# REPLACEMENT COST ASSESSEMENTS

## AN AIQS INFORMATION PAPER

AIQS

AUSTRALIAN INSTITUTE OF QUANTITY SURVEYORS

1st edition published July 2019
ISBN  978-1-876389-40-6

© Australian Institute of Quantity Surveyors Ltd (2019)

Any reproduction of copyright material must acknowledge the Australian Institute of Quantity Surveyors (AIQS) as the source of any such material reproduced.

Australian Institute of Quantity Surveyors Ltd
Level 3, 70 Pitt Street, Sydney NSW 2000 Australia
www.aiqs.com.au

## CONTENTS

## *INTRODUCTION*

### PURPOSE

The purpose of this Information Paper is to:

1. inform AIQS Members and their clients on factors impacting replacement cost assessments
2. establish a common approach to undertaking replacement cost assessments (e.g. providing relevant cost advice for inclusion in insurance reports covering events resulting in partial or total destruction/ loss of a building or other asset, in the drafting and notifying disclaimer clauses and qualification statements)
3. inform AIQS Members and their clients of common insurance inclusions and exclusions relating to replacement cost assessments
4. provide a checklist of items that the AIQS Member and their client should be aware of in relation to replacement cost assessments.

### STATUS

This Information Paper is intended to embody recognised best practice and therefore may provide some professional support if properly applied.

This Information Paper does not purport to be a comprehensive description of the law and AIQS Members should obtain independent legal advice as required. Particularly regarding strata buildings where relevant State and Territory legislation applies.

While this Information Paper is accurate at the time of publication, readers are advised to confirm relevant legislation and insurance requirements prior to undertaking a Replacement Cost Assessment, as these may change from time to time.

### APPLICATION

This Information Paper is pertinent to Members providing advice on Replacement Cost Assessments (e.g. reporting to clients on cost of replacement of building or other assets for insurance purposes).

Consistent with the AIQS Code of Conduct, an AIQS Member must operate within the limits of his or her qualifications and experience and must not accept instructions in a field of practice in which he or she possesses insufficient knowledge and skill to provide competent services to the client, unless the Member obtains fully informed consent from the client to undertake the services in conjunction with a person having the required competence.

Members undertaking Replacement Cost Assessments for insurance purposes require a broad range of professional skills and experience, including an understanding of:

- costs for the construction or supply of assets of a similar size and utility
- demand and supply of building materials and labour, professional services and planning and building approval processes which determine the timeframe for rebuilding
- installation and commissioning costs and timeframes for plant and machinery insurance valuations
- planning scheme provisions which could affect whether a building can be rebuilt in its present form
- heritage issues
- escalation of building costs
- market rental values (for loss of rent or allowance for alternative accommodation)
- the size and extent of all improvements including building structures and ancillary improvements.

## *MINIMUM REQUIREMENTS OF THE QUANTITY SURVEYOR*

### EXPERIENCE

The preparation and delivery of Replacement Cost Assessment reports should be undertaken by a Corporate Member of AIQS, holding the Certified Quantity Surveyor (CQS) designation.

Any employees undertaking this service must be supervised by a suitably experienced Corporate Member.

## PROFESSIONAL INDEMNITY INSURANCE LEVELS

To ensure that appropriate and not excessive levels of professional indemnity insurance (PI) are not called for, AIQS recommend the following levels of coverage:

| Construction Cost (excluding GST) | Level of PI |
|---|---|
| $ 0 – 5m | $ 1 m |
| $ 5.01m - $10m | $ 3m |
| $ 10.01m + | $ 5m |

## CONFLICTS OF INTEREST

Any conflicts of interest (real, potential, or perceived) such as previous involvement in the project or other services being provided for the Developer should be disclosed immediately to the client. These should not necessarily preclude the Quantity Surveyor from undertaking their role unless they are of a nature which may in practice or in perception prevent the Quantity Surveyor from acting on behalf of the client in an independent manner.

## LIMITATION OF SERVICE

Recognising that while the Quantity Surveyor is an expert in construction costs, they may not be experts in quality of workmanship or programming, and therefore, should limit their comments to areas in which they are competent to do so. Notwithstanding this, the Quantity Surveyor should make observations with regards to workmanship and programming based on their level experience.

Any change in the underlying land-use, zoning or planning control post the provision of the Quantity Surveyor's assessment will not be included in the Quantity Surveyor's scope of work. Clients should be advised that where such a change occurs, a new Replacement Cost Assessment should be undertaken.

It is not the role of the Quantity Surveyor to provide an opinion pertaining to the value of the site or the expected realisation of the development.

