

# Residential: what are the risks of underinsurance?

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- ▶ What is included in building insurance?
- ▶ What is underinsurance and how does it affect the industry?
- ▶ What are the forces driving an uptick in property underinsurance over the last three years?
- ▶ What measures are in place to ensure that underinsurance doesn't happen?
- ▶ What are the risks of underinsurance, as well as the factors that could impact your organisation's profit and reputation?
- ▶ Conclusion and QA

# BUILDING INSURANCE

Home Insurance comprises two separate policies:

- ▶ Building insurance – building structures and permanent home fixtures and fittings
- ▶ Contents insurance – possessions

Combined building and contents insurance:

- ▶ Cheaper and convenient
- ▶ Ensure the combined level of cover is adequate

Building insurance should cover the worst-case scenario. For example, a complete rebuild of the structure

# REBUILDING COSTS

Rebuilding costs for insurance purposes refer to the costs of:

- ▶ Demolishing and clearing away the existing structures including substructures, and
- ▶ Rebuilding the structures to the original design
- ▶ Rebuilding to a standard equal to the existing property, and in accordance with current Building Regulations and other statutory requirements

**Includes:**

- ▶ Temporarily making safe the damaged or adjoining structure
- ▶ Professional fees payable in connection with the rebuilding of the property
- ▶ VAT where applicable (professional fees and for works not directly connected to the use of the dwelling)

# COVER ALSO INCLUDES

## Permanent fixtures and fittings:

- ▶ Sanitary fittings – baths, hand basins, and toilets
- ▶ Fitted kitchens
- ▶ Bedroom cupboards

## Interior decorations

## Outbuildings and structures:

- ▶ Garages, greenhouses, garden offices and sheds
- ▶ Boundary walls, fences, gates
- ▶ Paths, drives and car parks

Check the clauses as some contracts exclude other structures like swimming pools

# EXTENSIONS OF COVER

## Alternative Accommodation

- ▶ Cost of alternative accommodation

## Liability

- ▶ Damages and cost for damages or injuries to third parties

## Underground Pipes and Cables

- ▶ The supply pipes for gas, electricity, oil, water, as well as sewage pipes, can be insured against accidental damage

## Breakage

- ▶ Glass – In doors, windows and skylights
- ▶ Sanitaryware - baths, washbasins and WCs

# EXCLUSIONS

## VAT for construction costs of dwelling

- ▶ Buildings designed as dwellings, or a number of dwellings, are zero-rated for VAT and are therefore excluded
- ▶ Work that is closely connected with the dwelling or allows the building to be used can also be zero-rated
- ▶ However, VAT is payable on professional fees and on other work unconnected to the construction of a dwelling, e.g. swimming pools

Removal and disposal of contaminated and/or hazardous materials

Utility infrastructure charges (electricity, gas, telecommunications, cable services, water and sewerage)

Always check the wording of the contract

# UNDERINSURANCE

According to the Association of British Insurers (ABI), underinsurance occurs when the insurance cover, or sum insured, is less than the value at risk

- ▶ Sum insured is the maximum amount of money that the insurer is obliged to pay in the event of a claim, in this case the full rebuilding cost of the property
- ▶ Value at risk is the measure of the possible financial losses for the insurer, i.e. the value of the insured property

Insurance should cover for the worst-case scenario

# CAUSES OF UNDERINSURANCE

## Inadequate assessments

- ▶ Cover should be for complete rebuilding of all structures, fixtures and fittings, and grounds
- ▶ Assessments should be carried out by a trained professional
- ▶ Assessments should be based on appropriate data, like BCIS Rebuild Online, and not the market value of a property or a mortgage valuation

## Out-of-date assessments

- ▶ Assessments should be reviewed annually to ensure they reflect any alterations and improvements
- ▶ Sum insured should keep up with inflation
- ▶ Sum insured should not be index linked over a long period
- ▶ Detailed assessments should be carried out from first principles every 3-5 years

