Australian Property Institute and
Property Institute of New Zealand

TECHNICAL INFORMATION PAPER - VALUATIONS FOR INSURANCE PURPOSES

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Contents

Technical Information Papers

The principal objective of a Technical Information Paper (TIP) is to reduce diversity of practice by identifying commonly accepted processes and procedures and discussing their use. A TIP is designed to be of assistance to property professionals and informed users alike.

A TIP will do one or more of the following:

- provide information on the characteristics of different types of asset that are relevant to the advice,
- provide information on appropriate practices and their application, provide information that is helpful to property professionals in exercising the judgements they are required to make in specific situations.

A TIP does not:

- provide training or instruction,
- direct that a particular approach or method should or should not be used in any specific situation.

The contents of a TIP are not intended to be mandatory. Responsibility for choosing the most appropriate approach is the responsibility of the property professional based on the facts of each task.

Whilst TIPs are not mandatory, it is likely they will serve as a comparative measure of the level of performance of a Member. They are an integral part of “Professional Practice”.

The reader should understand that legislation may change and whilst this TIP is accurate and relevant at the time it was completed, relevant referred reading and legislation should be investigated at the time of relying on this TIP.

Valuations for Insurance Purposes

1.0 Introduction

1.1 Objective

The objective of this TIP is to provide information, commentary, advice and recommendations to Members undertaking valuations of property, plant and equipment for insurance purposes.

As there are many types of assets and various levels of reporting, Members should decide which matters are applicable and the extent of detail required to ensure that the client is adequately and appropriately informed. This TIP is not intended to outline methods of valuation of any particular type of asset but may comment on matters that should be addressed in reports in respect of certain property types or uses. Where appropriate, methods of valuation are covered in other TIPs. It should be used in conjunction with other TIPs and/or practice standards which are either over-arching or directly applicable to the issues involved.

This TIP recognises the International Valuation Standards prepared by the International Valuation Standards Council. The guidance in this paper presumes that the reader is familiar with the International Valuation Standards and Technical Information Papers.

This TIP is also intended to be consistent with the concepts and definitions contained in those Standards, however, there may be departures from IVSC Standards to reflect Australian and New Zealand law and practice.

Insurance valuation services are commonly required for one of the two following reasons:

- To determine the amount of insurance required for the purpose of establishing insurance cover (i.e. to assist in assessing declared value or sums insured).
- To determine the sum to be paid following loss or damage as a result of an insured peril.

While this Guidance Note focuses primarily on insurance valuations for the purposes of determining the sums insured, a broad understanding of loss assessment following loss or damage is helpful. Furthermore, some Members provide loss assessment services.

In New Zealand, insurance valuations are also required as a basis for calculation of the Fire Service levy.

In addition to the responsibilities covered in International Valuation Standards and API/PINZ Professional Practice the Member's role (subject to the scope of work agreed with the client) is to advise:

- The reinstatement cost estimate and/or indemnity value estimate of the assets for insurance purposes at the date of valuation.
- Whilst risk managers and/or insurers commonly address factors that can or could impact adversely on the assets in respect of insurance issues, such as, upgrade requirements, loss of existing use rights, issues associated with party walls, proximity to nearby high risk activities, etc., Members can add value by attempting to quantify the adverse impact of risk or drawing the client's attention to the need for reassessment should these risks eventuate.

Valuations for insurance purposes are a specialised area of valuation practice requiring in-depth experience and knowledge of insurance and the particular property or item of plant and equipment. This TIP is directed at Members who have experience and training in this area and is not intended as a guide for practitioners with limited or no experience and training in this field.

Consistent with the API Code of Professional Conduct and the PINZ Rules of Conduct, Members must operate within the limits of their qualifications and experience and must not accept instructions in a field of practice in which they possess insufficient knowledge and skill to provide competent services to the client. However, assignments may be undertaken in conjunction with a person having the required competence after agreement with the client.

The assessment of insurance valuations requires a broad range of professional skills and experience, such as:

- an appreciation of costs for the construction or supply of assets of a similar size and utility;
- an appreciation of demand and supply of building materials and labour, professional services and planning and building approval processes which determine the timeframe for rebuilding;
- an appreciation of installation and commissioning costs and timeframes for plant and machinery insurance valuations;

- planning scheme provisions which could affect whether a building can be rebuilt in its present form;
- heritage issues;
- general insurance policy terms (including in particular difference between reinstatement and indemnity, inclusions and exclusions, co-insurance and averaging provisions);
- inflation on building costs;
- market rental values (for loss of rent or allowance for alternative accommodation);
- the size and extent of all improvements including building structures and ancillary improvements.

2.0 Definitions

The following defined words and terms have particular relevance to valuations for insurance purposes and appear in this TIP. Other words and terms that are also defined in the IVS Glossary and / or the joint API / PCA / REIA 2007 Glossary of Property Terms may be used but are not listed below in the interests of brevity.

Declared Value and Sum Insured

Declared value and sum insured are terms used to describe the sum total of all property insured at each situation declared by the insured and calculated in accordance with the basis of settlement including foreseeable expenses such as fees associated with planning, architects, surveyors, consulting engineers, legal advisors, etc. In larger organisations, there may be a team of professionals managing the development, and individuals maybe taking on certain roles and responsibilities and may have different disciplinary areas that are integrated to contribute to the broader process of development management.

Indemnity Value

The cost necessary to replace, repair and or rebuild the asset insured to a condition and extent substantially equal to but not better or more extensive than its condition and extent at the time that the damage occurred, taking into consideration the age, condition and remaining useful life of the asset.

Insured	The insured is a person or entity whose interests are protected by the insurance policy.
Property Insured	Property insured is a term commonly used to describe the property that is covered under the insurance policy. Insurance policies typically provide insurance cover for all real and/or personal property of every kind and description, unless specifically excluded, belonging to the insured or for which the insured is responsible or has assumed responsibility to insure. In some circumstances a property owner may self-insure some assets and these should be identified. The property insured also extends to all property in which the insured may acquire an insurable interest during the period of insurance. An insurable interest may result from the completion of an agreement to purchase an asset even though settlement may occur at a future time.
Reinstatement cost	Where property is lost or destroyed, in the case of a building, the rebuilding thereof, or in the case of property other than a building, the replacement thereof by similar property in either case in a condition equal to, but not better or more extensive than its condition when new. Where property is damaged: the repair of the damage and restoration of the damaged portion of the property to a condition substantially the same as, but not better or more extensive than its condition when new.
Replacement Cost	The current cost of a similar asset offering equivalent utility.
Reproduction Cost	The current cost of recreating a replica of the asset.
Situation	Situation is a term commonly used in insurance policies to refer to the specific location of the insured assets. The insured may have many situations covered by the same insurance policy.

