

Reinstatement Cost Assessments

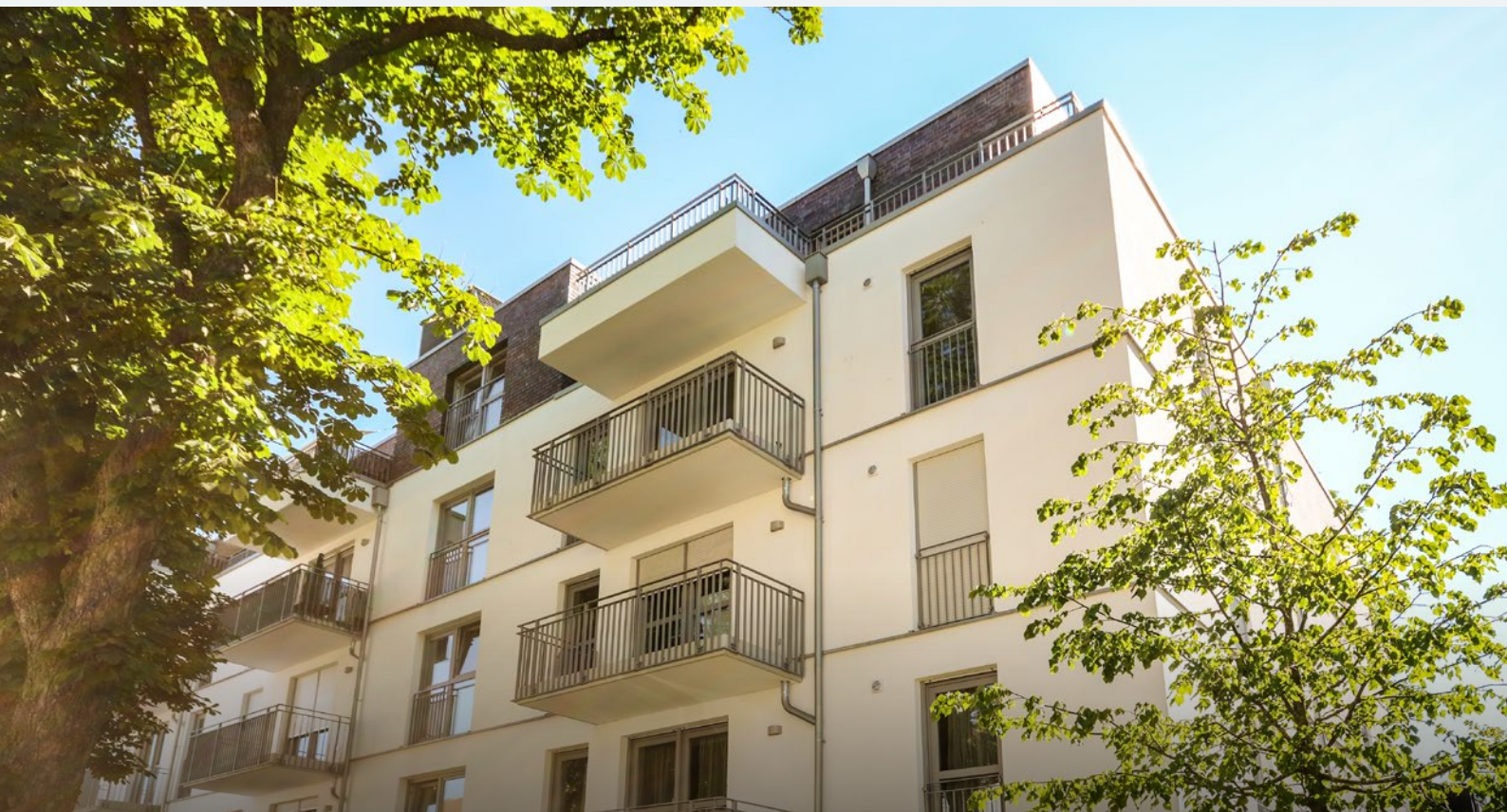
A Comprehensive FAQ for Property
Managers and Landlords

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Q What does 'Reinstatement Cost' mean?