# *ASSESSMENT*

## REASONS FOR PREPARING REPLACEMENT COST ASSESSMENTS

Replacement Cost Assessments for insurance purposes are required to be prepared when insurance is being taken out and/or when a disaster has occurred. Preparing Replacement Cost Assessments requires a high level of construction knowledge, use and cost of materials.

Disasters can and will occur to many buildings and infrastructure assets during their lifetime, with fire being the main risk which needs to be insured. However, other risks such as bush fires, floods, cyclones and or earthquakes can cause widespread disasters.

Where the insurance policy (or client's instructions) includes a requirement for consideration to be given to market rental values (for loss of rent or allowance for alternative accommodation), this should be noted as an exclusion by the Quantity Surveyor and referred to the appropriate real estate professional as required.

However, once a disaster has occurred the cost of replacement will need to include meeting the current building regulations and escalation to completion of reconstruction.

The Replacement Cost Assessment report will include:

- reference to the Owners Corporation number (if applicable) and property address as listed in either the Registered Plan of Sub-Division or on "As-Built" documentation for the property
- a description of the building structure, services and finishings
- works external to the building, with the extent of works outside the building to be in accordance with the insurance policy
- building areas
- summary of costs
- photographs.

If there is anything unusual or special about the building this will also need to be noted e.g. car stacking systems, solar panels, and embedded power network equipment.

## THE ASSESSMENT

The Assessment will consider the following:

1. location
2. building construction costs
3. additional/updated statutory requirements
4. professional fees, including (but not limited to) Surveyor, Architect, Structural Engineer, Civil Engineer, Hydraulics Consultant, Quantity Surveyor, and Project Manager
5. development application and other authority costs
6. demolition and removal of debris
7. duration of demolition, design, and construction
8. escalation during insured period
9. cost escalation during demolition, design and procurement
10. cost escalation during construction.

The sum of the above is known as the Capital Replacement Value excluding GST. GST will be applied as per the current legislation.

A physical inspection of the asset being assessed for replacement insurance should be undertaken as part of the initial Replacement Cost Assessment. In circumstances where this is not possible (e.g. due to geographic remoteness) and in accordance with the client's instructions, a 'Desktop' assessment should be undertaken.

In undertaking a Replacement Cost Assessment in areas subject to widespread disasters such as bush fires, floods, cyclones and or earthquakes which will likely result in extensive damage/destruction to numerous buildings and/or infrastructure, the Quantity Surveyor should take into account higher than usual construction costs due to significant increases in demand for materials and labour.

It is worthwhile noting that some insurance policies may include exclusions covering bushfire, storm, flood or tsunami in the first 72 hours of the policy.

The replacement cost for plant 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 costs and non-recoverable taxes and duties.

It is important to note that escalation indices will likely vary between types of development projects.

## METHODOLOGY

A typical methodology for the preparation of a Replacement Cost Assessment may include the following steps:

- submit fee proposal and obtain client approval
- obtain available drawings
- confirm date for insurance commencement/ renewal from client
- seek details of any improvement to original building or client owned fit-out
- visit site and check building against drawings
- prepare measured estimate and price at current rates
- estimate demolition cost
- calculate professional fees
- prepare outline program for the whole of the works
- prepare escalation index for the period of the program
- calculate replacement costs and prepare report
- list items not covered by report for reference.

## *LEGISLATIVE REQUIREMENTS*

It is important for the quantity surveyor to confirm any legislative or regulatory requirements when undertaking Replacement Cost Assessments. This includes (but not limited to):

- ACT Unit Titles (Management) Act 201
- NSW Strata Schemes Management Act 2015 No 50
- Northern Territory Unit Titles Act 2016

- Queensland Body Corporate and Community Management Regulations 2008
- Queensland Retirement Villages Act 1999
- South Australia Strata Titles Act 1988
- Tasmania Strata Titles Act 1998
- Victoria Owners Corporations Act 2006
- Western Australia Strata Titles Act 1985
- Western Australia Community Titles Act 2018
- Insurance Contracts Act (Cth) 1984.

The following are examples of clauses typically found (or similarly worded) in the legislation noted above.

## ACT UNIT TITLES (MANAGEMENT) ACT 2011

### BUILDING INSURANCE BY OWNERS CORPORATION

(1) An Owners Corporation for a unit's plan must insure and keep insured all buildings on the land for their replacement value from time to time against all of the following risks:

(a) fire, lightning, tempest, earthquake and explosion

(b) riot, civil commotion, strikes and labour disturbances

(c) malicious damage

(d) bursting, leaking and overflowing of boilers, water tanks, water pipes and associated apparatus

(e) impact of aircraft (including parts of, and objects falling from, aircraft) and of road vehicles, horses and cattle

(f) anything prescribed by regulation.

(2) The Owners Corporation must take out an insurance policy that covers, to the greatest practicable extent:

(a) the risks mentioned in subsection (1)

(b) costs incidental to the reinstatement or replacement of the insured building, including the cost of removing debris and the fees of architects and other professional advisers.