3.0 Common Insurance Policies and Conditions

3.1 Background

The preceding definitions and the following information is provided to assist Members in understanding the common types of insurance policies available and some of the terminology commonly used in those policies, but members should be aware that each policy of insurance could be subtly or dramatically different in how it defines the terms discussed herein. The mechanism by which values or costs of reinstatement are calculated will differ in each policy of insurance.

It is preferable for members to state whether they have or have not read or referenced the insurance policy associated with the property insured. If a policy has been referenced, a statement of any specific issues that have affected the Member's assessment should be noted, and if it has not been referenced, Members should acknowledge the same and ensure that the basis of their assessment is clear to the party to whom the report is addressed.

3.2 Common Insurance Policies

There are many different types of insurance policies available. The most common policies relating to the insurance of buildings and contents are:

3.2.1 Home Policies

Home policies can cover buildings and/or contents. The amount of cover provided under such policies is commonly described as the sum insured. The sum insured is the maximum amount the insurer will pay in the event of a loss under an insured peril.

The home owner nominates the amount of the sum insured. The sum insured may be the reinstatement cost or indemnity value of the house or home and/or contents as defined by the insurance policy.

A general definition of house or home is a residential building at the insured address including its structural improvements, fixtures, fittings and domestic outbuildings.

A general definition of contents is furniture, furnishings, unfixed electrical goods, valuables, portable personal possessions, clothing and unfixed household goods that are the property of the insured.

Insurers generally require separate amounts for items such as retaining walls, special features, swimming pools, tennis courts and other recreational facilities.

3.2.2 Industrial Special Risk (ISR) Policy

The ISR policy is the most common policy for commercial/industrial insurance. This type of policy typically addresses many areas in addition to buildings and contents.

Both of the above types of policies are most commonly offered on the basis of reinstatement cost and/or indemnity value, however, other valuation bases such as reproduction cost or replacement cost can also apply.

3.3 Typical Policy Indemnity Cover

Typical policies provide that in the event of any physical loss, destruction or damage, which has not been specifically excluded under the policy, the insurer will indemnify the insured in accordance with the applicable basis of settlement.

The insurer will also typically indemnify the insured, in addition to the cost of rebuilding, for the following, provided the liability of the insurer does not increase beyond the limit of liability:

- Fees associated with the cost of rebuilding such as those applicable to architects, surveyors, consultant engineers, legal advisors, etc.
- Local Government fees and charges.

- Costs and expenses incurred for the purpose of extinguishing a fire at or in the vicinity of the property insured and threatening to involve such property.
- Costs associated with making the property safe after a loss.
- Costs of replacing locks, keys or safe combinations in appropriate circumstances.
- Costs and expenses necessarily incurred in respect of removal of debris.
- Damage to tools and clothing belonging to Directors and employees of the Insured whilst on the Premises.
- Temporary protection of undamaged property.
- Temporary repairs.
- Property of others for which insured is legally liable.

  If the basis of insurance under the policy is indemnity value, or, in the event of a loss, if the insured elects not to replace/reinstate or repair the asset, then the insurer may make a payment on the basis of the indemnity value of the asset(s) at the time of the loss.

3.4 Extra Cost of Reinstatement

Policies for buildings and site improvements typically extend to include the extra cost of reinstatement of damaged property to comply with the requirements of building regulations in place at the time the loss occurs.

This extension is typically subject to the following provision:

The amount of the claim cannot include the cost of complying with a requirement which existed prior to the loss occurring and with which the insured was required to comply.

As a general rule the insurer will only insure the assets as they exist, not as they may be replaced. The reason for this is the incidence of a partial loss where repairs are made to the existing structure.

However, it may not be possible to reinstate an existing structure following a loss because it no longer complies with current building and fire regulations or other statutory encumbrances.

Insurers therefore allow the insured to insure for the extra costs associated with complying with these regulations.

3.5 Reinstatement Rights/Existing Use Rights

In the event of a total loss and where as a result of the exercise of statutory powers by a regulatory authority, the reinstatement of a building as it existed prior to the loss may be prohibited or restricted, the insurer may pay in addition to any other amount payable on reinstatement of the building the difference between:

a. the actual cost of reinstatement; and,

b. the cost of reinstatement if it were not prohibited or restricted.

Any payment made for the difference between (a) and (b) above would be made as soon as the difference is ascertained upon completion of the rebuilding works. In a number of policies this provision is only in respect of the floor space ratio index or plot ratio.

3.6 Co-insurance Clauses

Co-insurance clauses provide that, if at the time of the loss the value of the property insured exceeds the amount of cover, the insured is considered to be self-insuring for the difference in value and therefore bears a rateable proportion of any loss (including a partial loss). This process of sharing a rateable proportion of the loss is also referred to as averaging (Addendum C refers).

3.7 Limit of Liability

Insurance policies often include a limit of liability. Members are not usually required to assess this amount directly. The limit of liability is the amount representing the maximum liability of the insurer for any one loss or series of losses arising out of the one event at any insured situation. It therefore includes the total cost of reinstatement from the time that the policy commences up to the time reinstatement takes place after a loss.

In the worst case scenario, a loss could occur on the last day of the insurance period. The limit of liability would therefore include the reinstatement cost at the start of the policy, plus the reinstatement inflation for the policy period and the lead time and rebuild period, plus the cost of demolition.

3.8 Fiduciary Interests

Members should be aware that other parties, for example, lessors, financiers, trustees, mortgagees and the like, may have interests in the property insured and should act in the knowledge that liability may extend to those other parties. If a member does not wish to extend their liability to parties other than the person who has commissioned the valuation for insurance purposes then the member should include an appropriate disclaimer.

4.0 Instructions

As with any other valuation, the scope of work, basis of value, effective valuation date and any other factors relevant to the valuation should be agreed and confirmed with the client.

Ideally the client will provide the Member with a copy of the insurance policy which will detail the basis of insurance and extent of inclusions and exclusions under the policy.

In the event the Member is not provided with a copy of the policy it would be prudent for the Member to obtain clear instructions from the client confirming the scope of the work and any special inclusions or exclusions that are required. In circumstances where this is not possible the Member should state within the insurance valuation report the basis of assessment (e.g. reinstatement or indemnity) and the extent of inclusions and exclusions within the insurance valuation.