A The reinstatement cost, or reinstatement value is what it would cost, hypothetically, to reconstruct a given building from scratch to modern day building regulations but keeping the visible exterior and standard of fit-out in the interior more or less the same.

Q What is the difference between the Declared Value and Sum Insured, and which is given in the RCA report?

A The Declared Value (DV) is the full reinstatement value which is calculated by your surveyor conducting the RCA. The DV is the figure presented in the RCA report.

The Sum Insured (SI) is set by the insurer for the building, not the surveyor. The SI is the DV plus a provision for inflation which is typically 20% to 50% of the DV.

For instance, a DV of £5,000,000 as calculated by your RCA surveyor would become an SI figure of £6,500,000 after a 30% uplift as applied by the insurer.

For the purposes of an RCA, you only need to think about the DV.

Q Are there any other commonly used terms for an RCA?

A Yes:

1. Building Reinstatement Valuation
2. Building Reinstatement Cost Assessment
3. Insurance Valuation
4. Insurance Rebuild Cost Assessment
5. Fire Insurance Valuation

You may find other terminology used in older leases but RCA is the most up to date description and certainly the one used by RICS.

Q A lease for a building I manage requires a "fire insurance valuation"? Is this the same thing as an RCA?

A Yes — this is a term used by older leases and some lenders to emphasise the original purpose of buildings insurance — to cover against the risk of fire. Not a lot of people are familiar with this term though, and we would not recommend using it or asking for it.

Q What are the potential consequences of failing to organise regular RCAs?

A Underinsurance or overinsurance. A building may be insured for too high a DV, meaning the landlord, leaseholders or tenants (or all three) are paying too high a premium. This is overinsurance.

If the building is insured for too low a DV, then the insurer may pay a claim out in proportion to the underinsurance. They will exercise the 'average clause' in the policy wording. For instance, a building insured for £1 million that should be insured for £1.5 million is therefore 50% under-insured. In this scenario, an insurance claim for say £14,000 would only yield a pay out from the insurer of about £9,333, leaving the policyholder (e.g. landlord/freeholder/RMC) to pay the difference.

Q

If the DV is found to be inaccurate, what are the potential implications?

A

Similar to the consequences of failing to organise RCAs regularly, a DV that is too high will mean the contributors to the insurance premium are paying too much, and that could result in a claim against the landlord/freeholder. And if the DV is inadequate, underinsurance results, which may severely affect a pay-out from the insurer in the event of a claim.

It is not only crucial to have a reinstatement cost assessment carried out; it is equally important to ensure the surveyor appointed is suitably qualified. RCAs are a specialist area of surveying.

Q

How is the 'Reinstatement Cost' actually calculated?

A

That is for us to worry about! Briefly, we measure the building using the 'International Property Measurement Standards'. We obtain a 'building footprint' for each level of the building which often varies floor-by-floor. We examine the building components both externally and internally, and on every façade, and make reasonable assumptions based upon our knowledge and experience of buildings over what the superstructure, frame and hidden structural composition of the building will be.

We then carry out an 'elemental take-off' which is quantity surveyor speak for adding up roughly what all the different parts of the building would cost in a fair market. This forms the basis of our 'raw calculation'.

We then update our raw figure forward from the year and financial quarter the data originated, to whatever quarter of whatever year we are in at the moment e.g. Q4 2018 to Q3 2021, using a measure of inflation called the 'Tender Price Index'.

Most of the data EK RCA uses is from central London or sometimes provincial south east of England outside of London which has a Location Factor (LF) of about 112 at the time of publication — such is the variation in regional cost pricing across the country. So we then update this figure from the region the data came from, to the local area where the subject property is through a Location Factor Index. This ranges from around 130 for the most expensive Boroughs of central London down to the low 60s for certain parts of the north of England and Northern Ireland.

