

Exposure Draft

INSURANCE ASSESSMENTS

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Reference:	ANZVGP 104 Insurance Assessments
Published Date:	TBC
Exposure Draft period:	###
Effective Date:	TBC
Owner:	Manager Professional Standards

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Guidance Papers

Objectives

The principal objective of a Guidance Paper (*GP*) and Resource Pack (if applicable) is to clarify professional and industry processes, best practices, and procedures and to discuss their use and implementation.

A *GP* is designed to be of assistance to Members and those who use *Members'* services. They serve as a guide and measure of acceptable professional practice and conduct of a *Member*.

The intention of a *GP* is to:

- a) provide information on the characteristics of different types of assets that are relevant to the advice.
- b) provide information on appropriate practices and their application.
- c) provide information that assists *Members* in exercising the judgements they are required to make in specific situations.
- d) convey elements of what is considered "competent professional practice" for Australian Property Institute (*API*) *Members* and "best practice" for Property Institute of New Zealand (*PINZ*) *Members* and New Zealand Institute of Valuers (*NZIV*) *Members*.

A *GP* is not intended to provide comprehensive training, instruction or prescriptive practices and procedures, or direct that a process, professional approach, or method should or should not be used in any specific instruction or situation.

Member Obligations

The *Member* is responsible for choosing the most appropriate approach in a matter based upon the task and instruction. It is a matter for each *Member* to decide the appropriate practice in any situation, and if they are unclear, seek legal advice. *Members* have the responsibility of deciding when it is appropriate to depart from the guidance and practices contained in a *GP*.

The *Institute(s)* do not warrant that anything contained in this, or any *GP* is the definitive or final statement on any issue. *Members* must perform their own work pursuant to their own professional expertise and experience and if required, seek additional advice which might include legal advice.

Court or Tribunal Reliance

A court or tribunal may consider the contents of this *GP* to be relevant when deciding whether a *Member* acted to a standard required by law.

Currency of Publication

This *GP* is current at the time of publication, based on current case law and relevant legislation.

Departure or Non-Compliance

Where a *Member* considers that a circumstance exists that warrants the departure from or non-compliance with any of this *GP*, the *Member's* report (or other advice) should include a statement that outlines:

- a) the reasons for the departure or non-compliance with this *GP*; and
- b) any impact the *Members* departure or non-compliance may have on the content of the report.

Enquiries

If any *Member* considers any information or advice in this *GP* to not be accurate or up to date, or wish to raise any issue for consideration arising from the contents of this *GP*, please refer this to

API contact: standards@api.org.au

PINZ/NZIV contact: standards@property.org.nz

EXPOSURE DRAFT

1.0 Introduction

1.1 Scope of this Guidance Paper

The objective of this *GP* is to provide information, commentary, advice, and recommendations to *Members* providing insurance assessments of destructible improvements to real property and plant, machinery & equipment.

Assessments for insurance purposes are commonly required by clients for the following reasons:

- (a) To assist in assessing the sum insured when purchasing general insurance products that covers loss or damage to property. This is a highly specialized area of practice, that requires considerable knowledge of important insurance concepts, which is addressed in Section 4.0 Assessments for General Insurance Purposes.
- (b) To estimate the *replacement cost* of the improvements when undertaking real property valuations for mortgage purposes in Australia, utilising the PropertyPRO Supporting Memorandum (*PPSM*). This will be discussed in Section 5.0 Replacement Insurance Cost Estimates.
- (c) In New Zealand, to provide a Summary Certificate as recommended by *PINZ* and *NZIV* to *Members* to meet legislative changes, such as recommended by *PINZ* and *NZIV*, following changes to legislation, such as the Fire and Emergency New Zealand Act 2017 and Earthquake Commission Act. Guidance in relation to these Summary Certificates is set out in Addendum A to this *GP*.

1.2 Insurance Assessments Are

For the purposes of the *GP* an insurance assessment (or insurance cost estimate) is the result of a calculation by a *Member* of the cost of reinstating, replacing, or reproducing the subject asset as at the relevant/assessment date.

An insurance cost estimate is any assessment of the cost of replacement, reproduction, or reinstatement of destructible improvements to real property or chattels (including plant, machinery & equipment) undertaken for the purpose of advising on the insurable amount of the subject asset(s) in connection with the entry into, or proposed entry into, a contract of insurance.

2.0 Definitions

The definitions contained below and used in this *GP* are applicable to this *GP* and have been included to assist with the interpretation and understanding of certain stated terms used within this *GP*. Whilst a defined term may also have a common meaning or interpretation, their use in this *GP* is so limited.

Where a defined term is included in this *GP* it is shown in italics.

Assessment for General Insurance Purposes

An insurance assessment of the property insured as requested by the client which would normally, but not always be undertaken on a *reinstatement cost basis* or *indemnity value* basis.

This is further outlined in section 4.0.

Declared Value and Sum Insured

Terms used to describe the sum 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.

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 immediately before the loss or damage occurred, taking into *consideration* the age, condition and remaining useful life of the asset.

Insured

A *person* or entity whose interests are protected by the *insurance policy*.

Institute(s)

All references to *Institute(s)* mean, as the context requires, *API*, *PINZ* and / or *NZIV*.

Member

An individual who is a member of the *API*, *PINZ* and/or *NZIV*.

EXPOSURE DRAFT

Property Insured

A term commonly used to describe the property that is covered under an 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.

Other terms such as “insurable interest”; “asset insured”, “insured property” and “insured asset” are interchangeable terms for the purposes of this *GP*.

Reinstatement Cost

The total amount to replace or reproduce the *insured property* at the same location to a condition equal to, but not better or more extensive than its condition when new.

Replacement Cost

The current cost of replacing the *insured property* with that of an equivalent asset at the same location (*situation*) providing similar function and offering equivalent utility, but which is of a current design and constructed or manufactured using current cost-effective materials and techniques.

**Replacement
Insurance Cost
Estimate**

An estimate of the *replacement cost* of the improvements to real property included in a PropertyPRO valuation report by a *Valuer* in accordance with the requirements under the 'Insurance Assessments' section of the *PPSM*.

Reproduction Cost

The *current cost* of recreating the *insured property* with an exact replica of the asset, at the same location (*situation*). It is the sum of all costs involved with replicating (reproducing) the asset with the same materials and specifications as the insured asset based on current prices.