It is recognised that in many cases Members will be asked to prepare insurance valuations without the benefit of insurance policies. These situations include where a client is yet to select an insurer or policy, or where a Member has been asked to provide an insurance valuation in addition to a market valuation on behalf of a third party (i.e. not the insured).

Members may be asked to provide an insurance valuation as part of a valuation for mortgage security purposes, under instructions from a financier, in order to ensure the interests of the financier are appropriately insured. In these circumstances it is unlikely the Member will have access to insurance policy terms and the Member should qualify the valuation in terms of inclusions and exclusions having regard to typical insurance policy terms for that type of asset.

In the event a Member has been engaged to assess an insurance claim under an existing insurance policy, it would be prudent for the Member to request and consider the terms and conditions of the actual insurance policy.

When considering the terms and conditions of the actual insurance policy it may be prudent for the member to obtain legal advice as to the operation of particular clauses within the policy.

5.0 Assessing Reinstatement Cost

Reinstatement cost is sometimes referred to as the cost of reinstating an asset to an as new condition or new for old. The reinstatement cost notionally assumes a total loss.

In the case of a partial loss, reinstatement cost also covers the cost of repairing the property insured to its condition when new. The extent of damage and therefore the cost of repairs cannot be anticipated prior to an actual loss occurring. The cost of repairs may be more or less than the reinstatement cost of the property insured.

To the extent the estimated cost of repairs is greater than the estimated cost to completely replace or reinstate the property insured, it is to be assumed that the insurer would seek to completely replace or reinstate rather than repair the property insured. In any case, the assessment of repair costs is typically within the area of expertise of a loss adjustor or loss assessor and can only be completed after a loss has occurred.

It can be seen therefore, that seeking to estimate the costs of repair is neither possible nor relevant when completing valuations for the purpose of setting the amount of cover.

The sums insured under a reinstatement insurance policy usually include the following elements of cost:

- Reinstatement cost estimates
- Fees and contingencies
- Estimates in respect of cost increases during the policy period, lead time and reconstruction periods
- Demolition and debris removal

These are considered below however it is noted that whether it is a Member's responsibility to quantify these components of the sum insured will depend on the scope of work agreed between the Member and the client. The valuation report should clearly state whether these items have been included or excluded.

5.1 Reinstatement Cost Estimates

There are a number of ways of providing an estimate of reinstatement cost for buildings, structures and site improvements. Two of the more common approaches are: • an estimate based on building cost guides; and

• an estimate based on elemental costs.

In the former the estimate of reinstatement cost is based on construction cost rates (typically, but not always, rates per square metre) published in building cost guides and/or construction contract rates. This commonly used method is intended to provide indicative cost estimates.

Elemental building cost estimates determine the construction cost of a building, structure or site improvement by reference to the estimated cost of the individual components or elements of that building, structure or site improvement. The application of such an approach requires specific training and knowledge.

Members who are qualified to complete elemental cost estimates typically obtain detailed building plans and specifications or gather such information from a physical inspection of the site to assist in the accuracy of the determination. Where information is available, recent constructions of a similar nature may assist to determine the appropriate cost for each element. Consideration should be given to the reliability of evidence available and the information assessed in terms of comparability to the subject asset.

All other things being equal an elemental cost estimate is likely to produce a more robust cost estimate than an estimate based on building cost guides as is evidenced by the statement that the latter is intended to provide an indicative cost estimate.

In applying the selected method(s), Members should have regard to the following factors (if quantifiable):

- Specific materials used in the building (e.g. mixture of stone, brick, plasterboard, etc.)
- Location factors (e.g. remote or rural sites v metropolitan)
- Design of building including soil type, special footings, etc.
- External dimensions of a building (some cost guides relate only to internal building measurements)
- All fees associated with reconstruction including architects, survey and engineering fees
- Cost increases/decreases between the date of issue of published cost guides and / or the date of construction contracts, and the date of valuation

Valuations undertaken in non-metropolitan and remote areas would usually reflect regional costs associated with labour and materials. It may be possible to estimate the location factor by investigating local construction costs and / or by examining a sample of costs and relating them to known costs.

In respect of common home policies, unless specifically excluded, the following items are typically included in the insured value for buildings:

- permanent decks;
- greenhouses and garden sheds;
- patios, pergolas and built in furniture;
- aerials and satellite dishes that are attached to the home;
- fixed floor coverings;
- coverings fixed to the ceiling or wall, but not curtains, drapes or blinds;
- fixed light fittings and appliances permanently wired or plumbed to a gas plumbing or electrical supply;

- letter boxes, exterior blinds and awnings, fixed clotheslines and built in barbeques;
- septic tanks, heating oil tanks, service tanks, water tanks, and their fixed pumps and systems;
- permanent spa pools or swimming pools, including their fixtures, covers, pipes, and fixed pumps;
- walls, fences and gates;
- gas pipes, fresh-water pipes, underground drainage and sewerage pipes;
- electricity, data and telephone cables and poles;
- any driveways, bridges, paving and tennis courts;
- any private road, lane, right-of-way, access way or bridge providing access to a driveway owned by the home owner or shared by the home owner with other residential property owners and for which the home owner is responsible;
- permanently installed fish ponds and water features connected to the dwellings water supply;
- sculptures and artwork affixed to the home and/or land;
- the home owners share in any walls fences, gates, pipes, cables or driveways where these items are jointly owned by the home owner and other property owners;
- costs associated with rebuilding the home such as architects fees, site clearance, removal of debris, inflation allowance and wide area damage

In the case of industrial premises items such as masts, antennae, underground tanks and other similar items of equipment are more commonly included as part of the insured value of plant and equipment.

Unless specifically excluded under the terms of the policy or other legal requirement all site improvements should be specified and included in the sums insured.

Where there is plant and equipment and/or other services associated with a building, or where various components of the buildings, plant, equipment and other services are being assessed separately by different valuation specialists, it may be necessary for the different valuation specialists to confer to ensure that no components are either missed or double counted.

The reinstatement cost for plant and equipment should be based on the replacement cost of currently available equipment, including costs of transport, installation, commissioning, consultants' fees, engineering, procurement and construction management (EPCM) costs and non-recoverable taxes and duties. Design, EPCM and other similar costs (sometimes referred to as 'common distributable costs') are considered from the point of view of the reconstruction of a complete facility, rather than the cost of the original assets.

Members should be aware that the insurance basis for Heritage Assets (refer section 5.7 of this TIP) may require a reproduction or replication based assessment.