## Insufficient limits in the policy

# INFLATION

Sum insured should have provision for changes in rebuilding costs during the insurance year and the subsequent reinstatement period

## Two main ways to allow for inflation:

- ▶ Lump sum addition at the time of assessment – forecast to cover the insurance period, design, planning and rebuilding period
- ▶ Index linking sum insured

## Index linking

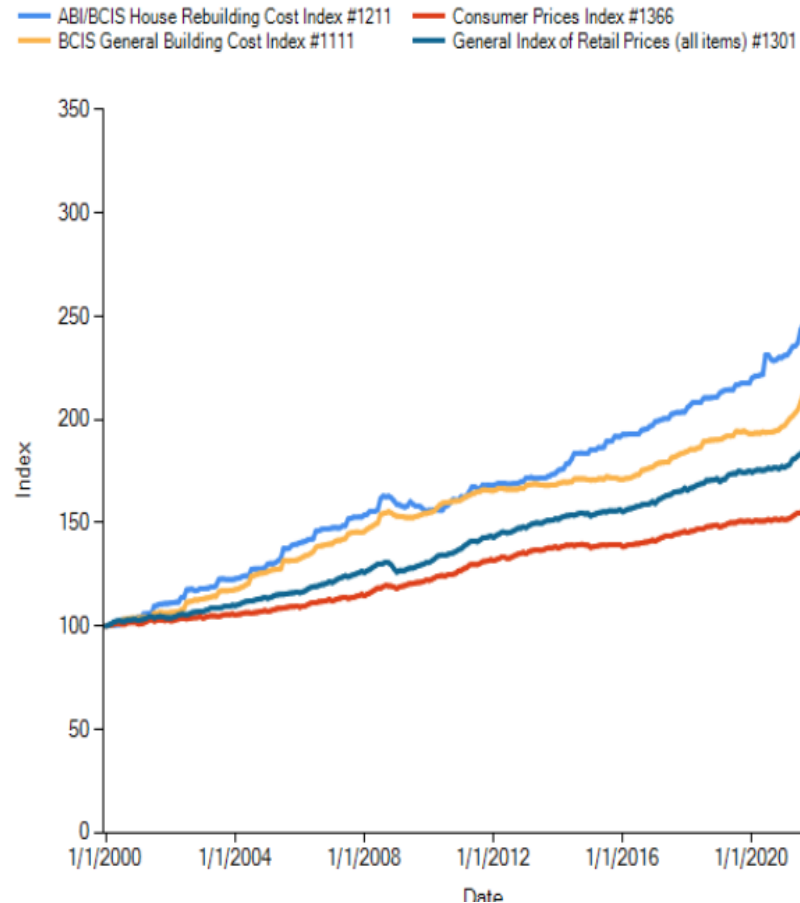
- ▶ Most policies have an 'index linking' clause to ensure that the insured value of the property is adjusted in line with inflation changes
- ▶ Understand which figure is used and when the index applies
  - ▶ Is the indexing applied regularly during the period of insurance?
  - ▶ Is it only applied at each renewal?
  - ▶ Does it continue after the loss and during design, planning and the rebuilding period?

## Limits of index linking

- ▶ Adequate for a year or so but it will start to drift over time
  - ▶ National index – does not take regional differences and local hotspots into consideration
  - ▶ Averages which do not take into consideration construction and building types
  - ▶ Will not take national differences in Building Regulations/Standards into account
  - ▶ It is no substitute for professional assessments