Situation

A common term 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 Instructions

3.1 In Writing

Instructions to provide an insurance assessment must be agreed and be in writing prior to the *Member* beginning work, and clearly outline the scope of work in a professional services agreement (retainer) between the *Member* and the client.

There must be no ambiguity in the instructions. Where the *Member* perceives ambiguity, the instructions must be referred to the instructing party/client to resolve the ambiguity.

Any variations to instructions during the course of work must also be in writing.

As a general rule, when instructed to do an *assessment for general insurance purposes*, the *Member* should state whether they have reviewed the policy wording and have applied the basis of assessment in the policy wording.

For *replacement cost insurance estimates*, the instructions are governed by the PPSM, which do not require *Valuers* to review any policy wording.

3.2 Accepting Instructions

Prior to accepting an instruction, the *Member* must possess the necessary skill, knowledge, experience and information to provide the insurance assessment.

It is important for *Members* to critically review any instruction to identify any risk issues prior to accepting instructions. Issues such as previous fire, flood or other insurable incident at or to the asset, a 'low' *sum insured* or other complicating factors such as heritage issues (where fully depreciated assets will have a much greater replacement value than reinstatement as is) will all need to be considered carefully by *Members*.

This is particularly important for *Members* providing insurance assessments of non-residential assets. *Members* accepting such instructions should possess a sophisticated knowledge of the insurance market as well as costing information for type and class of asset.

Australian *Members* need to understand that;

1. an insurance policy is a financial product and "dealing" in a financial product requires an Australian Financial Services Licence (AFSL). *Members* who do not hold an AFSL¹ must make it clear that the report or other advice is not providing advice relating to the adequacy of an insurance policy and that the report or advice is limited to the insurance assessment only. The *Institute* advises that such a qualification is usually prudent even if the *Member* is the holder of or acting under an AFSL, but this is a matter of judgement for the *Member* to decide in each case; and
2. it is usually not advisable for a *Member* to undertake an *assessment for general insurance purposes* without having access to a copy of the insurance policy, or at a minimum an awareness of the insurance cover the client has currently or has organised in the past. Ideally, the *Member* should be aware of the previous insured amount, the type of cover and any relevant exclusions.

¹ Means the *Member* must hold one for their firm (employer), or if not, be an authorised representative of an AFSL holder or be the employee of an AFSL holder.

In New Zealand, *Members* are generally not instructed or qualified to review policy wording, however knowledge of the cover previously or currently in place, as the case maybe, is an important factor in good risk management practice.

4.0 Assessments for General Insurance Purposes

Clients requesting an insurance *assessment for general insurance purposes*, usually require the *insured*, or a *Member*, to express an opinion as to the total cost of reinstating the *insured property* so that the *insurer* can determine how much they should insure the asset(s) for.

It is important to both an *insured* and *insurer*, that the insurance assessment of an asset insured is clearly understood. From the perspective of an *insured*, the higher the insurance assessment, the higher the premium the *insured* will be requested to pay. From an *insurer's* perspective, they want to receive a premium that accurately reflects the risk they are taking. If the asset is under insured, *insurers* can seek to reduce their liability by operation of a co-insurance clause, which is explained in Section 4.3.

An *assessment for general insurance purposes*, is usually an assessment of the cost of replacing the asset should it be destroyed, as at the date of assessment. It is distinctly different from an opinion of market value of a property. It involves assessing the cost of replacing or reproducing the insured asset if it is destroyed, not the price that would most likely be negotiated and concluded between a willing buyer and seller for the property.

Insurance *assessments for general insurance purposes* require understanding of the following matters:

- general insurance policy terms (including difference between *reinstatement cost* and *indemnity value*, inclusions and exclusions, co-insurance, and averaging provisions)
- an appreciation of how costs of replacement of insured assets can fluctuate over time, including inflation of building and manufacturing costs in the event of a widespread disaster, such as an earthquake, flood or bushfire
- understanding the impact heritage features and any other planning restrictions could have on *replacement cost* or *reinstatement cost*, should insured assets be damaged or destroyed
- an understanding of assessing costs of construction or manufacture, noting particularly when the services of an expert quantity surveyor or other costing expert should be recommended/obtained

The following section deals with general insurance policy terms, that cover an insured, for unintended damage or loss to the insured asset.

Whilst an outline of common insurance policies is contained below, *Members* should appreciate that policy wording varies from *insurer* to *insurer* and can be extremely technical depending on the type of policy and *property insured*.

4.1 Common Insurance Policies covering Property Damage or Loss

The most common policies relating to the insurance of buildings and contents are:

1. Home (and/or contents) policies
2. Industrial Special Risk (*ISR*) policies

Both types of general insurance policies are commonly offered on the basis of *reinstatement cost* and/or *indemnity value*, but other cost bases such as *reproduction cost* or *replacement cost* can also apply as detailed in the policy wording.

4.1.1 Home Policies

Home policies cover residential buildings against unintended loss or damage. For example, damage caused by a fire, or accident. The policy usually covers the cost of repairing or replacing the building and replacement of contents.

Members rarely requested to provide insurance assessments for domestic property, save for the higher end of the market. Normally a homeowner estimates the *declared value* or *sum insured* of their home and contents and purchases insurance. However, Members who undertake mortgage valuations, are often asked by their lender client, to provide a *replacement insurance cost estimate* for the improvements that are the subject of the valuation report to enable the lender to make a “health check” on the *sum insured* by the borrower, or in the case of a purchase scenario, the minimum *sum insured* that the borrower is required to have at settlement. These assessments are addressed in Section 5.0.

The amount of cover provided under home 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/event.

The homeowner nominates the amount of the *sum insured*. The *sum insured* may be the reinstatement or repair cost; or it may be an *agreed indemnity value* of the house or home and/or contents in the event of a total loss as defined by the insurance policy.

A house or home is generally defined as a residential dwelling at the insured address including its structural improvements, fixtures, fittings and domestic outbuildings.

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

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*.

4.1.2 Industrial Special Risk (ISR) Policy

An Industrial Special Risk (*ISR*) policy is the most common insurance policy that covers assets used for commercial and industrial purposes. *ISR* policies are one of the oldest types of insurance policies, having first been introduced to the insurance market in the early 1900s. As such, there are many cases that have considered *ISR* policies and the cover can be complex, requiring a high degree of specialisation.