5.2 Fees and Contingencies

Members should assess in each case the extent of involvement of professionals such as architects, surveyors, consultant engineers, etc. and where applicable, should include an appropriate allowance for their fees.

5.3 Lead Time

Lead time is the period of time after a loss occurs when the remaining improvements are demolished, plans and specifications of the replacement building are drafted and agreed upon, appropriate approvals are sought and obtained from the appropriate authorities and all matters are completed in preparation for rebuilding.

To the extent it is included within the agreed scope of work cost increases during this period need to be calculated. As this is a future estimate, it will require suitable qualification and a disclaimer. For plant and equipment, the unpredictability of future cost inflation/deflation, especially that caused by foreign exchange rate fluctuations, means that any such allowance is subject to significant potential estimation error and, if provided, should therefore be suitably qualified and subject to a disclaimer. For this reason Members may elect not to provide such an estimate.

For plant and equipment that is located within a building, in the event of a loss, the building will usually have to be replaced before the plant and equipment can be replaced. Therefore, the total lead time allowance may need to also include the building lead time.

Whether the valuation is to include an allowance for cost increases during lead time will be determined by the scope of work agreed between the Member and the client. The valuation report should state whether the values reported are inclusive or exclusive of such costs.

5.4 Reconstruction Period

The reconstruction period is the period from the time building approvals have been obtained to completion and handover of the new facility. To the extent it is within the agreed scope of work, cost increases during the reconstruction period need to be calculated.

For plant and equipment only, it is not common place to include such items in the scope of work, however, where it is to be provided, it is noted that:

For substantial installations, a lengthy period of time may be required whilst the plant is constructed, installed and commissioned.

Cost increases should be included only to the extent that the building or plant and equipment is completed in various stages. Members should consider each element of construction to determine what allowance for cost increases should reasonably be made. As this is a future estimate it will need suitable qualification and a disclaimer.

For plant and equipment that is located within a building, in event of a loss, the building will usually have to be replaced before the plant and equipment can be replaced. Therefore, the total reconstruction period allowance may need to also include the building reconstruction period.

The unpredictability of future cost inflation/ deflation, especially that caused by foreign exchange rate fluctuations, means that any estimate of the reconstruction period is subject to significant potential estimation error and if provided, should therefore be suitably qualified and subject to a disclaimer. For this reason, Members may elect not to provide such an estimate.

Whether the valuation is to include an allowance for cost increases during the reconstruction period will be determined by the scope of work agreed between the Member and the client. The valuation report should state whether the values reported are inclusive or exclusive of such costs.

5.5 Demolition and Removal of Debris Estimate

To the extent it is within the agreed scope of work, the cost of demolition and removal of debris should be estimated by having regard to any known demolition and removal costs for similarly constructed assets in the locality, and / or demolition costs published in building cost guides. Members should have regard to the relative difficulty of demolishing and removing the asset.

Consideration should be given to any generally known presence of asbestos or similar hazardous materials - particularly the potential for asbestos to contaminate the site and surrounding areas in the event of major damage to the property. If available an asbestos report should be obtained or noted if not available. Difficult access to a site may also be a factor that should be noted and addressed. Members should assume that all assets would be destroyed in a loss situation and would require removal prior to reinstatement.

Whether the valuation is to include an allowance for demolition and debris removal will be determined by the scope of work agreed between the Member and the client. The valuation report should state whether the values reported are inclusive or exclusive of such costs.

5.6 Goods and Services Tax (GST)

GST is payable on building costs, plant & equipment and professional fees, however, the manner in which a claim is settled may determine whether it is possible to claim the GST back as an input tax credit. For example, most insurers are eligible to claim back GST paid, however, the GST status of the insured may determine whether the insured is able to claim back GST paid. For most industrial and commercial assets, GST is therefore not typically included as either the insured and/ or the insurer will generally be able to obtain the benefit of the input tax credit. However insurance estimates for home insurance should include GST.

Members should clearly state whether the values reported include or exclude GST.

5.7 Heritage Assets

A heritage asset is one that is deemed worthy of preservation usually because it is a good example of its type, has historical, cultural or environmental significance, rarity, or a combination of these factors. Where a heritage asset has been officially designated as such by relevant heritage authorities, legislation may prevent renovations, modifications additions and the like by imposing strict requirements and lengthy approval processes. Many governments have enacted measures to safeguard specific historic properties or to protect whole areas/precincts of special architectural or historic interest.

In the case of a total loss where a heritage building has been destroyed along with the element of heritage to be preserved, then the historic significance is likely to have been lost.

In such circumstances heritage restrictions may then be lifted and the owner may be at liberty to replace the building or redevelop the site as per planning requirements, unaffected by heritage issues on the subject property.

However the risks arising from partial losses are heightened in heritage assets, given heritage legislation may require making good of damaged areas and this may require repairing or reproducing every component of the building in a style and form of construction that most closely resembles the remaining original structure. Increased costs may be incurred due to the engagement of suitable tradespeople, such as those skilled in stone masonry, iron tracery and stained glass, etc.

Given the risks of increased costs of reinstatement in the event of partial claims sums insured are therefore typically determined using a reproduction cost basis (i.e. the cost of rebuilding the structure as it exists allowing for all extra costs of reinstatement). This method establishes the current cost of reproducing every component of the building in a style and form of construction most closely resembling the original.

In completing valuations of heritage assets Members should consider likely increased lead times, higher constructions costs and professional fees. Members may also need to consider implications in terms of reinstatement/existing use rights or planning controls within heritage precincts (whether the subject building is or is not heritage listed).

In some instances, an owner may have the option to replicate rather than reinstate with a modern equivalent asset, even though replication may not be compulsorily required in the event of a loss, and will obtain an insurance policy that provides this basis of settlement. If this is the case, Members will require clear instructions as to the basis of assessment. In such cases, the asset will need to be insured and valued on a reproduction cost basis.

5.8 Other Related Bases of Value

This Guidance Note outlines the bases of value most commonly adopted in insurance policies in Australia and New Zealand. Numerous other bases of value are used by insurers. Whilst it is impossible to provide an exhaustive list, the IVSC definitions of reproduction cost and replacement cost are included in the Definitions sections of this TIP as they provide a useful reference.

It is important however for Members to ascertain which basis of value applies before commencing the valuation.

5.9 Betterment

Members should ensure that the valuation does not give rise to betterment. That is, the valuation should not be based on a more substantial or superior property than that which existed when the property was new.

