



The hidden risk of underinsurance: Why accurate asset valuation matters

Underinsurance is a silent but significant threat to many property owners in today's volatile economic landscape. The application of the average clause in insurance policies is a mechanism that can leave building owners seriously out of pocket at claim time. Add in the mounting pressures of input cost inflation and exchange rate volatility, the consequences of undervaluing assets are only getting worse.

An estimated 50% of building claims submitted to Bryte were subject to average of at least 20% being applied.

What is the average clause?

The average clause is a standard provision in many insurance policies that negatively impacts policyholders who underinsure their property. If the sum insured is less than the replacement value of the asset, any claim payout will be reduced in proportion to the level of underinsurance. It is important to note that the replacement value includes all costs associated with rebuilding, for example, clearing the site of debris, architect fees, etc.

Example

A building with a replacement value of R1 million is insured for only R700,000. That's 70% of its actual replacement value. If a fire causes R500,000 damage, the insurer may only pay 70%, an amount of **R350,000**, leaving the owner/policyholder to cover the remaining **R150,000** themselves.

Step-by-step calculation

Determine the percentage of insurance coverage

$$\text{Insurance coverage percentage} = \frac{\text{Insured amount}}{\text{Actual replacement value}} = \frac{700,000}{1,000,000} = 0.7 \text{ or } 70\%$$

Apply this coverage percentage to the loss amount to determine the claim payout

$$\text{Claim payout} \quad 70\% \times \text{R}500,000 = \text{R}350,000$$

Calculate the shortfall

$$\text{Claim amount, less claim payout} \quad \text{R}500,000 - \text{R}350,000 = \text{R}150,000$$

The exchange rate and the input cost inflation problem

The cost to rebuild or repair a building is not static. It's influenced by fluctuating material costs, rising labour charges, and increasingly the impact of currency exchange rates. A weaker local currency can significantly increase replacement costs for countries that rely heavily on imported building materials.

Drivers of increased rebuilding costs include:

- **Imported materials:** Steel, timber, mechanical systems, and specialised fixtures are often priced in USD or other strong currencies.
- **Labour shortages and labour inflation:** Labour constraints have increased wages, especially for skilled trades.
- **Fuel costs:** Inflation in logistics and transportation feeds directly into the cost of goods and services.

This means that the rebuilding cost of a property assessed two years ago may now be well below its actual replacement value, without any changes to the physical structure.

Why are many buildings now underinsured?

Unfortunately, many policyholders continue to insure their properties based on outdated valuations, unaware of how much the market has shifted. This creates a growing gap between the insured sum and the true cost to rebuild, leaving property owners exposed.

How to help clients ensure that their coverage is correct

1. Encourage regular professional valuations

Help clients arrange for buildings to be professionally valued every 1–3 years. Quantity surveyors or insurance-specific valuers can provide detailed assessments based on current market conditions.

2. Educate clients on the risks of underinsurance

Many clients don't understand the implications of the average clause. Use case studies and plain-language examples to demonstrate how shortfalls in their coverage can directly impact claims.

3. Review policies at renewal

Annual policy renewals are the perfect time to revisit building values. Encourage clients to update sums insured regularly—especially if they've made improvements or renovations. Adjust the sum insured based on inflation indices, helping to keep coverage in line with actual rebuild costs.

4. Factor in demolition and professional fees estimated at 15%

Replacement value should include not just the cost of materials and labour, but also:

- Demolition and debris removal
- Architect and engineering fees
- Compliance upgrades to meet current building codes
- Council consents

Example

Replacement value	R756,143
Demolition and debris removal, architect and engineering fees @ 15%	R113,422
VAT @ 15%	R130,435
Total estimated replacement value	R1,000,000

Final thoughts

Underinsurance is a risk that can be managed with the right advice, regular reviews, and up-to-date valuations. As advisers, brokers, and insurers, it's our responsibility to guide clients toward realistic sums insured that reflect today's market conditions. With inflation and exchange rates continuing to impact rebuild costs, there's no better time to act. Ultimately, the insured value is the client's decision and if they decide on a value that is too low, it could leave them underinsured.

If you need more information or have any questions, please contact us.