Finally we add on demolitions costs, planning and statutory fees which can vary from region to region and situation to situation. We make a judgement on VAT sometimes determined by the client and finally derive the final end 'Declared Value' (DV).

Q

What effect does the DV have on the insurance premium?

A

The insurer for your buildings will calculate the premium paid for each building by applying a rate (percentage) multiplied by the DV.

e.g. DV (£5,000,000) × 0.1% = £5000.

To this premium of £5000, insurance premium tax (IPT) is added, which is currently 12% for buildings insurance. The premium the client pays is £5600.

If terrorism insurance is applicable, the same DV is multiplied by a different rate (percentage) to calculate separate terrorism insurance premium.

e.g. DV (£5,000,000) × 0.04% = £2000.

IPT is also applicable to terrorism premiums, so the £2000 becomes £2240.

So you can see that the higher the DV, the higher the premium, everything else remaining equal.

Q How often should an RCA be done?

A The RICS October 2018 guidance note recommends a “major review” is carried to a building’s reinstatement cost “every three years or earlier should significant alterations be made” with annual adjustments made “to reflect inflationary effects”.

Our interpretation of the RICS guidance is to conduct a full RCA (site survey) every three years, with desktop reviews on a yearly basis. You may wish to rely on index linking of the DV imposed by your buildings insurer or instruct your surveyor to carry out a desktop review of the latest full RCA.

We carry out desktop updates ahead of insurance renewal dates at the end of the first and second years, often free of charge, where no significant changes have been made to the building in question. Yearly updates help property managers to budget more accurately and avoid potentially large variances every three years.

Q Whose responsibility is it to commission an RCA?

A The leases in place will determine the responsibilities for insuring the building in question and conducting RCAs. If the insuring responsibilities are unclear, please seek legal advice. For residential buildings, the responsibility normally falls to the managing agent on behalf of the landlord, but some landlords retain this responsibility in-house, hence our RCA work is for both managers and landlords.

With commercial buildings, if one tenant has the headlease under a ‘Fully Repairing and Insuring’ lease (FRI) it will normally be the head lessee who organises the RCA and insurance policy procurement, although not always. Sometimes in these situations, the freeholder will want to commission the RCA but then have the head lessee organise the insurance policy procurement and pay the premium.

With multi-tenanted commercial buildings it is common for the tenants to have ‘Internally Repairing Only’ leases where they only insure their own possessions and fit-out. Someone will still insure the common parts and envelope of the building, and this will normally be the freeholder or head lessee. The responsibility for organising RCAs and choosing the insurer, could rest with either the freeholder or head lessee, depending on the lease set-up.

Q Is an RCA on a residential or commercial building a legal requirement?

A No. It is up to the stakeholder what they insure their building for, however in a multi-occupied building containing leaseholders, tenants, or both, there will be lease agreements in place which compel the freeholder to insure the building for its full reinstatement cost or words to that effect.

It is commonplace for insurers to demand RCAs for listed buildings, or buildings thought to have DVs in excess of £600k which includes most properties other than single dwellinghouses. Even some two-unit split level maisonettes in terraced streets can have DVs in excess of £600k these days.

Q Do I need to provide you with any reports before asking you to conduct an RCA?

A Yes please. A copy of the latest health and safety/fire risk assessment would be useful. A copy of an asbestos survey can be very important indeed, as widespread asbestos in a property could have a significant impact on the DV, because removing asbestos is a specialist trade and expensive as a result.

Any plans and drawings you have of the building/development can be very useful in identifying the extent of the demise (what’s included, what isn’t), and details of the actual structures too.

Q

If my building has a claim, will the insurer check the DV before processing it?

A

Irrespective of the value of the claim, the insurer may check the DV. For larger claims, the loss adjuster will almost certainly check the DV and report to the insurer if they believe the DV is too low. Remember that if the DV is too low, the insurer may apply the 'average clause' and pay out the claim pro rata. In the worst case scenario, the insurer may attempt to repudiate the entire claim.

