COVER OVERVIEW

The Importance of Insurance to Value for Commercial Property Cover

When purchasing or renewing their commercial property insurance, it's vital for businesses to ensure such cover includes correct property valuations. Doing so can make all the difference in providing sufficient protection and preventing co-insurance penalties amid covered property losses. That's where conducting accurate insurance-to-value (ITV) calculations comes into play. Generally speaking, ITV refers to an approximation of the full cost to replace or restore insured property.

Businesses may end up with inaccurate ITV calculations for a wide range of reasons—whether it stems from leveraging ineffective property valuation methods, intentionally underestimating costs in efforts to secure reduced premiums or being impacted by factors outside of their control (eg inflation). Regardless, such inaccuracies are all too common. In fact, an estimated 80% of UK properties are underinsured, according to Rebuild Cost Assessment Ltd. This equates to around 587,00 properties—with a total value of £340 billion—standing without adequate buildings insurance.

With these findings in mind, it's evident that businesses need to take commercial property valuations seriously. This article offers more details on ITV, outlines factors to consider when determining a property's value, explains the pitfalls of property undervaluation and provides best practices for improving property valuation measures.

ITV Explained

An accurate ITV calculation represents as close to an equal ratio as possible between the amount of insurance a business obtains and the estimated value of its commercial property—thus ensuring adequate protection following property losses.

However, it's important to keep in mind that a property's worth may be assessed using several different values, including the following:

- **Market value**—This value is an estimate of what a property could be sold for in the present market. The market value of a property is based on elements such as plot size, building condition and location desirability.
- **Rateable value**—This value is an estimate by the Valuation Office Agency of a property's open market rental value, which is used to calculate a commercial property's tax—known as "business rates."
- **Replacement value**—This value is an estimate of the current cost to replace or rebuild a property. The replacement value of a property depends on characteristics such as material and labour expenses, architect services, debris removal needs, and any surveyor and local council costs.

Generally, insurance experts recommend using the replacement value of a property to conduct correct ITV calculations. Common approaches to accurately estimating this value include getting a property valuation from a third-party organisation, leveraging fixed-asset records that have been adjusted for inflation or relying on a basic benchmarking tool (eg pounds per square metre).

While valuations often require more time and resources than other replacement value estimation methods, they are largely deemed the most thorough and accurate.

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Factors Impacting Property Value

Apart from utilising replacement value estimates within ITV calculations, businesses should consider the following factors to determine correct property valuations:

- **Direct and indirect expenses**—In addition to direct costs, such as material and labour expenses, property valuations should incorporate indirect costs, such as consulting fees, engineering services and other expenses not directly associated with rebuilding.
- **Property age**—In the case of older structures, property valuations should include additional construction costs that may arise from upgrading outdated building materials and equipment.
- **Building regulations**—Older properties may also require certain modifications amid the rebuilding process to comply with modern building regulations (eg plumbing improvements, energy efficiency upgrades and safety enhancements). These adjustments may further compound construction costs, driving up property valuations.
- **Property accessibility**—Properties situated at steep locations or adjacent to neighbouring structures may need to have scaffolding or other safety measures put in place during demolition and rebuilding operations to ensure accessibility. These measures should also be factored into property valuations.
- **Unique features**—Some custom property elements (eg stained glass) could necessitate specialised construction work, elevating rebuilding costs. Therefore, it's crucial for these unique features to be incorporated into property valuations.

Consequences of Property Undervaluation

Businesses could face a number of ramifications if they conduct inaccurate ITV calculations and undervalue their properties. Namely, businesses may lack sufficient cover following property losses, forcing them to pay out-of-pocket expenses in order to fully rebuild. Depending on the severity of property losses and associated rebuilding operations, paying these costs out of pocket could lead to major financial setbacks and—in certain scenarios—bankruptcy.

Additionally, property undervaluation can sometimes result in co-insurance penalties. Most commercial property insurance policies include co-insurance clauses, which encourage policyholders to carry reasonable and accurate amounts of cover. Under a co-insurance clause, a policyholder is subject to a penalty—generally, a reduced payout—if their cover limit is not at least equal to a predetermined percentage (eg 80%) of the value of their property.

Ways to Improve Property Valuations

Here are some additional best practices businesses can review to help ensure accurate ITV calculations and improve their property valuation measures:

- **Find a reputable valuer.** Third-party chartered surveyors are considered the gold standard in property valuations by insurers, as they offer reassurance that calculations were conducted by experienced and objective professionals. As such, it's vital to secure a trusted and reputable surveyor.
- **Consult other parties.** Determining the value of a property should be a team effort. Make sure to compile a variety of property data from multiple qualified parties (eg accountants, contractors, estate agent professionals, risk managers, insurance professionals and chief financial officers) when making valuation decisions.
- **Make updates as needed.** The value of a property is always changing. This means it's imperative to update property valuations on a regular basis. For instance, valuations should be conducted at least every three to five years. Take note that property valuations may need to occur even more often.

The frequency will depend on factors such as changing property exposures, altered operations, building upgrades or modifications, the implementation of new technology or equipment on-site, shifting market conditions and property construction trends (eg inflated labour and material costs). It's best to work closely with trusted insurance professionals when updating property valuations to maintain ample cover and prevent co-insurance penalties.

In Conclusion

Ultimately, it's clear that correct property valuations are critical in securing adequate commercial property insurance. By better understanding how to conduct accurate ITV calculations, businesses can stay protected when covered events occur and avoid potential co-insurance penalties.

Contact us today for additional insurance guidance and solutions.