Generally, an *ISR* policy has two sections. The first covers material loss or damage, meaning the cost of repairing or replacing buildings, plant, machinery or equipment. The second covers consequential loss, which covers an *insured* for business losses that are incurred whilst their insured assets are damaged.

ISR policies are a highly specialised area of practice in the insurance industry. The range of options available for *insureds*, the complexity of the wording and the use of many terms that have specific legal meaning, indicate that Members providing insurance assessments for *ISR* policies, should have a detailed understanding of how these policies work, so that their advice is relevant to the way in which a claim will be paid under the policy.

ISR policies had significant publicity in Australia during the 2021 COVID-19 pandemic, as *insureds* tried to recover business interruption under these policies. In short, *insurers* have successfully rejected such claims in Federal Court proceedings on the basis that closure of a premises due to government order, was not “property damage” as defined in the policy. The Federal Court decisions do provide a detailed analysis of how *ISR* policies work and can be a useful resource for those operating or providing advice in these areas.

²

4.1.2.1 Typical *ISR* Policy Indemnity Cover for Commercial Assets

In the event of any physical loss, destruction, or damage to insured property, a property damage policy will indemnify the *insured* in accordance with the applicable basis of settlement. However, not all damage is covered. For example, damage caused by flood is usually excluded. Each policy will have a list of exclusions.

The basis of settlement clause is important because this refers to how the *insurer* will determine the amount to be paid to an *insured* if the property is damaged or destroyed. The most common basis of settlement is to restore the destroyed or damaged property “to a condition substantially the same as, but not better or more extensive than, its condition when new.” However, this can vary, so *Members* are encouraged to understand variations in basis of settlement clauses in policy wordings.

A property damage policy will also typically indemnify the *insured*, in addition to the cost of rebuilding, for the following:

- 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 based on the *indemnity value* of the asset(s) at the time of the loss.

The policy will have a policy limit, which is the maximum amount the *insurer* will pay.

² <https://www.fedcourt.gov.au/services/access-to-files-and-transcripts/online-files/covid-19-insurance-test-cases>

4.2 Reinstatement Rights/Existing Use Rights

In the event of damage to the insured improvements to real property, the reinstatement of a building as it existed prior to the loss may be prohibited or restricted by a statutory body. For example, local planning laws that specify reinstatement of heritage features. In such situations, the *insurer* may pay in addition to any other amount payable on reinstatement of the building the difference between:

- the actual cost of reinstatement; and,
- 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 several policies this provision is only in respect of the floor space ratio index or plot ratio.

4.3 Co-insurance Clauses

Co-insurance clauses provide that, if at the time of the loss, the *replacement cost* of the property insured exceeds the amount of cover, the *insured* is self-insuring for the difference in cost and therefore bears a rateable proportion of any loss (including a partial loss). These clauses are often controversial. In the event of a claim, an *insurer* may seek to rely on this clause to reduce the amount of the claim. If the *insurer* considers the *sum insured* for the property to be, say, 30% lower than it should have been, the *insurer* will only pay 70% of any claim.

These clauses are intended to ensure that an *insured* insures for the full cost of replacement of the property, so that the *insurer* can charge an adequate premium for the risk they are assuming/providing cover for. However, these clauses are a frequent source of conflict because the *sum insured* at inception of the policy is a matter about which reasonable minds can differ. This is a reason why *Valuers* are often asked, usually by an *insured*, to provide insurance assessments prior to the inception of the policy. Indeed, some policies provide that if assets are independently assessed prior to inception, the co-insurance clause will be removed.

Nevertheless, many insurance policies that cover property damage to buildings include "averaging provisions" which penalises policy holders for not declaring a sufficient *sum insured* at the commencement of the policy.

For example, if an insured declares the *sum insured* of an asset to be \$10 million when it should be \$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 *replacement cost* 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 cost* of \$10 million.
- The actual *replacement cost* at the time 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 therefore \$2.5 million out of pocket.

4.3.1 Risk Considerations for Members

The risk for *Members* is that if they provide an opinion as to the insurance *replacement cost* and this is less than the actual cost, then in the event of a claim, they may face significant exposure if an averaging provision applies.

There are several ways for *Members* to mitigate this risk which should be carefully considered given the circumstances of each instruction. *Valuers* should consider imposing a strict limitation of liability clause in relation to opinions given for insurance cost estimates, which maybe "added on" to mortgage security valuations as part of the instructions by a lender. As a minimum, *Valuers* should understand whether the insurance cost estimate provided in the mortgage valuation report will be used to effectively remove the co-insurance clause.

Removal of the co-insurance clause greatly reduces liability exposure for *Valuers* providing insurance assessments.

It is also important to understand that the insurance assessment will only be relevant to determine the total *reinstatement cost* of the *property insured* in the event of a total loss, which is extremely rare. Most claims involve a partial loss.

4.3.2 Australian Act

In Australia insurance policies, including "averaging provisions" are regulated by Section 44 of the Insurance Contracts Act.

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 *reinstatement cost* or *replacement cost* of the property at the time the contract of insurance was entered into; and
- any proportion is calculated by reference to 80% of the *reinstatement cost* or *replacement cost* of the property, not the full cost of the property.

Using the concept above, and assuming the property is a residential property, Section 44 regulates the position as follows:

- The *insured* provides a *declared value* of \$10 million.
- The *sum insured/declared value* should have been \$20 million.
- Property is damaged requiring \$5 million in construction/repair works.
- As the *sum insured* is less than 80% of the *reinstatement cost* or *replacement cost* of the property, the averaging provision can apply.
- In calculating the percentage, 80% of the total insurable amount of \$20 million is used, being \$16 million.
- Percentage insured is \$10 million/\$16 million = 62.5%.
- *Insurer* pays \$3,125,000 of the claim.
- *Insured* is \$1,875,000 out of pocket.

4.3.3 New Zealand Act

Under the New Zealand Insurance Law Reform Act 1985 the "pro rata condition of average" is excluded for policies relating to a dwelling house or any other contents

thereof. Other policies may contain a pro rata condition subject to the *insurer* clearly informing the *insured* in writing of the nature and effect of the condition.