Q

My client's buildings insurance policy is index linked, which means the DV goes up every year by a percentage. Do I still need to do an RCA every three years?

A

Index linking *may* be sufficient to keep the building in question appropriately insured for its full reinstatement cost. However, we regularly assess buildings where the index linking has been inadequate so relying solely on that is risky. One reason for this is that the original assessment cost may have been calculated a long time ago, thus inflationary amounts added annually have been unable to keep pace with actual inflation on the ground.

Legislation and best practice can also change as well. In the last 10 years for instance, the pendulum has swung increasingly towards including VAT in declared values even in fully residential scenarios. See our white paper on this matter [here](#).

Q

When I receive an RCA report from you, what should I do with it?

A

First and foremost, you will want to inform your client, as it's their building and their decision as to what their building is insured for. Most clients will expect their property manager to inform the insurance broker of the new DV, and the broker will liaise with the insurance underwriter to apply that number.

If you work with us across your portfolio, we will track every RCA done on behalf of your clients which will include the percentage increase or decrease compared to the current DV. That means you can give your clients the new value and the change from the current figure in percentage terms. e.g. "your building is under-insured by 11%".

Most insurers will apply the new DV right away which means you are likely to receive an invoice for the uplift in premium, assuming the DV has gone up. If the DV has decreased following our assessment, you can expect a credit from the insurer, and they will apply the newly ascertained DV when the policy renews.

Some clients ask for permission from the insurer to apply the DV at renewal, rather than mid-term. The important thing is to ensure the insurer knows the result of the RCA. Whether they apply an increase to the premium or not, is their decision.

Q

Is the DV related to the market value of the building?

A

No. The value that a property is worth for sale is usually a very different number to its rebuild cost. For instance, a block of flats in central London with a DV of £4 million may command a market value of well in excess of £10 million.

Conversely, there are buildings in parts of country that would cost more to reinstate than their market sale value. We frequently find that converted mill or warehouse buildings in the Manchester or Leeds areas often have rebuild values in excess of the sale values of all the flats put together, even though they are considered trendy and desirable areas to live in. In certain parts of country, especially in depressed post-industrial areas, there are ordinary residential houses built in the 1960s that are now worth less in private market sales than they would cost to rebuild. Look up some of the old mining villages between Sheffield and Doncaster on Zoopla, or the South Wales coal valleys. Hartlepool, Blackpool and certain streets in Liverpool also have shockingly low house prices.

Q Can RCAs be done without visiting the property?

A Yes but more accurate figures can be obtained from an on-site survey. Huge miscalculations can be made on the basis of the wrong assumptions made from Google Earth and Google Street View. If you are commissioning an RCA on a desktop basis, be sure to provide your surveyor with accurate plans of the externals and every storey level, ideally elevations as well. If you cannot do this, a physical on-site inspection may be essential to ensure the correct DV is calculated.

Surveyors who carry out desktop RCAs routinely over-value properties because they do not have the benefit of knowing what is actually inside them, and consequently they are fearful of setting the DV too low. Over-assumptions on fit-out and finishes will generate too high a DV. Any savings made by commissioning a desktop assessment vs a full inspection are likely to be erased — and surpassed — due to the higher insurance premium resulting from the unnecessarily inflated DV!

Q Is there ever a prudent time to commission a desktop RCA instead of one based on a physical inspection?

A If you're insuring hundreds of near identical buildings, you might elect to have your surveyor carry out physical on-site inspections on a couple of examples and then 'desktop' the rest using the full RCAs to derive a functional unit rate. This will be an uncommon occurrence for you however, so the short answer is very rarely.

Q Has COVID-19 changed the way you conduct RCAs?

A We currently wear facemasks whenever inspecting internally. We carry hand sanitiser and where we are allowed to inspect leaseholders' apartments and tenants' demises, we are particularly careful and only do this with their informed consent.