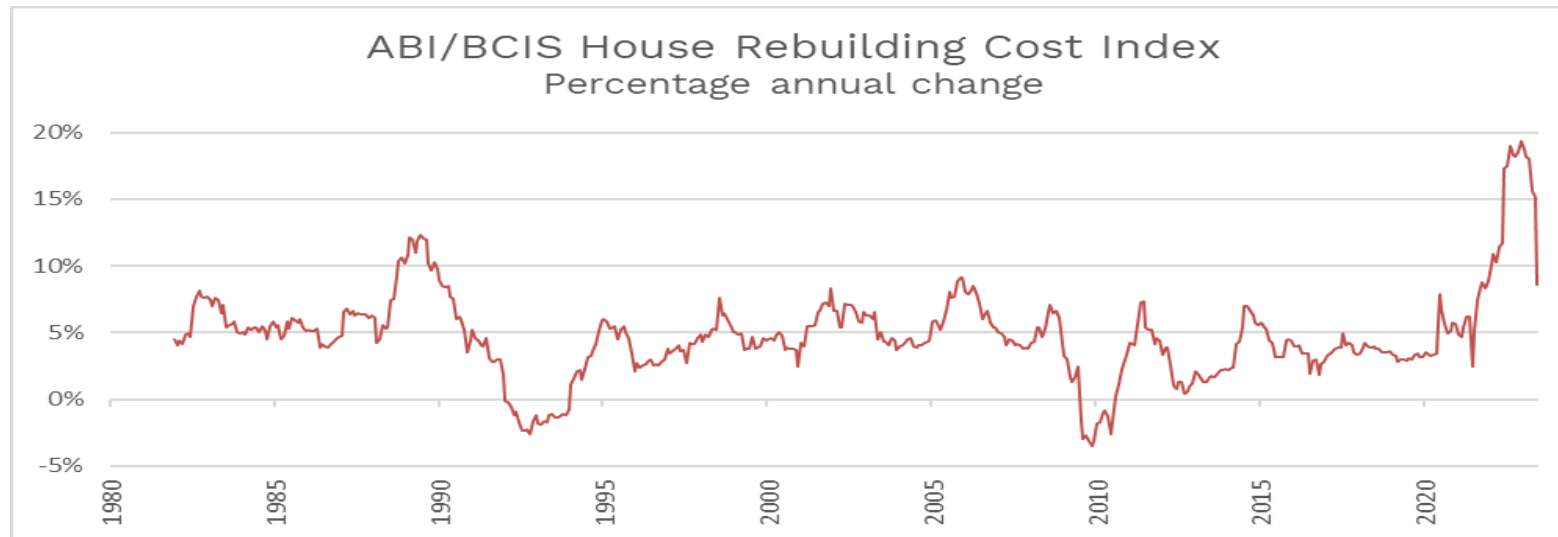
# WHICH INDEX?

- ▶ There are various ways of measuring the change in the prices of producing and acquiring goods and services over time
- ▶ Choose an index that is fit for purpose
- ▶ Since 2000:
  - ▶ HRCI +302%
  - ▶ GBCI +240%
  - ▶ RPI +226%
  - ▶ CPI +183%
- ▶ This demonstrates the importance of
  - ▶ understanding the basis of the index
  - ▶ the application
- ▶ The most appropriate index for rebuild estimates for dwellings is the ABI/BCIS House Rebuilding Cost Index