Note: If a Developer is the only member of the Owners Corporation, the Developer must on behalf of the Owners Corporation take out an insurance policy under s (2), unless exempted under s 101.

(3) A regulation may make provision in relation to an insurance policy required to be taken out by the Owners Corporation under this section including for the following:

(a) payment by unit owners of any excess payable under the policy

(b) combining the policy with other insurance policies

(c) notification requirements by unit owners in relation to improvements made to units

(d) the proportion of the premium payable for the policy by particular unit owners by way of a general fund contribution

(e) valuation of the insured buildings.

(4) For all purposes related to any insurance taken out by it under this section, an Owners Corporation is taken to have an insurable interest in the buildings on the land to the extent of their replacement value.

## NSW STRATA SCHEMES MANAGEMENT ACT 2015 NO 50

### PART 9 INSURANCE; DIVISION 1 - OWNERS CORPORATION INSURANCE OBLIGATIONS; SECTION 160 - OWNERS CORPORATION TO INSURE BUILDING

(1) The Owners Corporation for a strata scheme for the whole of a building must insure the building and keep the building insured under a contract of insurance, in accordance with this Division, that insures the building if it is destroyed or damaged by fire, lightning, explosion or any other occurrence specified in the policy (a damage policy).

Section 161 - Requirements for damage policy

(1) General requirements

The damage policy for a building must be with an approved insurer, be in the name of the Owners

Corporation, and any other person required to insure under section 160 and provide for the following:

(a) the building is to be insured for at least the amount determined in accordance with the regulations

(b) if the building is destroyed, the building is to be rebuilt or replaced so that the condition of every part of the rebuilt or replacement building is not worse or less extensive than that part when new

(c) if the building is damaged but not destroyed, the damaged part of the building is to be repaired or restored so that the condition of the repaired or restored part is not worse or less extensive than that part when new

(d) expenses incurred in removing debris are payable

(e) the remuneration of architects and other persons whose services are necessary as an incident to the rebuilding, replacement, repair or restoration is payable.

(2) Limited sum liability

Instead of providing for work and payments being made if a building is destroyed or damaged, the damage policy may limit the liability of the insurer in that event to an amount specified in the policy. The amount must not be less than an amount calculated in accordance with the regulations.

(3) Parts of building to be covered

The parts of a building to be covered by a damage policy include the following:

(a) owners' improvements and owners' fixtures forming part of the building

(b) a building consisting entirely of common property

(c) anything prescribed by the regulations as forming part of a building for the purposes of this section.

(4) Parts of building not required to be covered

The following parts of a building are not required to be covered by a damage policy:

(a) fixtures removable by a tenant at the expiration of a tenancy

(b) owners' improvements and fixtures comprising paint, wallpaper and temporary wall, floor and ceiling coverings

(c) anything prescribed by the regulations as not forming part of a building for the purposes of this section.

## NORTHERN TERRITORY UNIT TITLES ACT 2016

### INSURANCE BY CORPORATION

(1) Subject to subsection (3), a corporation shall insure and keep insured all buildings and other improvements (including fittings and fixtures) on the parcel for their replacement value from time to time against all the following risks:

(a) fire, lightning, tempest, earthquake and explosion

(b) riot, civil commotion, strikes and labour disturbances

(c) malicious damage

(d) bursting, leaking and overflowing of boilers, water tanks, water pipes and associated apparatus

(e) impact of aircraft (including parts of, and objects falling from aircraft) and of road vehicles, horses and cattle.

## QUEENSLAND BODY CORPORATE AND COMMUNITY MANAGEMENT REGULATIONS 2008

### SECTION 178: INSURANCE OF COMMON PROPERTY AND BODY CORPORATE ASSETS

(1) The body corporate must insure, for full replacement value:

(a) the common property

(b) the body corporate assets.

(2) Subsection (1)(a) has effect only to the extent that the common property is not required to be insured under another provision of this part.

(3) A policy of insurance taken out under this section:

(a) must cover, to the greatest practicable extent:

(i) damage

(ii) costs incidental to the reinstatement or replacement of insured buildings, including the cost of taking away debris and the fees of architects and other professional advisers; and

(b) must provide for the reinstatement of property to its condition when new.

(4) The owner of each lot that is included in the community titles scheme is liable to pay a contribution levied by the body corporate that is a proportionate amount of the premium for a policy of insurance taken out under this section that reflects the interest schedule lot entitlement of the lot.

SECTION 179: INSURANCE OF BUILDING INCLUDING LOTS

(1) This section applies if 1 or more of the lots included in the community titles scheme are created under a building format plan of subdivision or a volumetric format plan of subdivision.

