

PROPERTY INSURANCE – A DISCUSSION OF THE IMPORTANCE OF SUITABLE INSURANCE COVER AGAINST LOSS RELATING TO COMMERCIAL PROPERTY

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RINGKASAN

Terdapat banyak masalah berhubung dengan pemegangan hartanah perdagangan sebagai satu bentuk pelaburan. Salah satu daripada risikonya yang tertinggi ialah kemungkinannya membawa kerugian, samada sebahagian maupun sepenuhnya, yang disebabkan oleh kebakaran atau lain-lain kemalangan sepertinya. Nilai hartanah yang musnah setiap tahun akibat dari sesuatu bentuk kebinasaan adalah sangat besar.

Oleh itu mengadakan insuran yang sewajarnya ke atas hartanah amat diperlukan. Hal ini dapat digambarkan oleh beberapa malapetaka yang berlaku di negara ini sejak beberapa bulan yang lalu berkenaan dengan kehilangan hartanah. Dengan yang demikian polisi-polisi insuran seharusnya bersifat komprehensif, iaitu mahu menerima, dan dapat memastikan bahawa setiap kehilangan akan diterima dalam satu bentuk atau sebagainya.

Hartanah boleh diinsurankan di atas dua asas. Pertamanya ialah secara Indemniti, iaitu dengan cara menggantirugi harta yang telah musnah dan keduanya ialah dengan cara Reinstetmen, iaitu dengan memperbaiki atau memperbaharui hartanah berkenaan.

Insuran yang berpolisi indemniti memastikan bahawa pemilik hartanah itu tidak akan rugi dari segi kewangan akibat dari sebarang kerosakan ke atas hartanahnya.

Insuran yang berpolisi reinstetmen pula memperuntukkan pembaikan atau penggantian sebarang kerosakan, agar hartanah berkenaan dibaiki semula kepada bentuknya yang asal setelah kerosakan itu terjadi.

Beban untuk memulihkan nilai yang sesuai untuk penggunaan insuran jatuh terus ke atas pemilik hartanah yang diinsurankan. Pemberi insuran hanya akan menghitungkan premium insuran itu di atas jumlah yang berkenaan. Walaubagaimanapun apabila tuntutan dibuat, pemberi insuran itu akan menghitungkan 'nilai maksima satu-satu hartanah itu boleh diinsurankan' dan ini dianggap sebagai nilai yang tertinggi bagi sesuatu perlindungan insuran. Selain dari-

pada itu, jika nilai maksima ini lebih tinggi daripada nilai yang di-insurankan, peruntukan Pro Rata Average Clause biasanya dilaksanakan, dan hanya sebahagian daripada tuntutan itu akan diterima.

Keterangan ini menerangkan asas-asas kedua-dua bentuk insuran dan cara mentaksirkan 'nilai maksima satu-satu hartanah itu boleh di-insurankan'. Di sini juga diterangkan pelaksanaan peruntukan Pro Rata Average Clause dan peruntukan-peruntukan yang istimewa yang harus wujud di dalam satu-satu polisi insuran untuk hartanah.

Kesimpulan ini diakhiri dengan menekankan kepada tanggungjawab-tanggungjawab yang dihadapi oleh pengurus hartanah/penilai yang professional dalam memberi nasihat kepada pemilik hartanah mengenai sesuatu bahagian insuran hartanah yang semakin sulit dan mahal belanjanya.

Abstract

There are many problems related to holding commercial property as an investment. One of the greatest risks is the possibility of total or partial loss by fire or other misfortune. The value of property destroyed each year by some form of damage is immense.

The proper insurance of property is therefore of critical importance. This has been tragically illustrated by a number of recent local disasters concerning the loss of property. Insurance policies must therefore be comprehensive and ensure that any loss will be received in some form or other.

There are two bases on which property may be insured, namely, Indemnity and Reinstatement.

An Indemnity policy ensures that the property owner does not lose from a financial viewpoint following any damage to his property.

A reinstatement policy makes provision for the repair or replacement of any damage so that the property is reconstructed in exactly the same manner after the damage has occurred as it existed beforehand.

The onus for fixing a suitable value for insurance purposes falls directly on the insured. The insurer will calculate the insurance premium on this sum. However, when a claim is made, the insurer will calculate the 'full insurable value' of the property and this is taken as a ceiling value for insurance cover. Also, if the 'full insurable value' is higher than the 'insured value', the Pro Rata Average Clause is generally operated and only a proportion of the claim will be met.

This paper explains the bases of both forms of insurance and the methods of assessing 'full insurable value'. It also explains the working of the Pro Rata Average Clause and the special provisions which ought to be incorporated in an insurance policy for property assets.

Finally, the paper concludes by emphasising the responsibilities which face the professional property manager/valuer in advising the

property owner in the subject area of property insurance, which is growing increasingly complicated and expensive.

1.0 Introduction

The purchase of property has always been considered a safe investment. Rental values, and therefore capital values, have enjoyed consistent growth which at times has been spectacular.

However, there are inherent risks in holding property as an investment. Unlike investing in stocks and shares, or precious stones, the building cannot be neatly sub-divided and stored away for safe keeping. The return from holding property is in the form of annual rent and capital growth. To fulfil its full potential, therefore, landed property must be occupied. The investment is constantly in use and is therefore at risk from the dangers of natural elements and human negligence.

