Changes signalled to the way we insure our homes

The impact of the Canterbury earthquakes was profound and took an exacting toll on a much loved city. However, the aftershocks are ongoing with far more wide reaching repercussions especially on the method we use to insure our homes.

Both insurance companies[1] and reinsurers[2] are signalling a shift to an Agreed Value cover which will mean significant changes to how exposure will be defined.

Currently, New Zealand adopts the 'undefined cover approach' to insure our homes, remaining the only country in the OECD to do so. This cover is calculated on the floor area of a home, whereby a dollar value per square metre is used by the insurers to work out their risk. The current approach guarantees full replacement, however, there is nothing in the premium paid to reflect the fact that one house may be more superior with regard to build and fit out, and therefore the exposure to fully replacing it more costly.

Consequently, insurers and reinsurers alike around the world found that post earthquake Canterbury they faced the scenario of not knowing what their potential maximum exposure was. Accordingly Insurers and Reinsurers recognised they need to gauge their exposure more accurately and hence the shift to basing their exposure on an agreed replacement cost.

The 'Agreed Value' approach means that homeowners and the insurer will need to agree on what it would reasonably cost to replace the property and insure it for that amount. Former Insurance Council Chief Executive, Chris Ryan, said

there is no agreed date by the industry for this to happen. We understand brokers have been told by their underwriters that an Agreed value approach will apply to all domestic replacement insurance by mid-2013. To date, as Valuers we have normally only been instructed to undertake Replacement Insurance Valuations on houses over 500 square metres, however we are already being instructed to undertake Replacement Insurance Valuations on residential homes under 500 square metres signalling that the change to how exposure is defined is well underway.

Ryan stresses that full replacement cover is not on the way out but allows insurance companies and reinsures the benefit of assessing their actual exposure. Ryan also points out the benefits for homeowners, "There would be upsides too, with owners of middle to lower-valued homes likely to pay less for full replacement insurance. Those with more expensive homes would pay a little more."

However, as Valuers we have grave concerns that homeowners will become under insured. When homeowners are asked to come up with an agreed amount to replace their house, homeowners think of just the house itself and will use a dollar rate per square metre to approximate the replacement cost, which may be reasonably accurate. However, there are other important aspects to consider, such as demolition, site works and inflationary provisions, which all cost, as well as the replacement value of your home. If your house is damaged or destroyed by fire, there is a very genuine cost attached to removing/demolishing the existing structure so that you can commence work on your replacement, if demolition is not taken into account this sum simply gets deducted from your Agreed Value and you have less money to build your new home. If your home is destroyed on the last day of your insurance policy there is 12 month's worth of inflation on building costs, although it is likely to be considerably longer than that before you can rebuild. Demolition, drawing plans, getting council consents and then the build time could easily be another 12 months, meaning potentially 24 months on inflationary provisions will be required, if not allowed for, again you will simply have less money to rebuild with. This is also true of site works such as concrete sealed paths and drives, fencing, landscaping, clotheslines and even your letterbox. To replace them they all have a cost. If homeowners have not factored these costs into their Agreed Value, they will be the ones paying for the site works should they be faced with loss or damage of their property.

Obviously the sum to replace a metal letterbox is negligible; however the cost to replace 300 square metres of concrete seal is not. Just working out a per square metre rate on your house, will not in the future translate to full replacement as we currently understand it. However, you can get a Replacement Insurance Valuation from a Registered Valuer to ensure you are properly insured and can replace your home with the same size, scale and quality of home you had before the disaster. Whilst many New Zealanders remain fee averse with regard to paying for professional advice, it's important to remember; your home is your most valuable asset and worth properly insuring.

[1]Insurance is a tool used by individuals to manage risk. Insurance companies sell individuals insurance policies designed to guard against financial loss. In return, an individual pays the insurance company a fee (premium) for the policy.

The policy serves as a promise that the insurance company agrees to reimburse a policyholder (insured) for his financial loss due to a disaster or some other circumstance that results in a loss of life or property that the policy covers. For example, when an auto insurance policyholder has an accident, the insurer (insurance company) reimburses him for injuries and damage to his vehicle.

[2]Reinsurance is also a tool used to manage risk. Unlike insurance which protects individuals from financial loss, reinsurance protects the insurance company from financial loss.

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