(2) The body corporate must insure, for full replacement value, each building in which is located a lot included in the scheme, to the extent that the building is scheme land.

(3) A policy of insurance taken out under this section:

(a) must cover:

(i) damage

(ii) costs incidental to the reinstatement or replacement of insured buildings, including the cost of taking away debris and the fees of architects and other professional advisers; and

(b) must provide for the reinstatement of property to its condition when new.

SECTION 180: INSURANCE FOR BUILDINGS WITH COMMON WALLS.

(1) This section applies if:

(a) 1 or more of the lots included in the community titles scheme are created under a standard format plan of subdivision

(b) in 1 or more cases, a building on 1 lot has a common wall with a building on an adjoining lot.

(2) The body corporate must insure each building mentioned in subsection (1)(b) for its full replacement value.

(3) A policy of insurance taken out under this section:

(a) must cover:

(i) damage

(ii) costs incidental to the reinstatement or replacement of the buildings, including the cost of taking away debris and the fees of architects and other professional advisers; and

(b) must provide for the reinstatement of the buildings to their condition when new

(c) may give effect, in whole or part, to a voluntary insurance scheme.

“building” includes improvements and fixtures (but not including carpet) forming part of the building, but does not include:

(a) temporary wall, floor and ceiling coverings

(b) fixtures removable by a lessee or tenant at the end of a lease or tenancy

(c) mobile or fixed air conditioning units servicing a particular lot

(d) curtains, blinds or other internal window coverings

(e) mobile dishwashers, clothes dryers or other electrical or gas appliances not wired or plumbed in.

Damage, for coverage under insurance required to be put in place under this part, means:

(a) earthquake, explosion, fire, lightning, storm, tempest and water damage

(b) glass breakage

(c) damage from impact, malicious act, and riot.

## SOUTH AUSTRALIA STRATA TITLES ACT 1988

SECTION 30 - DUTY TO INSURE

(1) A strata corporation must keep all buildings and

building improvements on the site insured to their replacement value.

(2) The replacement value of buildings and building improvements is the cost of their complete replacement including the cost of any necessary preliminary demolition work, any necessary surveying, architectural or engineering work and any other associated or incidental costs.

(3) The insurance must be against:

(a) risks of damage caused by events (other than subsidence) declared to be prescribed events in relation to home building insurance under Part 5 of the Insurance Contracts Act 1984 of the Commonwealth

(b) risks against which insurance is required by the regulations.

## TASMANIA STRATA TITLES ACT 1998

### SECTION 99 - INSURANCE OF BUILDINGS, &C., BY BODY CORPORATE

(1) The body corporate for a strata scheme must take out and maintain a policy of insurance for the buildings and other improvements (if any) on the site in accordance with this section.

(2) The policy of insurance:

(a) must cover:

(i) damage from fire, storm, tempest or explosion

(ia) any other prescribed risks

(ii) costs incidental to the reinstatement or replacement of the buildings, including the cost of removing debris and the fees of architects and other professional advisers; and

(b) must provide for the reinstatement of the buildings and improvements to their condition when new.

(3) The body corporate for a community scheme must insure property in accordance with the requirements (if any) of the scheme.

## VICTORIA OWNERS CORPORATIONS ACT 2006

(Authorised Version incorporating amendments as at 22 April 2015)

### SECTION 59: REINSTATEMENT AND REPLACEMENT INSURANCE

(1) An Owners Corporation must take out reinstatement and replacement insurance for all buildings on the common property in accordance with this Division.

(2) The insurance required under subsection (1) is insurance for damage to property under which the Owners Corporation insures for:

(a) the cost necessary to replace, repair or rebuild the property to a condition substantially the same, but not better or more extensive than its condition when new

(b) the payment of expenses necessarily and reasonably incurred in the removal of debris and the remuneration of architects and other persons whose services are necessary, being incidental to the replacement, repair or rebuilding of the damaged property.

### SECTION 59(2A) INSERTED BY NO. 1/2010 S. 25.

(2A) The insurance required under subsection (1) includes reinstatement and replacement insurance for the Owners Corporation's portion of any shared services.

(3) The Owners Corporation must ensure that the insurance required under subsection (1) includes:

(a) a provision that the interests of mortgagees are noted

(b) a provision that a mortgagee whose interest is noted shall be given the notices that are required under section 59 of the Insurance Contracts Act 1984 of the Commonwealth at the same time that those notices are given to the insured

(c) a provision that the insurer cannot avoid the whole contract for breach of a condition of the contract unless the breach is by the Owners Corporation or all lot owners, but the insurer has a right of indemnity against those lot owners who breach the contract.