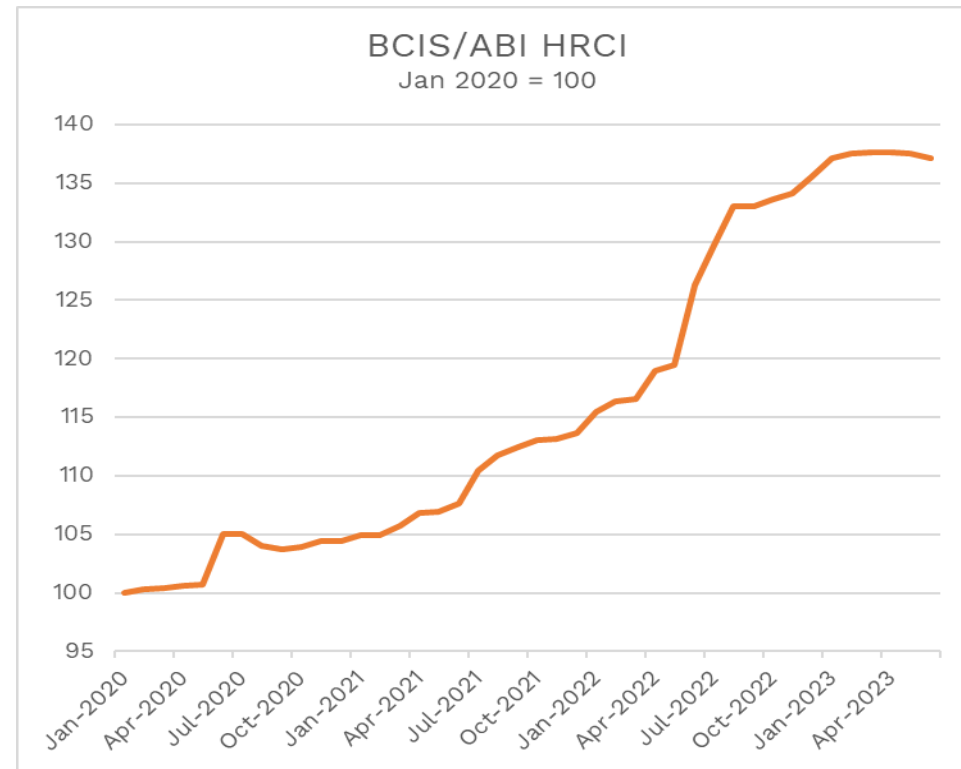
# The ABI/BCIS House Rebuilding Cost Index (HRCI)

- ▶ A bespoke cost index for updating rebuild costs between assessments
- ▶ It is not a substitute for regular reassessment of the sum insured
- ▶ Measures changes in building cost inflation but also takes account:
  - ▶ Changes in legislation, statutory levies like landfill tax
  - ▶ Impact of the changes in Building Regulations/Standards
  - ▶ Fluctuations in market factors as measured by contractors' preliminaries, overheads and profit and design fees