6.0 Assessing Indemnity Value

The common definition of indemnity established in case law is the loss that would be suffered by the insured in the event the asset was destroyed. This can be, but is not necessarily, the market value of the asset destroyed or damaged.

The measure of loss in the event an asset is destroyed can be estimated using either the market approach or the cost approach, depending on the nature of the asset, client instructions and the circumstances.

It is recognised that a single insurance valuation which covers multiple assets (for example, plant and equipment valuations may include both specialised and non-specialised assets) may require both types of approach to assessing indemnity value. Equally, Members may be requested to undertake a market-based estimate of indemnity value and/or a cost approach estimate of indemnity value.

However established the indemnity value assessment should take into consideration the age, condition and remaining useful life of the asset.

In the case of insurance, useful life is not synonymous with economic life, but rather only reflects physical life. The insured is entitled to insure the remaining physical life of an asset, even though the economic life may have expired.

Therefore, the determination of indemnity value using the cost approach requires in the first instance, the assessment of reinstatement cost and then an assessment of the likely physical life of the asset and the life expired. The expected physical life of an asset is assessed on the basis that reasonable maintenance is carried out to preserve the existing use.

Members should consider the expected life of assets in the location of the valuation and elsewhere as appropriate.

It is common practice to apply a straight-line method of depreciation when determining indemnity value, (especially in respect of specialised buildings, structures, plant and equipment) which assumes that the remaining service potential of the asset is used up at a constant rate assuming reasonable maintenance. However, there are types of plant and equipment, particularly those that experience rapid technological and functional obsolescence, for which other methods including the diminishing value method, may be more appropriate.

To the extent plant and equipment is valued on the basis of indemnity value using a market approach, the indemnity value may comprise two components, depending on the nature of the asset. The first component is the cost of acquiring a comparable item of equipment from the second-hand market to which is added the (un-depreciated) cost of installing and commissioning that item.

Members should include reference within their report/ covering letter that an indemnity value determined using a cost approach may not be the same as one determined using a market approach, and in some cases, the difference might be material.

To reduce the risk of co-insurance being claimed by the insurer in the event of a loss occurring, it would be prudent for agreement to be reached by all parties, including the Member, client and insurer or insurance broker, in respect of the method or methods to be adopted. Ideally this would be documented as part of the engagement agreement and within the insurance valuation report.

As for any other valuation, valuers should fully explain any assumptions, the methodology adopted and the reasoning that supports their conclusion as required by IVS 3. This will invariably require information, which should be included in the insurance valuation report or covering letter.

7.0 Report Content

7.1 Buildings

In addition to those items covered under IVS101 and IVS 103 an insurance valuation report for buildings and site improvements should include, (to the extent included within the agreed scope of work):

- A brief description of assets including a clear statement as to whether floor coverings, internal partitions, fit-out or other services are included in or excluded from the valuation.
- A reinstatement cost estimate and/or indemnity value estimate as at the date of inspection.

- An estimate of the cost of demolition and removal of building debris.
- An estimate of the cost increases during the policy period (this and the following two cost increase allowances are typically provided as separate inflationary estimates).
- An allowance for cost increases during the lead time, i.e. the period after a major loss when debris is removed, building plans are drafted and necessary approvals are obtained.
- An allowance for cost increases during rebuild period.
- A statement as to the treatment of GST.
- A statement of specific valuation exclusions such as plant, equipment tools, furniture, stock and materials in trade, and the costs of removal/disposal of these.
- Reference to the method and extent of fire protection services.
- A statement regarding the treatment of financing costs during reconstruction and whether it is assumed they are met by way of progress payments as costs are incurred.
- Any relevant qualifications and disclaimers, which includes comments upon any unverified information or assessments of future events.

Members should clearly describe the improvements that they have included in their insurance estimate.

Loss of rent/profits may also be required depending on the agreed scope of work.

7.2 Plant & Equipment

For plant and equipment assets, the report content should include or explain the following (to the extent included within the agreed scope of work):

- A brief description of the assets.
- A reinstatement cost estimate and/or indemnity value estimate as at the date of inspection.
- An estimate of the cost of demolition and removal of plant and equipment debris.
- An estimate of the cost increases during the policy period (this and the following two cost increase allowances are typically provided as separate inflationary estimates).
- An estimate of the cost increases during the lead time, i.e. the period after a major loss when debris is removed, building plans are drafted and necessary approvals are obtained (often any buildings housing plant will have to be reinstated before the plant can be reinstated) plus any additional lead time associated with the plant reconstruction and installation. This period can be substantial. Because inflation and, if applicable, foreign exchange rate changes can be volatile, any such estimates will require qualification.
- The treatment of obsolete assets. It is common for obsolete or unused assets to be excluded from a valuation; where this is the case, this should be explicitly noted.
- An allowance for installation and commissioning costs.
- A statement as to the treatment of GST.
- A statement regarding the treatment of financing costs during reconstruction.
- Any relevant qualifications and disclaimers, which includes comments upon any unverified information or assessments of future events.

7.3 Location (situation)

The location (situation) of the insured property should be identified. An owner may have many locations (situations) covered by the same insurance policy. Additionally, all freestanding buildings on a site will usually be separately identified as they may represent separate insurance risks.

8.0 Other Issues

Large-scale catastrophes and disasters can result in unforeseen escalations in building and other related costs due to the high demand for building materials and labour. Declared values or sums insured are usually determined on the basis of a single loss and not in the context of a more widespread catastrophe such as an earthquake, flood or bushfire.

Because such events can give rise to shortfalls between the declared values or sums insured and the ultimate cost of reconstruction, Members may wish to include suitable disclaimers when completing valuations for the purpose of setting sums insured, excluding possible cost escalations arising from such catastrophic events.

9.0 Additional Resources

A short video has been prepared by an industry expert to introduce and support the TIP. View the video for this TIP on **YouTube**.

10.0 Effective Date

Australian Adoption Date:

1 July 2015.

The above TIP, ANZVTIP 4, replaces the superseded Guidance Note “ANZVGN13 Valuation for Insurance Purposes” which operated until 30 June 2015.

New Zealand Adoption Date:

This TIP is effective from 1 January 2016.

The above TIP, ANZVTIP 4, replaces the superseded Guidance Note “ANZVGN13 Valuation for Insurance Purposes” which operated until 31 December 2015.