4.4 Limit of Liability

Insurance policies often include a limit of liability. 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 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 increases in the *reinstatement cost* for the policy period and the lead time and rebuild period, plus the cost of demolition.

Members are not usually required to assess this amount.

4.5 Fiduciary Interests

Members should be aware that other parties, for example, lessors, financiers, trustees, mortgagees, and the like, can have interests in the property insured and should act in the knowledge that liability may extend to those other parties.

4.5.1 Limiting Liability to Agreed Parties

If a *Member* does not wish to extend their liability to parties other than the person who has commissioned the insurance assessment, then the *Member* should include an appropriately worded third party disclaimer.

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5.0 Replacement Insurance Cost Estimates

In Australia, assessments of the *replacement insurance cost estimate* for the improvements to real property are often required as part of a valuation of residential property for mortgage purposes. The PropertyPRO Supporting Memorandum (*PPSM*) outlines the basis of the 'Insurance Assessment' included in PropertyPRO Valuation Reports.

The version of the *PPSM* applicable at the date of this *GP* notes that the 'Insurance Assessment' is;

"... an estimate of an insurable sum under replacement conditions. This would normally include:

- estimated construction costs,
- provision for cost escalation during period of insurance and rebuilding process,
- allowances for demolition and clean-up, and
- professional fees.

Cost of alternative rental accommodation is not included."

The *PPSM* further notes;

"Valuers are not experts in construction, construction costs and/or engineering matters and the insurance estimate is provided by Valuers in their capacity as Valuers, not as building or construction experts."

In relation to providing insurance assessments for heritage property the *PPSM* notes;

"... the Valuer may not have the required expertise to provide a Replacement Insurance Cost Estimate. In these situations, the Valuer must advise the Client to undertake their own investigations through a suitably qualified Quantity Surveyor, or similar."

Valuers are reminded that a *replacement insurance cost estimate*, requires a different analysis and calculation to a market value assessment. The investigations, analysis and calculations for an insurance assessment requires a detailed understanding of construction costs, as well as the risks of known or observable cost escalations in the market at the date of the assessment.

Valuers providing *replacement insurance cost estimates* should utilise available cost guides (such as Rawlinsons) and have a detailed understanding of construction costs in their local area from building contracts provided for construction valuations undertaken. As a minimum, Valuers are expected to have a working knowledge of the prevailing construction and demolition rates per square metre, as well as anticipated escalation on these costs in the markets they undertake mortgage valuations.

Lenders use the insurance assessments provided to check against the adequacy of insurance organised (the *sum insured*) by the borrower in order to limit the lenders exposure in the event of damage or destruction of the secured property.

6.0 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.

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

- reinstatement cost estimates,
- fees and contingencies,
- demolition and debris removal, and
- estimates in respect of cost increases during the policy period, lead time and reconstruction periods.

6.1 Reinstatement Cost Estimates

There are several ways to provide an estimate of *reinstatement cost* for buildings, structures, and other site improvements. Two of the more common methods 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 method 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 calculations. Where information in relation to recent constructions of a similar nature are available, these may assist the *Member* to estimate the appropriate cost for each element. *Members* should consider the reliability of evidence or information provided, sourced, or made available, and assess the information in terms of its comparability to the subject asset.

An elemental cost estimate is likely to produce a more robust cost estimate than an estimate based on building cost guides.

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(s) including soil type, special footings, etc,
- external dimensions of a building (some cost guides relate only to internal building measurements),
- fees associated with reconstruction including architects, survey, engineering and statutory fees, and
- cost increases/decreases between the date of issue of published cost guides and/or the date of construction contracts, and the date of the assessment.

Insurance assessments undertaken in non-metropolitan and remote areas would usually reflect additional transport costs associated with labour and materials. It may be possible for a *Member* to gauge an estimate of the location factor/loading by comparing local construction costs and/or by examining a sample of costs and relating them to known costs in metropolitan areas for equivalent construction costs as a baseline.

The basis for the insurance assessment of heritage assets may require a reproduction or replication-based assessment (see Section 6.7).

In respect of common home insurance policies, unless specifically excluded, the following items are typically included in the insurance assessment for domestic improvements:

- 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 the electrical, water, or gas 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 homeowner or shared by the homeowner with other residential property owners and for which the homeowner is responsible,
- permanently installed fishponds and water features connected to the dwellings water supply,
- sculptures and artwork affixed to the home and/or land,
- the homeowners share in any wall's fences, gates, pipes, cables, or driveways where these items are jointly owned by the homeowner and other property owners, and
- costs associated with rebuilding the home such as architects' fees, site clearance, removal of debris, inflation allowance and wide area damage.

Unless specifically excluded under the terms of the policy or other legal requirements all site improvements should be specified and included in the insurance assessment. All improvements should be included in the insurance assessment unless the Member receives instructions to the contrary. Any improvements excluded from the insurance assessment should be clearly stated in the report or other advice.

New Zealand Members are reminded that in New Zealand these requirements are slightly different and New Zealand Members should have regard to Addendum A to this GP.

6.1.1 Plant, Machinery & Equipment Considerations

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 amount of plant and equipment.

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

The *reinstatement cost* for plant, machinery 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.

6.2 Fees

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 in their cost calculations.

6.3 Lead Time

Lead time is the period 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 statutory authorities and all matters are completed in preparation for rebuilding.

To the extent it is included within the agreed instructions cost increases during the lead time period need to be taken into account in cost estimates. As this is a prediction of the future, the estimate should be appropriately qualified.

Whether the insurance assessment is to include an allowance for cost increases during lead time will be determined by the instructions agreed between the *Member* and the client. The report or other advice should state whether the insurable amounts reported are inclusive or exclusive of such costs.

6.3.1 Lead time considerations for Plant, Machinery & Equipment

In the case of plant, machinery 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 appropriately qualified. For this reason, *Members* may elect not to provide such an estimate.

For plant, machinery 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, machinery and equipment can be replaced and commissioned. Therefore, the total lead time allowance may need to also include the building reconstruction period lead time.

6.4 Reconstruction Period

The reconstruction period is the period from the time building approvals have been obtained to completion and handover of the new building. To the extent it is within the agreed instruction, cost increases during the reconstruction period need to be taken into account and included in calculations.