SECTION 54 – WHAT IS AN INSURABLE BUILDING

"building" includes any building on the plan of subdivision and:

(a) any improvements and fixtures forming part of the building

(ab) any shared services

(b) anything prescribed as forming part of a building.

but does not include:

(c) carpet and temporary floor, wall and ceiling coverings

(d) fixtures removable by a lessee at the end of a lease

(e) anything prescribed as not forming part of a building.

SECTION 54 DEF. OF SHARED SERVICES INSERTED BY NO. 1/2010 S. 24(3).

"shared services" includes any pipes or cables used to provide services including water, electricity, gas and telecommunications to the building that are shared with a person other than the Owners Corporation or any of its members.

SECTION 61 - INSURANCE FOR LOTS IN MULTI-LEVEL DEVELOPMENTS

(1) If a building on a plan of subdivision is located above or below common property, a reserve or a lot, the Owners Corporation must take out the following insurance in respect of all lots in the plan:

(a) reinstatement and replacement insurance for all buildings on each lot in accordance with section 59

(b) public liability insurance in accordance with section 60, as if any reference in those sections to common property were a reference to those lots.

SECTION 61(2) SUBSTITUTED BY NO. 2/2008 S. 14.

(2) Subsection (1) does not apply to:

(a) a single-storey building

(b) a plan of subdivision that was registered under the Cluster Titles Act 1974 or the Strata Titles Act 1967 unless one or more lots in the plan is located above another lot in the plan.

## WESTERN AUSTRALIA STRATA TITLES ACT 1985

DIVISION 4 — INSURANCE

SECTION 53 - TERMS USED

In this Division - "building" includes any building on the parcel for a scheme whether shown on the strata/survey strata plan or not and also includes:

(a) proprietors' improvements and proprietors' fixtures forming part of the building including paint and wallpaper but excluding carpet and temporary wall, floor and ceiling coverings

(b) anything prescribed as forming part of a building for the purposes of this definition.

but does not include:

(d) fixtures removable by a lessee at the expiration of a tenancy

(e) anything prescribed as not forming part of a building for the purposes of this definition.

"replacement value" in relation to a contract of insurance of a building, requires provision to be specified in the policy:

(a) for:

(i) the rebuilding of the building or its replacement by a similar building in the event of its destruction

(ii) the repair of damage to, or the restoration of the damaged portion of, the building in the event of its being damaged but not destroyed.

so that, in the case of destruction, every part of the rebuilt building or the replacement building and, in the case of damage, the repaired or restored portion, is in a condition no worse nor less extensive than that part or portion or its condition when that part or portion was new; and

(b) for the payment of expenses incurred in the removal of debris and the remuneration of architects, surveyors, engineers and other persons whose services are necessary as an incident to the rebuilding, replacement, repair or restoration.

### SECTION 53A - APPLICATION OF THIS SUBDIVISION

References in this Subdivision:

(a) to "scheme" are to a single tier strata scheme

(b) to "strata company" are to a strata company for such a scheme

(c) to "proprietor" are to a proprietor of a lot in such a scheme.

### SECTION 53B - INSURANCE FOR LOTS IN SINGLE TIER STRATA SCHEMES

(1) For the purposes of this Act:

(a) whether there is insurance in respect of:

(i) any building on a lot in a scheme

(ii) damage to property, death or bodily injury for which the proprietor of a lot in a scheme could become liable in damages

(b) the occurrences to be insured against by the proprietor in relation to those matters

(c) the terms on which any insurance is obtained;

are, subject to this section, at the discretion of the proprietor of the lot.

(2) A strata company for a scheme may determine that it is a function of the company to insure in respect of the matters referred to in subsection (1), and may at any time revoke the determination.

(3) While such a determination is in force the strata company shall comply with section 53D.

### SECTION 53C - INSURANCE FOR COMMON PROPERTY IN SINGLE TIER STRATA SCHEMES

(1) The strata company for a scheme shall:

(a) insure and keep insured any building, or part of a building, or improvement on the parcel that is common property

(b) effect and maintain insurance in respect of damage to property, death or bodily injury for which the proprietors of lots in the scheme could become liable in damages as holders of the common property.

(2) The strata company does not have the obligations described in subsection (1) if:

(a) there is no common property in the scheme except:

(i) cubic space in which there is no building or improvement above or below the horizontal boundary of any lot

(ii) fencing on the boundary of the parcel or any lot.

or

(b) the strata company has by resolution without dissent (or unanimous resolution in the case of a two lot scheme) determined that subsection (1) is not to apply to the scheme.

### SECTION 53D - STRATA COMPANY'S OBLIGATIONS WHERE IT HAS AN INSURANCE FUNCTION IN SINGLE TIER STRATA SCHEMES

(1) This section applies where:

(a) a determination is in force under section 53B (2)

(b) in accordance with section 53C, a strata company has the obligations described in subsection (1) of that section.