Addendum A – Legislation and Other Matters Specific to New Zealand

A1.0 Legislation

Members should be aware that in New Zealand, the insurance valuation report provided may be used in the context of the following legislation:

A 1.1 Fire Service Act

In New Zealand the Fire Service levy is collected from the insured and it is generally calculated as a prescribed percentage of the indemnity value of the insured asset. Therefore it will usually be necessary for indemnity value to be assessed even though the insured may have insured on the basis of Reinstatement.

Indemnity is not defined in the Fire Service Act and, if it is assessed for Fire Service Levy purposes, should be assumed to have the same meaning as in the insurance industry and in insurance case law. Please refer to Section A2.11 for more detail in relation to the Indemnity Value estimates carried out for Fire Service Levy purposes.

Certain categories of property (mainly ancillary structures such as roads, paths, drains, bridges, tunnels, reservoirs, etc.) are exempted from the Fire Service Levy (refer Section 467B (Third Schedule) of the Fire Service Act). On a large site these may comprise a substantial portion of the total indemnity value. The insured may wish to have these assets identified separately, so as not to pay levies that are not legally required.

A1.2 Earthquake Commission Act

In New Zealand the Earthquake Commission Act (“ECA”) provides for cover against natural disaster. It applies only to residential property.

Cover under and the ECA may be based on the floor area and therefore insurance valuations of residential buildings should include the gross floor area for each individual unit within the insured property, either within the asset description or in the covering letter/report.

Furthermore, services, including bridges and culverts, retaining walls and support systems within 60 metres of the perimeter of an insured residential use building are generally covered by ECA.

Historically, in relation to site development, Members have commonly only included assets which are located within eight metres of the perimeter of the insured structure. However, the “eight metre” requirement only applies to residential structures referenced under the ECA.

Members should be aware that the “eight metre” requirement above, only applies to ECA cover, and should not be applied for general insurance cover, which is discussed more fully in this Guidance Note.

A2.0 New Zealand Insurance Form

A2.1 Insurance Form

The insurance form commonly used by PINZ and NZIV Members (both land and building and plant and machinery valuers) is attached as Addendum B. Generally:

- The purpose of the report is to provide useful information to clients as well as the insurance industry and in an easily recognisable summary format.
- Only those values or estimates required should be entered on the Valuation Report Form with a notation, ‘not required’ or ‘not provided’ placed against the other headings, where appropriate. The intention is to allow for a range of information tailored to the needs of the insurance industry.

- The opportunity exists for all valuers to liaise closely with clients so that useful and quality information will allow a decision to be made as to appropriate levels of insurance cover.
- There may be instances where the information provided in standard form is insufficient to meet client requirements. In such cases, a more detailed report should be provided.

A2.2 Asset Description

Members should include a brief description of the insured assets. For buildings, a general description of the main building(s), site development and essential construction components should be included.

For the purposes of the underwriters risk assessment, Members are encouraged to identify the method of fire protection (for example, sprinkler system or heat/smoke detectors and automatic alarm) and this should be noted, along with the extent of coverage (for example, warehouse/office/canopies). For commercial buildings, the valuation should state whether floor coverings, heating ventilation and air conditioning services, internal partitions or other fit-out are included or not.

All freestanding buildings on a site should be separately identified as they represent separate insurance risk.

A2.3 Upgrade Requirements

Due to ongoing legislative changes, many buildings will not comply fully with building ordinances and the like. The modern equivalent asset assumption is intended to embody upgrade requirements without necessarily explicitly addressing compliance deficiencies. Typically, it will be helpful to summarise major differences between the insured asset and the modern equivalent asset under the heading Upgrade Requirements.

A2.4 Age

This is the earlier of the estimated year of completion of the asset or the commissioning date. The year of any significant upgrade or addition should be noted.

A2.5 Land Contour (Building valuations only)

This is a classification of the land contour containing the building/s and immediate yard areas. To ensure uniformity, classification should correspond in general terms with those specified in the text, Urban Valuation in New Zealand, Volume 1, 1991 by Rodney L Jefferies, published by PINZ, PO Box 27-340 Wellington. (page 9.14).

A2.6 Subsoil Type (Building valuation)

This information is required by Underwriters as a broad indicator of seismic stability. The perception gained from the definition can have a significant impact on insurance cost particularly in earthquake prone areas throughout New Zealand. It is important to discuss this aspect with your client and where potential penalties could arise; the insured should be encouraged to seek more detailed information from the Local and Regional Authority or engineering specialists. An entry should only be made in this portion of the report when the valuer has accurate knowledge as to the sub-soil type.

A2.7 Other Known Characteristics

These will include any items not otherwise covered within the report, which will be of assistance to the client and/or insurers and should only be detailed when information is known on the particular characteristics e.g. locational factors, surrounding property uses, etc.

A2.8 Use/Occupation

This should include a short description of the main site use. Where mixed use occurs, e.g. commercial/residential, this should be recorded. Members should be aware that the use of insured property is an important factor for insurers.

A2.9 Reinstatement Cost Estimate (1.0 A)

This definition on the reverse of the form has been redefined in line with common insurance valuation practice in New Zealand as:

“an estimate of the cost, as at the date of valuation, including relevant fees, of replacing the asset with a new modern equivalent asset, including where appropriate the use of current equivalent technology, materials and services. This is intended for the purpose of assisting the parties to the insurance contract in negotiating insurance premiums and, unless specified elsewhere, is not based on a detailed elemental and schedule of quantities approach as would be undertaken by a quantity surveyor or costing engineer. In construction unanticipated problems often arise and actual rebuilding, repair or replacement costs may vary from the estimate.”

However, Members who have suitable experience and relevant information may undertake a more detailed, elemental, (see Section 4.1 of this Guidance Note) approach to estimating the Reinstatement Cost, and may provide an amended definition. If reproduction cost is provided (and where agreed with the client, the existing construction materials/methods are not modern materials/methods), then the standard Reinstatement Cost Definition will certainly require modification.

The Reinstatement Cost Estimate is only valid as at a particular date (generally the date of inspection) unless stated otherwise. Notwithstanding that for insurance valuation purposes, valuers may give an indication of inflationary provision. Insurance values are not to be provided as at future dates as per IVS 3, AUSNZ 5.1.2.4.

Additional clarification is included to explain that the Reinstatement Cost Estimate does not include any allowance for catastrophic events (for example an earthquake) that may drive up replacement costs within a locality by increasing demand for repairs and rebuilding and creating an unusual shortage of labour and materials.

Members should note that no specific identification is made in the Reinstatement Cost Estimate of the cost of different materials and additional services. Should separate identification and calculation of costs be required, then this should be supplied on request. However, for any major items required, including a summary of such items may be appropriate.