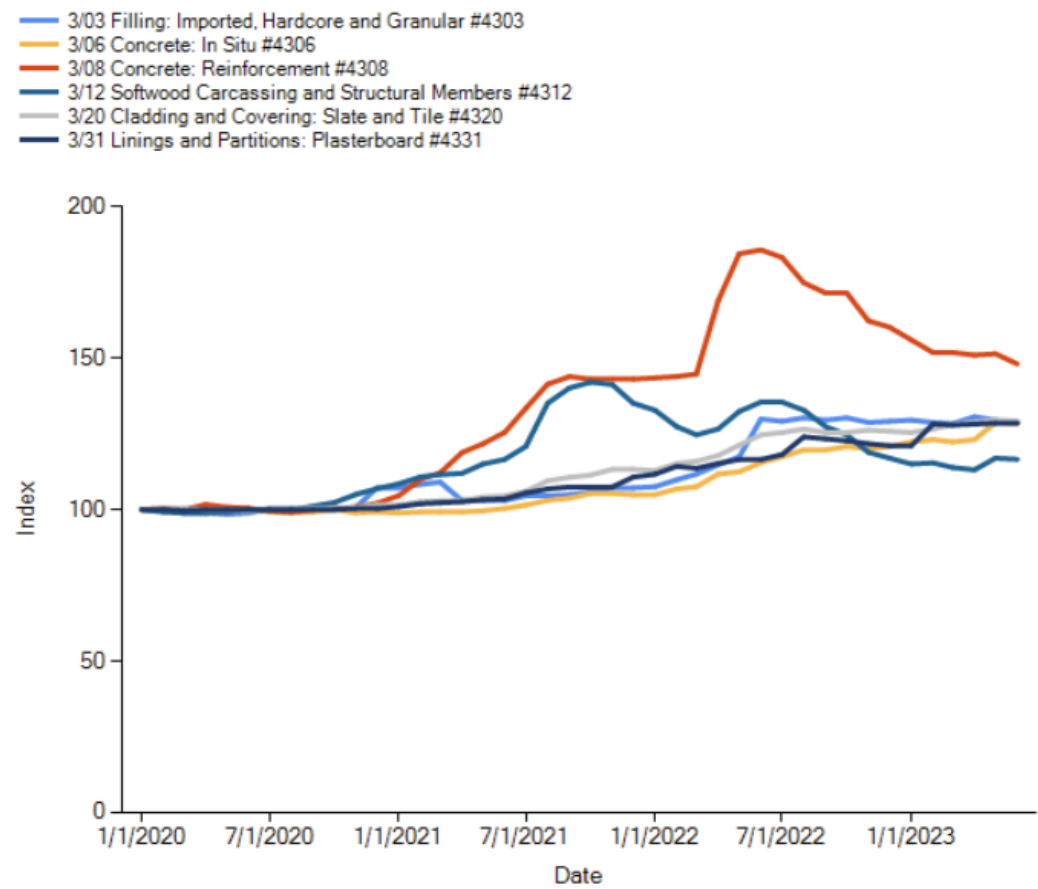
# HRCI INFLATION: 2020 to DATE

- ▶ HRCI + 37% since Jan 2020
- ▶ Apr 2020 – Pandemic lockdown
- ▶ Jun 2020 – Pandemic Adjustment + 4.3%
  - ▶ Reduced productivity
  - ▶ Temporary material shortages
  - ▶ Increased contractors' preliminaries
- ▶ Dec 2020 – UK formally completed its separation from the EU
- ▶ Feb 2022 – War in Eastern Europe
- ▶ Jun 2022 – Building Regulations Adjustment + 5.7%
  - ▶ Part L – Conservation of fuel and power (+4.5%)
  - ▶ Part F – Ventilation (+0.5%)
  - ▶ Part O – Overheating (+0.5%)
  - ▶ Part S – Charging Infrastructure for electric vehicles (+0.5%)



# INFLATION – DRIVERS

Index value over time



PAFI Work Items	% change Jan 20 - Jun 23	Peak % change	
3/08 Concrete: Reinforcement	48%	86%	Jun-22
3/03 Filling: Imported, Hardcore and Granular	29%	31%	Apr-23
3/20 Cladding and Covering: Slate and Tile	29%	30%	May-23
3/06 Concrete: In Situ	28%	29%	May-23
3/58 Pipes and Accessories: Copper	28%	31%	Mar-23
3/10 Brickwork and Blockwork	25%	26%	May-22
3/31 Linings and Partitions: Plasterboard	25%	25%	Jun-23
3/39 Windows and Doors: Plastic	25%	25%	Apr-23
3/02 Excavation and Disposal	21%	30%	Oct-22
3/12 Softwood Carcassing and Structural Members	17%	42%	Oct-21

# WHAT HAPPENS WHEN THINGS GO WRONG

## **'It didn't feel real': Fire leaves family £450,000 out of pocket**

Insurance comparison websites calculate property rebuild costs - but they are not always right



# RISKS OF UNDERINSURANCE

## Property owner must provide the correct value of insured property

- ▶ Responsibility of value is with the insured – make sure the valuation is correct
- ▶ Insurers will accept the valuation provided by insured
- ▶ Insured should provide accurate and honest descriptions of and information about property
- ▶ Check all pre-filled parts of the forms and online calculators
- ▶ Insured should ensure property is assessed regularly by a professional
- ▶ Check level of cover using online tools like BCIS/ABI calculator

## Underinsurance can lead to:

- ▶ Cancellation or voiding of policy with the insured losing their premiums
- ▶ Application of averages clause

$$\text{Payout} = \text{Claim} \times \text{Sum Insured} / \text{Current Value}$$