(2) This section also applies where a strata company makes a determination to insure common property that it is not obliged to insure by reason of section 53C(2)(a).

(3) In those cases the strata company shall:

(a) insure and keep insured any building to which its obligation extends to the replacement value against fire, storm and tempest (excluding damage by sea, flood or erosion), lightning, explosion and earthquake

(b) effect and maintain insurance in respect of damage to property, death, or bodily injury for not less than $5 000 000 or such other amount as may be prescribed in place of that amount.

(4) Section 54(2) and (3) apply to a strata company's obligations under subsection (3) as if they referred to that subsection.

## WESTERN AUSTRALIA COMMUNITY TITLES ACT, 2018

PART 8, SUBDIVISION 2, SECTION 83
REQUIRED INSURANCE;

(1) A community corporation must ensure that the following insurance is in place for the community titles scheme:

(a) all insurable assets of the scheme must be insured against fire, storm and tempest (excluding damage by sea, flood or erosion), lightning, explosion and earthquake:

(i) to replacement value

(ii) to replacement value up to, for an event of a specified kind, a maximum amount specified in the contract of insurance that is a reasonable limitation in the circumstances; and

(b) the community corporation must be insured against damage to property, death, bodily injury or illness for which the community corporation could become liable in damages to an amount of not less than an amount determined in accordance with the regulations.

## WHEN TO CARRY OUT REPLACEMENT COST ASSESSMENTS

When considering the initial cost of replacement for insurance purposes it is normal to prepare the replacement cost based on the value of complete replacement at the first day the insurance is taken out, and then escalating the cost to the renewal date of the insurance. Costs should also include work external to the building (i.e. fences, pools, paving and any signage).

It is not necessary to prepare a full initial cost of replacement every year, it is sufficient to apply a percentage for escalation, however a full review should be undertaken at least every 2 – 3 years (but definitely not more than 5 years between updates), to track changes in demolition and construction costs, alterations/upgrades/changes to the insured property, or a change in the property's classification (e.g. to Heritage classification), to ensure that the correct value continues to be insured.

To minimise risk exposure, members undertaking replacement cost assessments should inspect the subject property when preparing each annual assessment to satisfy themselves with respect to any changes affecting the property.

## UPDATES TO REPLACEMENT COST ASSESSMENTS

Updates to Replacement Cost Assessments are typically undertaken by one of three methods:

(a) Manual Update: where the client/insurer applies an escalation to the previous Replacement Cost Assessment by applying CPI/construction indices to the original Replacement Cost Assessment

(b) Desktop Review: where the client engages the Certified Quantity Surveyor who undertook the original Replacement Cost Assessment to undertake a reassessment of functional / elemental rates, and demolition, redesign and reconstruction timeframes

(c) Full Update: where the client engages a Certified Quantity Surveyor (new or original Quantity Surveyor) to re-measure and reassess the previous Replacement Cost Assessment and provide a new Replacement Cost Assessment.

## EXAMPLE

The following summary example reflects a post-event valuation, in this case where a fire has destroyed the two top storeys of a 4-storey building on a 'specific date'.

Documentation, development application and procurement for the new work will be five months.

Demolition is considered to take approximately three months.

Construction will take six months.

A copy of the estimated reconstruction costs should be appended to the report.

| | CAPITAL REPLACEMENT VALUATION | AMOUNT AU$ |
|---|---|---|
| 1 | Demolition and removal of debris | 80,000 |
| 2 | Estimated reconstruction cost at time of 'specific date' | 5,000,000 |
| 3 | Escalation to commencement of construction (3 months @ 2.5% per annum) (calculated: $5,000,000 / 12 x 3 x 2.5%) | 31,250 |
| 4 | Escalation during construction period (6 months @ 3% per annum x 50%) (calculated: $5,031,250 / 12 x 6 x 3% x 50%) | 37,734 |
| 5 | Professional fees for design and project management ($5,148,984 @ 10%) | 514,898 |
| 6 | Development application and other authority costs | 25,000 |
| | **Sub Total** | 5,688,883 |
| 7 | Escalation over life of policy ($5,688,882 @ 3%) | 170,666 |
| | **Capital Replacement Value** | 5,859,549 |
| 8 | GST @ 10% (2019 value) | 585,955 |
| | **Capital Replacement Value including GST** | 6,445,504 |

## ASSUMPTIONS AND EXCLUSIONS

(a) Escalation has been assumed for this example at 2.5% during redesign and 3% during construction.

(b) Typically, 50% is used to adjust for escalation over the contract period, this usually being the average escalation cost over the construction period. This average will vary across differing project types.

