



# UNDERINSURANCE - WHAT IS IT AND HOW DOES IT AFFECT YOUR BUSINESS?

## What is underinsurance?

Underinsurance is what happens when the cover you purchase does not meet your business's requirements. Insuring assets for incorrect values, or setting cover limits too low, is likely to result in underinsurance.

## What are the consequences of underinsurance?

In the best case yet highly unlikely scenario, nothing happens - your business runs smoothly with no issues, and you never need to make a claim. But even the best run businesses can face unpredicted problems such as flash flooding, fire, burglary, and malicious damage, so it's likely that you will need to make a claim at some point. But if you're underinsured, it means that your assets are valued and insured at less than their current rebuilding/reinstatement cost (at today's prices) in the case of buildings or current replacement value as new for contents, leaving your business with inadequate protection. Therefore, in the event of a claim, you would receive a reduced insurance payout that could have a negative impact on your business.

## How does underinsurance happen?

There are several ways underinsurance can happen to policyholders.

Referring to some online calculators or simply making your best guess at a building's valuation means that you may be insuring the property for less than its actual worth. Using an online calculator is not necessarily a bad thing if you are using a tool such as the ABI Public Rebuild Calculator.

## Average

Many customers are unaware how the insurance principle of 'average' works and how it affects the value of a future claim. The average clause is typically found in commercial property insurance clauses. Any shortfall in a buildings sum insured or other sums insured will be reflected in a proportionate shortfall in claim settlement in the event of an insurable loss.

In simple terms, if your declared sum insured is only 50% of the true rebuilding or new replacement value of all the property, then insurers may only pay 50% of your total property claim.

Most policies have an index linking clause which helps policyholders keep up with inflation, by automatically increasing your sum insured annually in line with various indices. This should ensure that your sums insured are maintained at a level where 'average' should not apply.

This presupposes however that the base values are correct in the first place. The consequence of under insured values would be compounded if the sum insured is set too low at the outset.

Your rebuilding costs should be reviewed annually to take into account improvements or extensions made to the property.

It is a misconception that the sum insured is the same as market value - there is no correlation between the two. Neither should it simply be based on new build developers' costs.

Your building sum insured should also allow for the costs of demolition, debris removal, site clearance as well as the architects', surveyors' and other professionals' fees. Also don't forget to factor in costs for gates, fences or car parking areas into your calculations.



**CHRISTIE INSURANCE**

Part of the Christie & Co Network

## What factors affect rebuilding cost and can cause underinsurance?

It is very difficult to accurately calculate the rebuilding costs of a property as a variety of factors need to be considered:

- Size
- Location
- Type of property - unusual or specialist design?
- Construction and materials
- Age and if it is 'listed'
- Your VAT status

What else should be considered when arranging buildings insurance?

- Loss of rent; payable if you are a tenant and rent receivable if you are a landlord
- The cost of Alternative accommodation
- Business interruption also known as loss of revenue
- Increased and additional costs of working additional cost that might arise if an insured event occurs e.g. renting alternative premises to keep the business trading

**You should consider the potential interruption caused to your business impacted by the length of the rebuilding period and subsequent recovery of your trading to the same levels as applied prior to the damage occurring. In the worst case scenario you may be unable to trade until the property is rebuilt. This could be anything from 12, 18, 24, 36 months or longer.**

During this period, you may suffer a total or severe reduction in income and also may have lost customers. How will you pay your bills and continuing overheads? How long will it take you for your business to recover? You should discuss this recovery time with us, in order to determine the correct indemnity period suitable for you.

This is important as claims payments will cease once the indemnity period has been reached.

## How can I avoid underinsurance?

Here are some tips on making sure you avoid underinsurance when taking out a policy:

- Get an expert valuation. Christie & Co can assist with this.
- Don't use general market prices.
- Take care when using online calculators to get the value of your property – some of these may be inaccurate and may not include unique features or existing property damage which could impact the valuation.
- Check the VAT status. Some aspects of a building's reinstatement might attract VAT while others might not, and the position can vary depending on each organisation's tax arrangements- consider commercial/residential, new or refurbishment.
- Average clause. Understand how the "condition of average" clause applies typically included in property insurance policy wordings.
- Contents valuation. Don't forget that contents should be insured for their new replacement value and the value should be sufficient to cover all of your contents. You must not omit items and insure everything; while small items may seem insignificant when considering values, it is important to accurately value and include them when making a decision. These can add up quickly, and it's worth keeping an up-to-date inventory of all the items you wish to insure to make your valuation go as smoothly as possible. We suggest you make a list room by room.
- Stock insurance. When you hold stock, this should be insured for the cost of replacement to you, not the price you sell at. Many businesses are seasonal. A convenience store may require seasonal increases over the Christmas or Easter periods. You must take account of the maximum stock levels in your property at any one time, and not the value that may be present when arranging your insurance cover.
- Review values at risk regularly. We recommend that buildings are professionally revalued for rebuilding costs at least every three years. Property values fluctuate and so it may happen that the insurance you took out five years ago may now not be sufficient cover.
- Business changes. You should also consider adjusting your policy when you make changes to the business. If you get new machinery or technology in the building, that can have a significant effect on the level of cover you will require. Discuss the changes with us before you go ahead with them, so you aren't caught by surprise later.
- Ensure you insure the property for the build costs and not the market value.

To speak to a member of the team about how Christie Insurance can assist your business call **03330 107189** or email **christie@christieinsurance.com**. You can also visit our website to find out more **www.christieinsurance.com**