A2.10 Inflationary Provision (Reinstatement Cost) (1.0 B)

This should include for cost inflation during the lead time and construction period. It should be noted that no allowance is to be made for any delay due to the need to comply with the provisions of the Resource Management Act including possibly the requirement to reinstate on an alternative site. All inflationary estimates provided should be suitably qualified.

A2.11 Indemnity Value Estimate

The valuation covering letter / report should reference the methodology applied in assessing indemnity value, acknowledging the comments referenced in Section 6.0 of this Guidance Note. A suggested explanation of the approaches to indemnity is provided as follows:

(1) Market Related Estimate (2.0 A)

Market related value is the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing, wherein the parties had each acted knowledgeably prudently and without compulsion.

For buildings, this excludes any land, and will be the added value that the asset gives to the market value of the land (assuming that, if appropriate, the property is leased at market rental). Should the insured wish to have indemnity estimate based on actual income, then this must be stated by the valuer. This situation may arise for property which is over or under rented and where the client specifically requires rent recognition.

For plant and machinery, personal property and loose chattels; market related value equates to the cost of a second hand equivalent asset plus the (un-depreciated) cost of installation and commissioning (if applicable), as at the date of valuation.

(2) Depreciated Replacement Cost (DRC) (2.0 B)

For buildings, DRC this is the current cost of replacing an asset with its modern equivalent less deductions for age and physical deterioration.

For plant and equipment, DRC is the current cost of replacing an asset with its modern equivalent asset, less deductions for age, physical deterioration and technical and functional obsolescence, taking into account the total estimated life of the asset and anticipated residual value (if any). The value does not allow for economic obsolescence (if any).

Members may be requested to undertake a market related indemnity value estimate and/ or a depreciated replacement cost estimate; the New Zealand Insurance Form (Addendum B) provides two options for reporting indemnity, being 2.0 A Market Related Value and 2.0 B Depreciated Replacement Cost. Where Depreciated Replacement Cost is provided, as is common for example with valuations completed for Fire Service Levy purposes, and the Member considers that this figure is not consistent with a Market Related Estimate, a clear statement noting this disparity should be provided in the covering letter/report accompanying the Insurance Form.

A2.12 Inflation Provision (Indemnity) (2.0 C)

If cost inflation is likely to exceed the depreciation over the insurance period, (usually one year) an allowance for indemnity inflation is necessary. Some asset classes, for example, computer equipment, are unlikely to experience cost inflation in excess of depreciation over the same period, but indemnity inflation is common for buildings and other assets that depreciate slowly.

A2.13 Functional Replacement Cost (3.0 A)

Functional Replacement Cost is the estimated cost required to replace all assets with new assets that perform similar tasks but under optimum current design and layout conditions with capacity requirements not greater than currently available.

This would apply to assets unlikely to be reinstated to the same extent, or to the same design or construction material as existing. This would be required when demand necessitates a smaller or different asset due to changes in technology, economics and other factors. Examples could be a dated, two-level, freezing works, which would better be replaced by a single level structure, through to a two-story retail/office building in a district where there is no demand for first floor office space and the ground floor retail would therefore likely only be replaced.

A2.14 Demolition Estimate (4.0)

This normally assumes that the total asset to be demolished has been damaged beyond repair. The Demolition Estimate covers the cost of demolition and removal as debris of the asset, excluding the cost of removal of any noxious materials such as asbestos, or removal of debris on adjoining premises. Where there is generally known presence of asbestos or similar hazardous material, this should be noted. If allowance is required to be made for the salvage or removal of fixtures, fittings and contents, then this should be specified and referred to in an attached letter. This could also apply to undamaged plant which must be removed from the property if considered necessary.

The Demolition Estimate does not include for shoring up any structures, either on the insured property or neighbouring properties. Furthermore, it does not include for the removal of building contents.

A2.15 Site Improvements

The Reinstatement Cost Estimate, Indemnity Value Estimate and Functional Replacement Cost figures, if required, should relate to the asset/s together with other assets within or adjoining the structure, as referenced in Section 4.1 of this Guidance Note.

A2.16 Valuer’s Signature, Qualifications and Name

These must be clearly stated. If the letterhead logo of the NZIV or PINZ is used, the name of the Member’s firm or organisation should also be shown at the bottom of the report. This would not be required if the company’s letterhead is used.

A2.17 Valuation Date

This is the effective date of valuation, which will usually be the date of inspection. Members should avoid statements that the value is valid for periods in the future. Only the inflation estimates may be estimated for a future period. Members must follow the provisions of IVS 3, particularly AUSNZ 5.1.2.4 Date of Valuation.

A2.18 Lessee’s Improvements

The valuation figures should exclude items installed and paid for by a lessee, unless requested by the client and detailed in the asset description. For buildings, the asset description should also state whether the valuation report includes any plant or equipment.

A2.19 Disclosures

The Valuation Report should also disclose any key assumptions and explain the reasons for the adoption of the particular methodology or methodologies utilised.

Addendum B - New Zealand Insurance Form

VALUATION FOR INSURANCE PURPOSES

Name of Client:
Address of Assets:
Asset Description:

Upgrade Requirements:
Age: Use/Occupation:
Land Contour: Subsoil Type:

Other Known Characteristics:

1.0 REINSTATEMENT
- A. Reinstatement Cost Estimate
- B. Inflationary Provision

2.0

INDEMNITY
- A. Market Related Estimate
- B. Depreciated Replacement Cost
- C. Inflationary Provision

3.0

FUNCTIONAL REPLACEMENT

Refer to valuation report/letter for the specification of the functional design

- A. Functional Replacement Cost
- B. Inflationary Provision

4.0

DEMOLITION ESTIMATE

VALUER'S SIGNATURE: QUALIFICATIONS:

NAME & COMPANY:

VALUATION DATE:

Please note: this report summary must be read in conjunction with the attached covering letter/report.

(a) All figures quoted are exclusive of Goods & Services Tax, finance costs and other indirect costs.

(b) All figures are exclusive of any allowance for land value.

(c) This form must be read in conjunction with the definitions of terms on the reverse hereof.

(d) The information in this report has been prepared to establish insurance values and may not be used for other purposes without the written consent of the Valuer.

(e) All figures assume compliance with building regulations and bylaws.