(c) Exclusions:

Structure of two lower levels and foundations, except for rectification of water damage

External works

Loose furniture and equipment – separate insurance policy or self-insured

Tenant's property

Loss of revenue, temporary accommodation, and any other costs associated with responsibilities to tenants, rental voids

Pro-longed costs beyond stated construction program.

(d) Cost only reflects the design and construction associated with the new and refurbishment work and does not include council fees or other development costs.

(e) Costs associated with making the property safe after the disaster are included in demolition.

(f) Acceleration of Work.

(g) Temporary protection of undamaged property is included in demolition.

(h) State that the insurance policy has not been seen.

## *DISCLAIMER AND QUALIFICATIONS*

Each project will be different, as the building may be totally destroyed or only partly damaged.

Consideration will be given to what can be salvaged and what must be removed.

Common exclusions may include (depending on the requirements of the client):

- Loose furniture and equipment
- Damaged produce
- Tenant's fittings, plant and equipment
- Loss of revenue
- Relocation and/or temporary accommodation costs
- Limitations on external works (if any)
- Finance and holding costs
- Compliance with the Building Code of Australia
- Replacement of footings or inground services (to confirmed by insurer)
- Additional escalation due to delays (for whatever reason).

These items may well be covered by other insurances or at the risk of the client and this should be confirmed by the Quantity Surveyor.

Where the cost for insurance purposes only reflects the design and construction costs associated with delivering the building, and excludes any other development costs, this may result in co-insurance activation.

## INSURANCE POLICY RISKS

Members clients should be aware that their insurance policy risks should be addressed by the client's insurer or insurance broker.

## CO-INSURANCE CLAUSES (AVERAGING PROVISIONS)

Many insurance policies contain averaging provisions to ensure building assets are fully insured. The full value will vary depending on whether the insurance is for replacement value or market value.

Co-insurance clauses provide that, if at the time of the loss, the cost to replace the asset insured exceeds the amount of cover, the insured is considered to be self-insuring for the difference in value and therefore bears a proportion of any loss (including a partial loss). The Co-Insurance Clause is written into policies principally to encourage clients to make sure they have a sum insured that is adequate to obtain the maximum protection from the policy.

Members should be aware that providing a replacement cost insurance assessment which is less than the actual value in the event of a claim may face significant exposure if an averaging provision applies.

## FIDUCIARY INTERESTS

Members should be aware that other parties such as lessors, financiers, trustees, and mortgagees may have interests in the insured asset, and should act in the knowledge that liability may extend to those other parties. Members not wishing to extend their liability to parties other than the person who has commissioned the replacement cost assessment report, should include a disclaimer to that effect in the report.

## SCOPE OF WORK

As with any other service provided by a member, the scope of work, basis of assessment, effective valuation date and any other factors relevant to the replacement cost assessment should be agreed and confirmed with the client, in writing and clearly included in the Replacement Valuation Report.

Ideally the client will provide the Member with a copy of the insurance policy which will detail the basis of insurance and extent of inclusions and exclusions under the policy. In the event the Member is not provided with a copy of the policy, the Member should obtain clear instructions from the client confirming the scope of work and any special inclusions or exclusions that are required. In circumstances where this is not possible the Member should state within the replacement cost valuation report the basis of assessment and the extent of inclusions and exclusions within the insurance valuation.

It should be recognised that in many cases Members will be asked to prepare Replacement Cost Assessments (for insurance purposes) without the benefit of insurance policies.

## HERITAGE ISSUES

Most Australian governments have regulations in place to protect specific historic properties or whole areas/precincts of special architectural or historic interest. Where a building has been officially designated a heritage asset by relevant government authorities (usually the applicable State / Territory or Commonwealth Heritage Council), legislation may prevent or limit redevelopment, renovations, modifications, and additions by imposing restrictions and time-consuming approval processes.

Where a heritage building is substantially destroyed to the extent that none, or very little, of the original building remains, much of the asset's heritage value would most likely be lost. Reconstruction would not necessarily restore those values, and as such, would neither be required, nor necessarily favoured. Consequently, any heritage restrictions on the subject property may be lifted with the owner being able to replace the building or redevelop the site in accordance with underlying planning requirements, unencumbered by any of the former heritage restrictions.

Risks arising from the partial loss of a heritage building may be exacerbated where heritage legislation requires making good damaged areas which may require repairing or reproducing some or all of the building in a style and form of construction consistent with the remaining original structure. Consequently, increased costs may be incurred due to the engagement of specialised trades, including those working in stone masonry, wrought iron, and stained glass.

With the risk of increased costs of reinstatement in the event of partial claims, insurance values are typically assessed by determining the current cost of rebuilding the structure as it exists, including reproducing every component of the building in a style and form of construction most closely resembling the original.