Cost increases should be included only to the extent that the building or plant, machinery 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 prediction of the future, the estimate should be appropriately qualified.

It is not usual for instructions for insurance assessments of plant, machinery or equipment located in a building to include a requirement for all allowances for the reconstruction period to be included, however, where it is requested, it should be noted that for substantial installations, a lengthy period may be required whilst the building and plant is constructed, installed, and commissioned.

For plant, machinery or equipment that is located within a building, in event of a loss, the building will usually have to be replaced before the plant, machinery or equipment can be replaced and commissioned. 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. For this reason, *Members* may elect not to provide such an estimate.

Whether the calculation is to include an allowance for cost increases during the reconstruction period will be determined by the instructions agreed between the *Member* and the client. The report or other advice should state whether the insurance cost estimate(s) reported are inclusive or exclusive of such costs.

6.5 Demolition and Removal of Debris

Members should assume that all assets would be destroyed in a loss situation and would require removal prior to reinstatement.

To the extent it is within the agreed instruction, 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(s).

Consideration should be given to any generally known presence of asbestos or similar hazardous materials. The potential for asbestos to contaminate the site and surrounding areas in the event of major damage to the property is an important consideration for those undertaking insurance assessments. An asbestos report should be obtained or noted in the report or advice and, if not available or provided this should also be noted in the report of advice.

Difficult access to a site may also be a factor that should be noted and considered in allowances for demolition and removal of debris.

Whether the insurance assessment is to include an allowance for demolition and debris removal will be determined by the instructions agreed between the *Member* and the client. The report or advice should state whether the insurance cost estimates reported are inclusive or exclusive of such costs.

6.6 Goods and Services Tax (GST)

GST is payable on building costs, plant, machinery and equipment, and professional fees. The way a claim is settled may determine whether it is possible for the *insured* to claim the GST paid 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.

Most insurance assessments for non-residential (retail, industrial and commercial) assets, do not include GST in the calculations as either the *insured* and/or the *insurer* will generally be able to obtain the benefit of the input tax credit for any GST paid on the *reinstatement costs*. This is not the case for insurance cost estimates for home insurance which should include any GST payable as a cost component in the calculation.

Members should clearly state whether the insurance cost estimates reported include or exclude GST.

6.7 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 any damaged areas and this may require repairing or reproducing components 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.

When providing insurance assessments of heritage assets *Members* should consider increased lead times, higher constructions costs and professional fees. *Members* will also need to understand the prevailing 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 and should obtain clear instructions as to the basis of assessment. In such cases, the insurance assessment will normally be instructed on a *reproduction cost* basis.

6.8 Other Related Bases of Value

Members should note that an insurance policy is a private contract between an *insured* and *insurer*. Whilst the terms are in standard form, an *insurer* and *insured* can agree a different basis of assessment if they wish to. This is not common, but this is why it is recommended that when providing an *assessment for general insurance purposes*, *Members* are advised to review, when provided, the policy wording as a different basis of assessment may need to be considered and applied so that the *Member's* insurance assessment reflects the relevant basis as set out in the insurance policy.

7.0 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 as at the date of destruction or damage that resulted in the insurance claim.

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.

An insurance assessment which covers multiple assets and types of assets (e.g., plant, machinery and equipment assessments may include both specialised and non-specialised assets) may require multiple approaches to assess the *indemnity value* of all assets included. *Members* may also be specifically instructed to utilise the market approach and/or the cost approach to estimate *indemnity value*.

When establishing the *indemnity value* of an asset the assessment should consider 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.

The determination of *indemnity value* using the cost approach therefore requires firstly, the assessment of the *reinstatement cost* and secondly 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 asset 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, machinery or equipment) which assumes that the remaining service potential of the asset is used up at a constant rate assuming reasonable maintenance. However, there are many types of assets, particularly those that experience rapid technological and functional obsolescence, for which other methods including the diminishing value method, may be more appropriate.

Where plant, machinery or equipment are assessed based on *indemnity value* using a market approach, the *indemnity value* may, depending on the nature of the asset, comprise two components. The first component is the cost of acquiring a comparable asset from the second-hand market to which is then added the (un-depreciated) cost of installing and commissioning that asset (where applicable).

Members should include reference within their report or other advice that an *indemnity value* arrived at using a cost approach may not be the same as one 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 approach or methods to be adopted. This should be clearly stated in the agreed instructions and within the insurance assessment report or other advice.

As for any other professional services undertaken which contain a *Members* opinions or conclusions *Members* should fully explain any assumptions or limitations, the methodology adopted and the reasoning that supports the opinions and conclusions reached so as to fully inform the agreed user of the report or other advice.

In New Zealand, *indemnity values* are also used for the purposes of assessing the Fire and Emergency Levies on replacement insurance policies. *Members* should refer to the New Zealand specific addendum of this *GP* for further information relating to the assessment of *indemnity value* for this purpose.

8.0 Report Content

8.1 Buildings

An insurance assessment report for buildings and other site improvements should clearly describe the improvements that are included in the insurance cost estimate, and should also include, to the extent included within the agreed instructions:

- A concise description of assets including a clear statement as to whether floor coverings, internal partitions, fit out, retaining walls, other site improvements and services are included in or excluded from the assessment.
- Reference to the method and extent of fire protection services.
- A statement of specific exclusions such as plant, equipment, tools, furniture, stock and materials in trade, and the costs of removal/disposal of these.
- A *reinstatement cost estimate* as at the date of assessment and/or an *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 changes (increases or decreases) during the policy period.
- An allowance for cost fluctuations (increases or decreases) during the lead time, i.e. the period after a loss or significant damage when debris is removed, building plans are drafted and necessary approvals are obtained.
- An allowance for changes in costs during rebuild period.
- A statement as to the treatment of GST.
- 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.

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

8.2 Plant & Equipment

For plant, machinery and equipment assets, the report content should include or explain the following to the extent included within the agreed instructions:

- A description of the assets.