Definitions of Insurance Valuation Terms

The following definitions pertain to and form an integral part of the Valuation on the reverse hereof. ,

GENERAL	
Name of Client	Normally the insured
Address	Physical location, including street address at which the assets are situated.
Asset Description	General description giving sufficient detail to identify the range of assets encompassed in the valuation including details of principal structure showing main construction materials. Any exclusions should be noted.
Upgrade Requirements	Typically, it will be helpful to summarise major differences between the insured asset and the modern equivalent asset.
Age	Estimated year of completion and dates of any major additions and upgrades.
Use/Occupation	Nature of main activity carried out at location.

Contour	Valuer's classification of the land contour containing building and immediate yard areas: 1) Level 2) Gentle 3) Easy 4) Medium 5) Steep 6) Other – as specified
Subsoil Type	General classification of land supporting building and immediate yard areas: 1) Bedrock 2) Firm natural ground 3) Filled ground 4) Unknown 5) Other – as specified As a geotechnical survey has not been undertaken the description is without prejudice.

	Unless otherwise stated, the figures contained in the insurance valuation assume that the insured property can be reinstated on the land, and that this reinstatement can be achieved without incurring foundation costs greater than the costs assumed in the valuation assessment, noting that these costs would typically reflect the cost to replace a modern equivalent asset on subsoil conditions as assumed.
1.0 REINSTATEMENT	

A. Reinstatement Cost Estimate	Is an estimate of the cost at date of valuation (including relevant fees) of replacing the asset with a new modern equivalent asset, including, where appropriate, the use of current equivalent technology, material and services. This is intended as a guide for the purpose of setting insurance premiums and, unless specified elsewhere, is not based on a detailed elemental and schedule of quantities approach as would be undertaken by a quantity surveyor or costing engineer. In construction, unanticipated problems often arise and actual rebuilding, repair or replacement costs may vary from the estimate. In the case of partial destruction no specific allowance has been made for any additional requirements that any Council, Government or other Authority may require as additional expenditure to upgrade, alter or amend the undamaged portion of the asset. Reinstatement does not allow for cost escalation due to a catastrophic event causing a general or localised surge in demand for new assets or rebuilding/repairs. Where an asset has elements of an historic or heritage nature, unless otherwise specified, reinstatement does not include for reproduction of the existing asset with the original heritage features, but allows for a modern asset of similar size.
B. Inflationary Provision	This amount has been estimated on the basis of a loss occurring on the last day of a 12 month insurance period, if appropriate. The inflation provision under 1.0 B and 3.0 B incorporates an allowance for the additional time required for damage inspections, demolition, preparation of new preliminary proposals and their approval by the Territorial Authority, preparation of working drawings and specifications, schedules of quantities, in addition to an estimated period of construction contract. No allowance is made for any delay due to the need to comply with the provisions of the Resource Management Act. All inflationary provisions are future projections, based on recent trends and are given without prejudice. Inflation and in particular, foreign exchange rate fluctuations affecting imported assets, are notoriously difficult to predict and the valuer cannot be responsible for any inaccuracy.
2.0 INDEMNITY	
A. Indemnity Value Estimate	Is an estimate of the loss that would be suffered by the insured in the event the asset was destroyed. This may be assessed using the Market Approach, Income Approach or the Depreciated Replacement Cost Approach, as appropriate. (See valuation report for guidance).

B. Inflationary Provision	Is the estimated amount by which cost inflation exceeds depreciation over a 12 month period.
3.0 FUNCTIONAL REPLACEMENT	
A. Functional Replacement Cost	Is the estimated cost required to replace all assets to perform similar tasks but under optimum current design and lay-out conditions with capacity requirements not greater than currently available. The value of any partial loss has been disregarded in this context.
B. Inflationary Provision	This is calculated as per 1.0B but based on 3.0 Functional Replacement.
4.0 DEMOLITION ESTIMATE	
	For the purpose of valuation, it is assumed that 100% of the assets have been damaged beyond repair and have no salvage value. Unless otherwise noted in the valuation covering letter, Demolition Estimate covers the cost of demolition and removal as debris of the assets valued only excluding the cost of removal of any noxious materials, or removal of debris on adjoining premises. The Demolition Estimate does not include for: 1) shoring up any structures, either on the insured property, or neighbouring properties 2) the removal of building contents.

Addendum C – Averaging provisions and Section 44 of *the Insurance Contracts Act*

Most insurance policies that cover property damage to buildings include "averaging provisions" which penalises policy holders for not declaring a sufficient insured value at the commencement of the policy.

For example, if an insured declares the value of an asset to be $10 million when it is actually $20 million, then an insurer can often rely on the averaging provision clause which means it will only pay 50% of the claim. The rationale is that the insured has only declared 50% of the value of the asset and is therefore assumed to be effectively self-insuring (or co-insuring) for the other 50%, so should only receive 50% of the claim.

The difference can be significant. As an example:

- The insured declares a replacement value of $10 million.
- The actual value is $20 million.
- The asset suffers a partial loss, requiring $5 million in construction work to reinstate the building.
- The insurer only pays $2.5 million of the $5 million expenses.

- The insured is $2.5 million out of pocket.

Such a scenario can lead to a claim against a Member, if the Member has given an opinion as to the value of the asset for insurance purposes.

These "averaging provisions" and insurance policies are moderated by Section 44 of the Insurance Contracts Act.

Firstly, an insurer cannot rely on an averaging provision unless the insured was clearly informed of the provision before the contract was entered into (Section 44 (1)).

In relation to residential properties, the averaging provision only applies:

- if the sum insured is less than 80% of the value of the property at the time the contract of insurance was entered into; and
- any proportion is calculated by reference to 80% of the value of the property, not the full value of the property.

Using the worked example above, if you assume the property is a residential property, Section 44 moderates the position as follows:

- The insured declares value of $10 million.
- Value declared should be $20 million.
- Property is damaged requiring $5 million in construction works.
- As the sum insured is less than 80% of the value of the property, the averaging provision can apply.
- In calculating the percentage, 80% of the total value of $20 million is used, being $16 million.
- Percentage insured is therefore $10 million/$16 million = 62.5%.
- Insurer pays $3,125,000 of the claim.
- Insured is $1,875,000 out of pocket.

Warning: if Members give an opinion as to the insurance value and this is less than the actual value in the event of a claim, they face significant exposure if an averaging provision applies. There are a number of ways for Members to mitigate this risk which should be carefully considered by each Member, given the circumstances of each instruction. Members should carefully consider imposing a strict limitation of liability clause in relation to opinions given for insurance purposes, which are effectively "added on" to valuations of market value for mortgage security purposes for instance.