## INDEMNITY COVER

It is important that Quantity Surveyors be aware of the type of insurance policy held by their client. Where this is an indemnity policy, both the Quantity Surveyor and the client should be cognisant that this will only cover the value of repairs or replacement based on the value of the property at the time of the loss event. This may not be the same as replacement value.

Where property is damaged, indemnity insurance covers the cost of repair (less an allowance for betterment if the repair considerably improves the pre-loss condition of the property).

Where property is lost or destroyed, it generally covers the market value of the property as at the date and place of the loss (other than for marine insurance, when it is calculated at the date of the commencement of the risk).

## REINSTATEMENT AND/OR REPLACEMENT COVER

This insures property on a "new for old" basis. In the event of loss, the insurer will pay the cost of replacing the property or restoring the damage to a condition no better or more extensive than new, without deduction for depreciation. The pre-loss condition of the property is not relevant.

If reinstatement is impossible because of changes in planning or building laws, the loss is usually assessed on the basis of the market value of the property at the date of the loss.

## REINSTATEMENT RIGHTS/EXISTING USE RIGHTS

In the event of a total loss, and where a regulatory authority exercises its statutory powers, the reinstatement of a building as it existed prior to the loss may be prohibited or restricted. In such circumstances, 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 the actual cost of reinstatement and the cost of reinstatement if it were not prohibited or restricted, would be made as soon as the difference is ascertained upon completion of the rebuilding works. In some policies this provision is only in respect of a reduction in the floor space ratio index or plot ratio.

In addition, where the building sum insured is not exhausted, some policies may make payment for any loss of land value as a result of government or local authority legislation that reduces the floor area of the building(s) insured.

## QUANTITY SURVEYORS LIABILITY

Quantity Surveyors need to be aware of grossly understating replacement costs as they may leave themselves and/or their company exposed to potential claims from their client.

Where a Replacement Cost Assessment is being undertaken for an existing insurance policy, the Quantity Surveyor should note inclusions and exclusions as included in the relevant Product Disclosure Statement.

Members should be cognisant that they are not experts in insurance cover policy details and should provide commentary as such. The Member should advise their clients to engage an insurance broker to ensure the clients insurance requirements are adequately addressed.

## *APPENDIX*

| | |
|---|---|
| **Assessment Period** | A period of time immediately following the event of destruction. This time period is intended to allow for authority investigations, safety inspections, and settlement of the site prior to any demolition works commencing. |
| **Building** | Any construction, be it a house, office block, hotel, factory or other structure which is capable of being insured. |
| **Contents** | Building Contents usually forms part of a separate insurance and should be excluded from the Replacement Cost. Contents can include tenancy fit-out, loos furniture and equipment, specialised plant etc. The scope of work should be confirmed in the context of the applicable insurance policy. |
| **Date of Disaster** | The date at which the actual disaster event occurs. |
| **Demolition** | Includes the removal of all affected work and debris caused by the disaster (special allowances or exclusion notes should be included for treatment or removal of contaminated materials, preservation of any heritage features, and any temporary protection or temporary supporting to adjacent properties). |
| **Desktop Assessment** | A Replacement Cost Assessment based upon information provided by the client which excludes any requirement for a physical inspection of the asset. |
| **Disaster** | An event such as fire, water (heavy rain and/or flooding), cyclone, earthquake and other physical damage resulting in total or partial destruction |
| **Escalation** | Is the amount that construction costs have moved or are forecast to move in a particular time period. |
| **Extra Cost of Reinstatement Cover** | Additional costs which might be required to comply with regulatory upgrades in building requirements (because more extensive or expensive design and materials are required when rebuilding). |
| **Hold Harmless Agreements** | Any agreement which prevents the insurer from recovering a loss caused by a third party, without first obtaining the insurer's consent in writing. These clauses are often found in rental agreements, maintenance or supply contracts from burglar alarm or fire protection installers and building or repair contracts. Such agreements may void part or all, of the insurance policy. |
| **Professional Fees** | Include any fees required to see safe demolition of the building, the redesign and construction covering all disciplines including project management costs. |
| **Replacement Cost** | Refers to how much it would cost to replace a current asset at today's market prices with the same or similar asset. If the replacement cost being calculated is of a damaged asset, then that cost relates to the asset in pre-damaged condition, including demolition. |
| **Underinsurance** | Only applies if the policy holder is underinsured. Most policies provide a 10% - 15% error margin. Where the insurance value is less than the cost to replace the asset, the insurer will generally only pay the proportion of the insurance value (Refer section 5.1). For example, if the full insurable value for replacement is $2M and the policy is for $1.5M, the insurance company will only pay 75% of the replacement cost. Underinsurance may breach financing arrangements with financial institutions where the building owner has a mortgage against their property. |

AIQS

AUSTRALIAN INSTITUTE OF QUANTITY SURVEYORS