- A *reinstatement cost* estimate as at the date of assessment and/or indemnity value estimate as at the date of inspection.
- An estimate of the cost of demolition and removal of debris.
- An estimate of the changes in costs (increases/decreases) during the policy period.
- An estimate of the cost fluctuations (increases/decreases) 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)
- An allowance for cost changes (increases or decreases) due to any additional lead time associated with the plant reconstruction, installation, and commissioning. This period may be substantial.
- The treatment of obsolete assets. It is common for obsolete or unused assets to be excluded from an insurance assessment; where this is the case, this should be explicitly noted.
- An allowance for installation and commissioning costs, where applicable.
- A statement as to the treatment of GST.
- A statement regarding the treatment of financing costs during the reconstruction, installation and/or commissioning period.
- Any relevant qualifications and disclaimers, which includes comments upon any unverified information or assessments of future events.

8.3 Location (situation)

The location (situation) of the insured property should be identified.

All freestanding buildings on a site will usually be separately identified as they may represent separate insurance risks.

An owner may have many locations (situations) covered by the same insurance policy.

9.0 Other Issues – Large Scale Catastrophes

Declared values or *sums insured* are usually determined based on a single loss and not in the context of a more widespread catastrophe or disaster such as an earthquake, flood, or bushfire.

Large-scale catastrophes, disasters and even unrelated regional or international events such as geo-political issues, wars or pandemics can result in unforeseen escalations in building and other related costs due to the high demand or impacts to supply chains for both materials and labour.

Such events may result in shortfalls between the *declared values* or *sums insured* and the total cost of reinstatement or replacement. *Members* should attempt to limit their liability to the agreed user(s) of any insurance assessments by including suitable and appropriately worded limitations and warnings (qualifications statements) as well as disclaimers when providing insurance assessments for the purpose of setting *sums*

insured or insured amounts. Such qualification statements would have the intention of excluding possible cost escalations arising from such catastrophic events.

10.0 Effective Date

This *GP* is effective from ## ### 2023. Earlier adoption is permitted and encouraged.

This *GP* replaces ANZVGP 104 which was effective from 1 July 2021 and was withdrawn from ## ### 2021

EXPOSURE DRAFT

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 and Emergency New Zealand Act 2017

The Fire and Emergency New Zealand Act 2017 repealed the two Acts governing fire services, the Fire Services Act 1975 and the Forest and Rural Fires Act 1977. The Act was given Royal Assent on the 11th of May 2017. Whilst the Act is in place, the new basis for levy calculation has not been finalised. In April 2019, the Fire and Emergency New Zealand (Levy Rates and Information Requirements in Transitional Period) Amendment Regulations 2019 came into force. The amendment removes the reference to an implementation date of 1 July 2019 to provide that the regulations will be revoked when the new levy regime comes into force.

At the effective date of this GP, Fire service levies are to be calculated in accordance with the 1975 Fire Services 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 is necessary for the indemnity value to be assessed even though the insured may have a Replacement Policy.

Indemnity is not defined in the Fire Services Act 1975 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 fencing, retaining walls, roads, paths, drains, bridges, tunnels, reservoirs, etc.) are exempted from the Fire Service Levy (refer Section 47B (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 or excluded, so as not to pay levies that are not legally required.

The Standards Board will look to amend this Section if and when the structure around Fire Service Levy collection is enacted.

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. Between the insurer and EQC, in the event of an earthquake whether a partial or full loss, subject to the property being fully insured in monetary terms then the property owner will be covered. Although each may have limitations on specific items, from a valuation perspective the objective is to ensure that an adequate sum insured is determined so the property owner may be fully insured as opposed to being concerned with whether the EQC or insurer pay.

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, Some 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, and should not be applied for general insurance cover, which is discussed more fully in this GP. In summary the Valuer should allow for all improvements and if an item is not included then this must be clearly stated.

A1.3 Domestic ‘House Insurance Policies’

In New Zealand, ICNZ identifies three different forms of policy cover:

Fixed Sum Insured – This is specified by the homeowner and is based on the full rebuild cost of the home. If the house is destroyed, cover is up to this amount.

Indemnity – Cover is for what the house was worth prior to loss (excluding land) factoring in general wear and tear. ICNZ specifies that some older homes (pre-1945) may only qualify for Indemnity Cover unless they have been modernised.

Total Home Replacement – This is where the premiums are based upon the size of the house and insurance would cover the entire cost of replacement if damaged.

For more detailed information, we advise members (and their clients) to peruse detail on the ICNZ Website.

It is important to highlight that that ICNZ advise that for most Home policies insurers require separate identification of the following:

‘Retaining Walls’

‘Recreational features’ – ICNZ defines recreational features as ‘permanently fixed outdoor items built for the purposes of recreation, such as swimming pools, spa pools and tennis courts’ and that these (along with retaining walls) may have limited cover or in some cases, no cover at all. It is recommended that improvements that fall into this category are separately itemised.

‘Other Special features’ – ICNZ defines the following improvements as being ‘special features’ and are excluded from most house policies:

- a) Jetties.
- b) Wharves.
- c) private landings or airstrips.
- d) permanent fords or dams.
- e) bridges and culverts.
- f) cable cars.
- g) private utility plants (such as windmills, water mills or diesel generators).

For more detailed information, we advise members (and their clients) to peruse the ICNZ Website for detail on policy types and information insurers require.

A2.0 New Zealand Insurance Form

A2.1 Insurance Form

For many years PINZ and NZIV members (both Land and Buildings and Plant & Machinery Valuers) provided a valuation in certificate form summarising the information for the clients as well as the insurance industry in an easily recognisable summary format.

As a result of national disaster events and changes to insurance policies, legislation, and levy calculations the insurance industry now requires reports to contain more detailed information to assist stakeholders with the insurance process.

To meet the requirement of clients and stakeholders, PINZ & NZIV recommend that insurance valuation reports contain a Certificate which complies with FENZ requirements and is very similar to that previously provided, with additional information on subsequent pages. 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 is provided which will allow a decision to be made as to appropriate levels of insurance cover.