E.g. A claim of £40,000 on a property insured for £400,000 but with a current valuation of £500,000, could reduce proportionally by the insurer to £32,000

- ▶ Other adjustment of claim

# RISKS OF UNDERINSURANCE

## Brokers and insurance agents:

- ▶ Have a duty to truly understand the profile of insured to mitigate a potential claim
- ▶ Must ask clear and specific questions in order to correctly represent the risk
- ▶ Provide clear advice or point clients to trusted sources of information, for example online calculators

## Surveyors and assessors:

- ▶ Need to provide assessment that follows established guidance and standards
- ▶ Give rebuild estimates within a reasonable margin of error
- ▶ Use reliable and most up-to-date data sources such as the BCIS Rebuild Online

## Disputes could lead to:

- ▶ Sanctions by respective professional membership bodies
- ▶ Reputational loss
- ▶ Higher business and professional indemnity insurance premiums
- ▶ Disputes can be referred to the Financial Ombudsman Service (FOS)
- ▶ Serious offenders could be required to set up Financial Conduct Authority consumer redress schemes
- ▶ Litigation

# COMPLAINTS

- ▶ Most complaints are handled by the Financial Ombudsman Service
- ▶ 2022/2023 has seen a rise in household insurance complaints
- ▶ A third of all cases considered by FOS have been upheld

Top 5 most complained about products  
FOS 2022/2023

1. Current accounts

26,039

2. Credit cards

14,504

3. Motor insurance

11,851

4. Hire purchase (motor)

11,446

5. Building insurance

6,497

# FINANCIAL OMBUDSMAN SERVICE

FOS can make businesses compensate for the loss:

Money awards

- ▶ Up to £415,000 for negligent acts or omissions by firms on or after 1 April 2019

Awards for distress, inconvenience, pain and suffering, damage to reputation

Other costs incurred as direct result of the loss

Interest on the amounts owed and other costs and awards

# WHAT TO LOOK OUT FOR

## Design and specification of dwellings

- ▶ Non-traditional design, MMC, system-built dwelling
- ▶ Unconventional materials – stonework, thatch
- ▶ Availability of materials, e.g. closed local stone quarry
- ▶ Unusual or period features such as timber panelling, ornate brickwork, plasterwork
- ▶ High-net-worth properties

## Extensions and alterations

- ▶ Additions to property since last assessment, which could increase the rebuild costs
- ▶ Improvements including high spec fittings, sustainability features, etc.

## Common mistakes

- ▶ Ignoring grounds and garden structures
- ▶ Not allowing for higher floor to ceiling height in dwellings
- ▶ Incorrect assessment of the age and quality of the property

# Other issues

## Flats

- ▶ Best insured as a block
- ▶ Enhanced fitted kitchens, bathrooms, etc. may have to be insured separately

## Bedroom rated estimates

- ▶ Cost estimates based on the number of bedrooms
- ▶ These are not likely to be as accurate as measurement-based estimates

# LISTING

Any type of listing will have an impact on the reinstatement cost

## Listed dwellings:

- ▶ Most buildings built before 1850 are listed
- ▶ Listed Building Consent is required for all work
- ▶ Exact reinstatement – use reclaimed materials or materials that are as close to the original as possible

## Conservation areas:

- ▶ Some areas are subject to special controls called 'Article 4 Directions' which restrict work on dwellings
- ▶ Appearance should match the original using modern material

# SUMMARY

- ▶ Building insurance should cover the worst-case scenario – rebuilding all structures
- ▶ Both the insured and their advisors have a shared responsibility to get the sum insured right
- ▶ It is important to review the sum insured regularly, especially during times of economic instability
- ▶ Underinsurance could lead to financial losses for both the insured and the advisors
- ▶ Surveyors and brokers can have further regulatory penalties imposed on them from their professional membership bodies and/or financial regulators
- ▶ BCIS has tools to help mitigate the risks of underinsurance in dwellings

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