- The need to protect undamaged sections of a building from the elements etc.
- Less efficient work programming requirements
- The scale of scaffolding and other access costs
- The need to protect and prop adjacent buildings
- The differing profile of professional fees.

Developers in a planned build also work efficiently across sites with fewer access issues. An example of this, for larger buildings, is the location of tower cranes.

Have a look at the following time-lapse photography of a 300-unit Barratt development along the River Thames in London, which will provide further insight www.youtube.com/watch?v=Pdjz5nHOE7I.

Q – Should VAT be included in the reinstatement cost?

A – The subject of VAT is a complex and sometimes thorny area. Some valuers will remain 'silent' or suggest that you contact an accountant or insurance professional for advice.

VAT notice 708: Buildings and construction (December 2020) gives an interpretation of the law in connection with construction works from the point of view of HM Revenue & Customs. VAT tribunals and court decisions since the date of this publication will affect the application of the law in certain circumstances.

The notice is available on HM Revenue & Customs' website: www.hmrc.gov.uk/index.htm

As an example, the erection of a new single dwelling or residential block is zero-rated for VAT, however, the vast majority of insurance claims are not for total losses and therefore VAT is applicable to rebuilding costs.

A second consideration is the VAT status of the policyholder and/or claimant. Many property owners or landlords are not registered for VAT. In this scenario, the expectation would be that they will want to recover VAT on material and labour costs as part of the reinstatement as they are unable to claim this from HM Revenue and Customs.

These are only a couple of examples, and there are too many different permutations to mention here. Typically there are three main considerations:

- What is the occupation/proposed occupation of the property?
- What is the VAT status of the client/insured?
- What is the insurer's position relative to the application of VAT?

VAT – A real example

A block of 96 flats were valued and insured for the full rebuilding cost, but the residents decided not to include the VAT in the total - to reduce their premium spend. Subsequently there was a large fire at the property and the building needed to be demolished and rebuilt.

Unfortunately, due to changes in legislation for private dwellings, the clients, were only granted planning permission to rebuild 90 flats on the site. This left a choice to be made:

Rebuild the property as 90 flats and 6 people lose their homes or; to reinstate the property instead of demolishing. The only option here was to reinstate.

As the client had chose not to include VAT on the rebuild value, the property was more than 20% underinsured and the rebuild value was woefully inadequate to reinstate the block.

VAT is only waived on a complete rebuild of residential properties and the property owners had to fund the additional 20% shortfall personally - causing a great amount of distress and financial loss.

We take our client's instructions regarding the inclusion/exclusion of VAT, so seek to understand their requirements before completing a reinstatement cost assessment.

We hope that the above information proves helpful to you.