Successive lockdowns have meant we have had to assess many flats without viewing them first-hand or measuring them ourselves. We have a raft of alternative approaches we can call upon to provide accurate valuations that we have become known for. These include the use of GIS satellite data; trawling through the EPC records in domestic settings or business rates data to obtain floor areas in commercial units; freely available online sales; council tax banding; and marketing literature can also be a goldmine of information, so we do not necessarily need to enter dwellings these days in order to understand accurately what they are like inside.

Our preference — to ensure accurate results — is to inspect in person.

Q

For a residential block, do you need to visit each flat to ensure an accurate DV?

A

No. Access to a representative flat or flats is very helpful and welcomed. For particularly opulent flats which are in stark difference to the rest of the units, a special visit is advisable.

Q

If I commission an RCA and the new DV is wildly different to the old DV from 3 years ago, what do I tell my client?

A

Normally if you drill down into it, there will be a difference in the original instructions given to the two surveyors. Check to see if the recent DV was derived from an elemental (more accurate) form of analysis; perhaps the old one was derived from the more generic and often deceptively lower cost 'functional unit rate' method. If there is a difference between calculation methodology, it is not unusual to see vast differences with the DVs. Check to see if the changes between GEA/IPMS have influenced the calculation: are the balconies now being included? Did the lower DV exclude external areas etc? Was the first RCA a 'desktop' survey and so the building was not surveyed?

If you've exhausted these checks and there is still an unexplained discrepancy, then send both reports over to us and we'll see if we can untangle it for you.

Alternatively, consider ordering a "double-blind" RCA from us: instruct us without letting us know the previous DV, or the recently received contested one, and see what we produce. Then get all 3 surveyors to a meeting and thrash it out there. If all three survey instructions are accurate comparisons with each other, the third survey report will probably agree with one of the others, in which case the errant party will probably end up offering to refund you their fee. If they do not, you have a very good case for a complaint, and with any RICS firm that will be taken very seriously by an independent third party on your behalf.

Q

How should I deal with a surveyor who is unwilling to show their calculation methodology?

A

Challenge them. No surveyor worth their salt should be afraid of showing you their methodology, rates or calculation build-up. It's often unhelpful to share this publicly with every stakeholder in a development, as it can lead to subjective analysis and misunderstanding, but there is no reason why an informed property manager or director of an RMC/RTM with a reasonable layperson's understanding of insurance should not see the methodology behind the figures. It's basic arithmetic at the end of the day, not rocket science.

Q

How would you go about valuing the reinstatement cost of a building with timber balconies or cladding at the moment?

A

The same way we would value any other building with a deleterious component: we would allow for equivalent replacement with a contemporary material — see [our blog](#) on this exact subject, as we explain our rationale behind this most topical of issues.

Q What PI cover level should your surveyor be holding to carry out RCAs?

A We recommend that a reasonable margin of error to protect the insured would be 10% of the DV, i.e. if a surveyor is valuing a £50 million building they should be holding £5 million of PI cover.

Large estates running into hundreds of millions are rarely insured under one singular policy, and the risk can be spread by simply asking the surveyor to break down any one singular figure that exceeds 10x their PI cover limit into sub-DVs, or separate reports. This is a common approach across the industry, and one of the reasons why smaller firms can get involved with quite large RCA instructions without risk to their clients.

Q If you are doing a reinstatement cost assessment for a large estate that includes lots of buildings separately insured or in different cost centres, how do you divide your DV figures accordingly?

A Our RCAs will be itemised so that you can give the insurer DV figures for each separately insured or itemised building or unit. Often, we separate commercial premises from residential, as the freeholder of the building invoices the commercial elements separately from the apartments.

Please let us know in advance of instruction how you would like the DVs broken down, assuming a breakdown is necessary.

Q Do your RCAs include all plant and equipment in a building, such as a communal boiler system or a lift?