Key information to be included on the Summary Certificate and subsequent pages includes:

- a) A more detailed description of the improvements that are included in the valuation retaining walls, underground services, common property, and other site improvements etc. Also, clear detailing of improvements that have been excluded from the valuation.
- b) 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. As some items of fit-out can be Tenant owned, it is important to seek confirmation from the client as to what is to be included / excluded from the valuation.
- c) Insurers require information as to the nature and value of shared property to make appropriate allowances for insurance risk on that shared property. These can include shared driveways or other such common areas. In terms of cross-lease properties where multiple insurers can be involved, unless improvements lie within an area of land defined in the Flats Plan as exclusive use, the insurers pro-rata the total reinstatement cost over the total number of Flats. In a Unit Title situation however, there is only the one insurer. The valuation should clearly state how such "common property" has been treated.
- d) Aerial photo and location map.
- e) Inclusion of a Value summary into a table format if multiple improvements are being valued (as shown in Addendum B).
- f) For residential properties, inclusion of a Value summary into a table format separating any Recreational Features, Retaining Walls, or Special Features (as shown in Addendum C).
- g) The certificate should only include those values or estimates required or requested. If a market related indemnity value, functional replacement or indemnity inflation estimates are required columns should be added to hold this data.

The requirement for additional information in many cases may make it impractical to include all relevant information on a 1-page summary or certificate. Accordingly, industry stakeholders have requested, and members are encouraged to provide a summary similar to the historical certificate as shown in the Addendum B with additional information on subsequent pages including an aerial photo, location map and more comprehensive construction detail and other matters (if required) together with the appropriate definitions and limitations.

The insurance Council has requested that Valuers include a depreciated replacement cost as detailed herein which provides for physical depreciation only.

In some circumstances such as where an indemnity insurance policy is in place, a Market based indemnity value may be required. This should be confirmed by the client as part of the instruction.

As a reminder, Section 5.6 of this GP refers to the treatment of GST.

Where a home insurance valuation is provided on a plus GST basis, it is recommended that a GST inclusive total amount also be shown in the summary.

A2.2 Asset Description

Members should include in the summary a condensed description of the insured assets and clarifying what is excluded from the assessment. For buildings, a general description of the main building(s) including main construction components, and site development should be provided. The description needs to be clear as to what plant & equipment as well as underground & overhead services are included.

For the purposes of the underwriter's 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.

For residential properties, identification of improvements that fall under the categories of Recreational features, Retaining walls and Special features together with confirmation within the report as to whether these improvements have been included or excluded within the valuation.

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.

If publicly available, comment should be made as to any likely impacts because of hydrology issues (flood plains, overland flow paths, flood prone areas, etc) and land subject to liquefaction or within close proximity to a fault line, etc. Such environmental

matters may impact on foundation / structural designs that would be over and above the 'modern equivalent'.

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. Valuer's classification of the land contour containing building and immediate yard areas, common terms include Level; Gentle; Easy; Medium and Steep and may include a comment if the land is retained.

A2.6 Subsoil Type (Building valuation)

This information is required by Underwriters as a broad indicator of seismic stability and other geological land risk factors such as potential liquefaction and fault lines. An entry should only be made in this portion of the report when the valuer has accurate knowledge as to the sub-soil type.

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.

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 a particular topic, e.g. tenant fit out exclusions, locational factors, surrounding property uses, hydrology issues (flood plains, overland flow paths, flood prone areas), 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. Because of FENZ and EQA requirements some stakeholders may require the value of the residential component to be separately shown.

A2.9 Reinstatement Cost Estimate (1.0 A)

The definition which is included in 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 5.1 of this GP) 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.

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 12-month insurance period, 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

This is the estimate of the loss that would be suffered by the insured in the event the asset was destroyed.

Members may be requested to undertake a market related indemnity value estimate utilising a depreciated replacement cost estimate or other alternative methodology that would assist in identifying the loss in economic value the improvement(s) had to the insured. The New Zealand Insurance Form (Addendum B) provides two options for reporting indemnity, being Market Related Value and Depreciated Replacement Cost. Where an alternative method is provided, the method should be clearly detailed on the form, the scope of work and explained within the report.

Indemnity Values are also provided for the purposes of calculating Fire and Emergency Levy's and for this purpose, a number of items can be excluded from the assessment. This is detailed below in the Depreciated Replacement Cost Section as this is the primary method used for this purpose.

The valuation scope of work / report should reference the methodology applied in assessing indemnity value, acknowledging the comments in this section of this TIP. A suggested explanation of the approaches to indemnity is provided as follows:

Market Related Estimate

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.

This may be assessed using the sales comparison approach, income approach or the depreciated replacement cost approach as appropriate.

The assessment excludes any land and will be the added value that the assets give to the market value of the land (assuming that, if appropriate, the property is leased at market rental). Should the insured wish to have an indemnity estimate considering other factors such as 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. Furthermore, should the client wish to have an indemnity estimate reflect economic value lost, then this should be stated by the valuer, along with a clear explanation as to how the Indemnity Value has been derived under this specific method.

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.

However, the actual loss to the insured may differ from the market value of the asset (refer to Falcon v State Insurance 1975). Where a Market Related Estimate is provided, and the Member considers that this figure may not be consistent with the actual loss, a clear statement noting any potential disparity should be provided in the scope of work/report accompanying the Insurance Form.

Depreciated Replacement Cost (DRC)

The commonly used definition is included on the form. DRC is the current cost of replacing an asset with its modern equivalent less deductions for age and physical deterioration. The value does not allow for economic obsolescence (if any).

For plant and equipment, DRC also considers technological and functional obsolescence. The value does not allow for economic obsolescence (if any).

DRC for Replacement Policies

This estimate is required by most insurers to consider whether they will offer replacement insurance on assets which are near the end of their useful life. As the DRC may bear little relationship to the market related value of the building or the true insurable "indemnity value" as defined by case law, a clear statement noting the potential disparity between both methods should be provided in the scope of work/report accompanying the Insurance Form. It is also for this reason that this approach may not be suitable for application in case of a claim.

DRC for assessing Fire and Emergency Levies

DRC is also commonly relied on for the purposes of calculating Fire and Emergency Levies. When provided for this purpose, the act allows several items to be excluded from the assessment. These are detailed in Section 47B (third schedule) of the Fire Services Act 1975. If provided for this purpose, It is recommended that members qualify the documented Indemnity Value highlighting that this has been calculated for the purposes of assessing Fire and Emergency Levies only.

A2.12 Inflation Provision (Indemnity)

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 more than depreciation over the same period, but indemnity inflation is common for buildings and other assets that depreciate slowly.

A2.13 Functional Replacement Cost

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.

Members should consult with clients prior to assessing on this basis.

