

# ARE YOU CORRECTLY INSURED?



## Guidance on underinsurance and the impact of VAT



Image credit: [www.bbc.co.uk/news/uk-14461868](http://www.bbc.co.uk/news/uk-14461868)

Recent research by the Buildings Cost Information Service (part of RICS) has suggested that 80% of commercial properties are not insured for the correct reinstatement value.

For buildings valuation 'Reinstatement' is the method normally applied. It reflects the cost of replacing the building irrespective of its age, size or suitability. Reinstatement value should include the cost of demolishing and clearing away the existing structure and rebuilding it in modern materials, using modern techniques, allowing for professional fees and in accordance with current Building Regulations and other statutory requirements.

There is confusion surrounding underinsurance and the impact of VAT, with neither surveying professionals nor the insurance industry giving clear guidance on whether to include or exclude VAT when declaring values to insurers and what the implications are of incorrect declared values. Our guidelines overleaf help highlight the risks of underinsurance and examine the impact of VAT on values at risk.

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## Should declared values include VAT?

Whether to include or exclude VAT when declaring your insurable value to your insurers depends upon a number of factors such as whether the property is commercial or residential, or a mixture, and whether you are VAT registered including your VAT recoverability status.

In view of the inherent complexities in this area we advise including VAT at 20% on the insured amount. The decision not to include VAT should be given careful consideration to avoid the perils of being underinsured and if in doubt advice should be sought from a VAT specialist.

## How Average works when buildings are underinsured...

Declared Value	Reinstatement Value	Cost of Damage	Payment by Insurer	Total Refusal
£1,000,000	£1,500,000	£1,000,000	£666,000	£0
The figure declared to insurers	As defined above	The cost of repairing the building	This represents 2/3rds of the damage	Possible cancelled policy for deliberate underinsurance

If the declared value is incorrect then 'Average' can be applied. This is the "rule" which allows insurers to pay only a percentage of the loss if a building is underinsured. In simple terms, if the building is only insured for half of what it would cost to rebuild, the payment will be half of the loss and in certain circumstances the insurer will refuse to pay completely. However, if the building is over insured unfortunately the reverse does not apply and there is no profit, simply a wasted over-payment of premium. It is therefore worthwhile ensuring that the reinstatement cost is correctly calculated.

### For more information contact:

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### Top Broker Tips

1. Always try to get a valuation by a RICS qualified surveyor
2. Take advantage of the preferred supplier rates on offer for valuations
3. Annually assess valuations using one of the online calculators widely available to pinpoint a risk of an erroneous valuation
4. Try to avoid the temptation to remove index linking applied to the declared value by many insurers; the rate of increase is not plucked out of the air!
5. Make sure that you keep increasing the declared value in line with rebuilding costs
6. VAT should be included at 20% on the insured amount, to avoid underinsurance



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