A Yes, if it's a fixed item to the building, then it's included. We generally exclude furniture, moveable items and anything that could conceivably form part of the 'contents' of the building as these tend to be separately assessed. In commercial buildings, we are sometimes asked to exclude commercial fit-out beyond 'Cat A'. And other times we are asked to include it in full reinstatement. If excluding, in industrial settings these exclusions can be enormous (we could end up deducting out factory assembly lines and millions of pounds worth of manufacturing equipment) but in a residential setting it is generally restricted to common parts furniture.

Q Aside from the 'bricks and mortar' cost of rebuilding, what else goes into your calculations?

A Our RCAs provide you with DVs that include the costs of demolition, professional fees (e.g. surveyors, structural engineers), statutory authority fees, VAT and other costs that could be relevant when rebuilding or reinstating.

Q Which elements of the RCA have VAT applied to them and which do not?

A This is a complex area and our [white paper](#) on this subject details our approach. Generally speaking, VAT is applied nearly all of the time, but there are certain specific circumstances regarding total or near-total losses involving purely residential buildings or buildings owned by charities where it may be possible to claim back the VAT from HMRC.

Q **If a residential leaseholder undertakes a substantial refurbishment of their apartment, should I organise an RCA after they have completed the works? If so, who should pay?**

A The cost of replacing all insured fixtures and fittings may not be close to the price paid for them, so that whilst the DV will almost certainly increase overall due to an expensive refurbishment of a particular apartment, it may not increase as much as you might imagine. It would be reasonable to procure a new RCA to take into account the works. If this is the only substantial change since a full RCA was carried out, the same surveyor could reasonably carry out a desktop assessment, given he/she is provided with sufficient detail on the apartment works (plans, photos, costings). If agreed beforehand and as part of a licence to alter, the cost of the reinstatement cost assessment can be passed on to the owner of the apartment.

High-end kitchens and bathrooms are regularly sold privately to consumers with enormous hidden profit margins. Much of the 'costs' are in 'perceived value' that a premium manufacturer or designer adds to a product. Private consumers will be procuring all their installation costs at a premium from subcontractors who will basically charge them inflated day-rates. A main contractor may have these operatives working in-house for them, and even when subcontracting will achieve a better deal than a private consumer could.

Q **If a lower ground floor flat builds an extension, will that affect the DV and should I commission a new RCA?**

A Whilst an internal flat refurbishment may marginally affect the DV of the whole building, an extension to a ground floor flat will definitely have a significant effect, pushing the DV upwards. The extension would have required the necessary permissions and as part of that consent process, the cost of a new RCA ought to be borne by the leaseholder in question, unless the RCA was due in any case. It is possible that the landlord will insist on a recalculation of the insurance premium apportionment or indeed the service charge apportionment as a whole, given the lower ground floor now enjoys a larger floor area. If, however, a new storey is developed on top of an existing block of flats, then a re-apportionment of the service charges will be certain.

Speak to us about any eventuality that may necessitate a new RCA following substantial works to a building. We can provide values in advance of the works, during the works, or after the works. Quite often we provide a before (provisional) valuation so that everyone knows roughly where they stand, followed by a free of charge 'follow-up' inspection once the project is complete to make a final edition report with any minor changes necessary.

Q **Do listed buildings require a different approach when doing an RCA?**

A The technique for valuation is more advanced and in order to be accurate this would need to follow the elemental cost assessment method which we employ for all valuations. Listed buildings cannot be valued accurately using the generic 'functional unit rate method' which many surveyors use on simpler rectilinear estate housing.

Specialist period construction techniques data is not readily available in pricing books or databases. For instance, you won't find cost data on thatching in SPONS pricing book or on the BCIS. But if the surveying firm undertaking the RCA has experience in the listed building sector (as we do) they may have their own unpublished 'in-house' data on a variety of period construction techniques and be able to make informed judgements on the reinstatement costs of just about any historic or period building technique.

Call us today if you have a question not covered in our FAQ.



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At EK RCA we work with all types of buildings, from single houses to residential blocks and commercial properties.

This means we bring a range of building surveying expertise to bear, rather than looking at RCAs in isolation.

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