A2.14 Demolition Estimate

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, (whilst excluded from the assessment) 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 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.

A2.16 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

Name of Client: Body Corporate No XXXX, Address of

Assets: XX, City

Asset

Description: 20 level apartment/hotel tower including four basement carparking levels. Studio, one, two and three bedrooms plus penthouse unit configurations. Ground floor reception, lounge, restaurant, swimming pools, spa pool, sauna, fully equipped gym and changing room facilities.

Construction: Reinforced concrete foundations and floor slabs, steel structural frame. Exterior cladding comprises concrete block, concrete panel and 'alucobond' aluminium composite panelling with aluminium joinery and tinted glazing. Profiled steel roof. Airconditioned, sprinklers, fire alarm, CCTV security system. Tiled balconies with metal and glass balustrades. Internal walls and ceilings are plasterboard, with carpet and tile floor coverings. Good quality residential appointments. Two 13 person 1,000kg passenger lifts to all levels. Entrance Canopy. Site sealing, landscaping and signage.

Services: Underground services include 3 Phase power, Gas, Fibre optic Data & Telephone cabling, Water supply, Wastewater & Stormwater disposal.

Construction

Date: 2003

Use/Occupation: Residential – Level 5 and above, 187 residential apartments Commercial - Unit A, Office & reception; Unit B, Restaurant.

Contour: Level (1) **Soil Type:** Unknown.

Other: The Depreciated Replacement Cost has been assessed for Fire Service Levy calculation purposes only. The assessed value excludes some elements of the insured property which are exempt from the Fire Service Levy

ASSET	REINSTATEMENT ESTIMATE	REINSTATEMENT INFLATIONARY PROVISION	DEPRECIATED REPLACEMENT COST ESTIMATE	DRC INFLATIONARY PROVISION	DEMOLITION ESTIMATE
Building 1 Retail	\$2,000,000	\$160,000	\$1,200,000	\$60,000	\$200,000
Building 2 Offices	\$1,500,000	\$120,000	\$900,000	\$45,000	\$150,000
Building 2 Residential	\$3,000,000	\$240,000	\$1,800,000	\$90,000	\$300,000
TOTAL (excl GST)	\$6,500,000	\$520,000	\$3,900,000	\$195,000	\$650,000

VALUERS

SIGNATUR

E NAME

INSPECTION DATE:

INSURANCE PERIOD:

- (a) *All figures quoted are exclusive of G.S.T, Finance costs, Relocation expenses 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 Explanations, Assumptions and Disclaimers of terms etc on the following pages.*
- (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.*

EXPOSURE DRAFT

Addendum C - New Zealand Insurance Form (Domestic 'Home Policies')

Name of Client: XX

Address of Assets: XX, City

Asset Description: Single level 3-bedroom residential dwelling with 2 bathrooms. Timber decking. Internal access double garaging. Detached metal clad unlined storage shed with power supply. Concrete driveway. Exposed aggregate and tile paving. Timber and concrete block fencing.

Construction: Concrete foundations, timber weatherboard and brick veneer external walls, double glazed aluminium framed window joinery and pressed metal tile roof cladding.

Recreational Features: Inground concrete swimming pool & associated pump equipment

Retaining Walls and Special Features: Not Applicable

Services: Gas, Fibre optic Data & Telephone cabling, Water supply, Wastewater & Stormwater disposal.

Construction Date: 2008

Use/Occupation: Residential

Contour: Level (1)

Soil Type: Unknown

ASSET	REINSTATEMENT ESTIMATE	REINSTATEMENT INFLATIONARY PROVISION	DEMOLITION ESTIMATE
Main Building & Other Improvements	\$500,000	\$25,000	\$40,000
Recreational Features	\$60,000	\$4,000	\$5,000
Special Features			

Retaining walls			
TOTAL (incl GST)	\$560.000	\$29,000	\$45,000

VALUERS SIGNATURE: NAME:

INSPECTION DATE:

- (a) All figures quoted are inclusive of G.S.T
- (b) All figures exclude Finance costs, Relocation expenses and other indirect costs.
- (c) All figures are exclusive of any allowance for land value.
- (d) This form must be read in conjunction with the Explanations, Assumptions and Disclaimers of terms etc on the following pages.
- (e) 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.
- (f) All figures assume compliance with building regulations and bylaws.

Definitions of Insurance Valuation Terms

The following information forms an integral part of the valuation on the preceding pages.

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. Any exclusions should be noted.

Construction:

Includes details of the principal & ancillary structures and describes the main construction materials.

Upgrade Requirements:

Typically, it will be helpful to summarise major difference between the insured asset and the modern equivalent asset.

Age:

Estimated year of construction and dates of, or reference to any major additions and upgrades.

Use/Occupation:

Nature of main activity carried out at location. A separate schedule may be provided for multiple tenancy buildings.

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:

As a geotechnical survey has not been undertaken the description is without prejudice and is based upon a visual inspection only.

Other Known Characteristics:

Additional information that assists in quantifying the parameters of the risk to be insured.

Reinstatement Estimate:

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. Geotech requirements for a replacement building may differ from those relating to the existing structure.

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.

EXPOSURE DRAFT

Functional Replacement:

Where provided this 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.

Inflationary Provisions:

This amount has been estimated based on a loss occurring on the last day of a 12-month insurance period, if appropriate.

Inflation provisions on Reinstatement and Functional Replacement estimates incorporate 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.

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.

Market Related Indemnity Value:

Where provided this 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 sales comparison approach, income approach or the depreciated replacement cost approach as appropriate.

Depreciated Replacement Cost:

This cost has been calculated utilising the estimated reinstatement cost allowing for normal physical depreciation only. If relevant it also takes due note of any significant upgrades or accelerated deterioration. This method is not market based and accordingly, the value may bear little relationship to the market value of the building or the true insurable "indemnity value" as defined by case law. It is not an estimate of the loss that would be suffered by the insured if the asset were destroyed.

Demolition Estimate:

For valuation, it is assumed that 100% of the assets have been damaged beyond repair and have no salvage value.

Unless otherwise noted the Demolition Estimate covers the cost of demolition and removal of debris of the assets described only and excludes the cost of removal and disposal of any noxious materials or removal of debris from adjoining premises, unless otherwise specified.

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

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

EXPOSURE DRAFT