The value of landed property destroyed in some way during the course of one year is immense.

Property owners, therefore, must cover themselves against the possible part or total destruction of their investments through the purchase of adequate insurance policies.

The need for suitable property insurance has been tragically emphasised by certain serious losses of property – Campbell Complex, the old Bank Bumiputra Building, the old Fitzpatrick Building – which have occurred over the last few years.

This paper has, therefore, been prepared as a result of close consideration of some of the problems of property insurance in relation to the proper cover of risks.

Insurance is a contract, often complex as well as comprehensive, which should be the subject of careful consultation between the insured and the insurer with the object of making certain that each is clear about the objects and intentions of the other party to the contract. Occasionally, there has been a serious gap between what insurers intended in insurance policies covering properties against such risks as fire, storm, flood, etc. and what the public and, indeed, property managers and valuers understood was the cover afforded by such policies.

This paper therefore will attempt to answer some of the general and particular questions concerning commercial property which could be of assistance to the property manager and valuer in his role as general adviser on risks relating to all aspects of property management.

2.0 The Basis Of Property Insurance

There are two bases on which property may be insured.

- a) Indemnity, and
- b) Re-instatement.

The principle of indemnity requires that the insured should be left after settlement of the loss in as nearly as practicable the same position (as far as money can do this) as if the loss had not occurred.

The principle of reinstatement requires that the damage to the property whether total or partial should be 'made-good' so that the repairs to or reconstruction of the property would return the property to its similar condition before the damage occurred.

Whichever basis is adopted it should be noted that a policy usually contains the Pro Rata Average Clause (or Condition of Average). This clause is introduced to deter the under-insurance of property, (see later comments on this clause).

3.0 Assessment Of The Sum To Be Insured

3.1 The Need For Insurance Valuation

The insurer must have a figure on which to base his premium calculation and which he knows represents the absolute limit of his liability.

The insurer is not concerned whether the figure is a true representation of the cost of replacing the subject property since once the figure is included in the policy that will be the maximum advance on total loss.

Furthermore, in the case of partial loss, the Pro Rata Average Clause will ensure that the insurer will only pay a proportion of the loss based on the ratio between the insured value and the "full insurable value" which is always calculated by the insurer at the time of loss.

e.g. Insurance Valuation of office block \$100m
Annual premium say \$150,000 p.a.

On total loss:—

"Full insurable value" calculated by insurer \$135m
Insurance payment \$100m

On partial loss:—

Claim \$25m
Full insurable value, as above \$135m

∴ Insurance payment (assuming Pro Rata Average Clause)

$$\frac{100}{135} \times 25\text{m} = 18.5\text{m}$$

Thus, the responsibility for fixing the "full insurable value" is entirely that of the insured. There is great pressure on the valuation

to be correct since too low a value will create problems relating to the Average Clause. However, too high a value means that the insurance premium, already a considerable expense for the property owner, is unnecessarily high.

3.2 The Assessment

If On A Reinstatement Basis

The sum insured is based on the *cost* of totally rebuilding the property to its existing specification. Since the land is considered to be indestructible, the value of the land is not included in the “full insurable value.”

The valuation however should include all development costs, such as debris removal, foundations, superstructure and all professional fees.

If On An Indemnity Basis

The rebuilding cost may be discounted by a percentage representing wear and tear depreciation to date. Also, in the case of older properties, the cost of reconstructing a suitable replacement to a more modern (and probably less expensive) specification may be taken as the “full insurable value.”

In valuing on an indemnity basis, there is always a problem concerning “part-loss” claims and the insured must be certain that in the circumstances he is not penalised by the Average Clause.

3.3 The Need For Regular Reviews

Because of the penalties incurred for under-insuring the value of property, it is vital that the “full insurable value” is upgraded at regular intervals.

Until recently, revaluation of property has been carried out on an irregular basis, perhaps, every five years or more. However, with the modern trend of rapidly rising building costs it may soon be necessary to carry out revaluations annually to ensure full coverage.

4.0 Special Provisions

4.1 Professional Fees

It is important that an allowance for the cost of professional fees is not overlooked when the sum insured is being renewed. The normal clause is virtually all property insurances refer to “architects’ and surveyors’ fees” but if other specialist fees are likely to be incurred e.g. structural or service engineers’, specific reference should be made.

4.2. Loss Of Rent

Loss of rent is insurable as a separate item which must specify the period and amount of rent to be covered. Normally, loss of rent will be paid during the period the property is unfit for occupation, not exceeding of course the period stated in the item.

4.3 Debris Removal, Demolition, Etc.

The sum to be included to allow for this cover will depend on the type, design and situation of the building and it is usually prudent to ask for the standard clause noting the inclusion of these costs to be added to the policy.

5.0 Insurance Cover

A standard fire policy covers:—

- a) Fire, whether resulting from explosion or otherwise, but excluding:—
 - (i) Earthquake and subterranean fire;
 - (ii) Riot, civil commotion and war risks generally;
 - (iii) Spontaneous combustion;
 - (iv) Fire resulting from heat process applied to the property.

(Exclusions (iii) and (iv) are of little relevance to insurance on buildings).

- b) Lighting;
- c) Explosion, (subject to exclusions (i) and (ii) above of domestic boilers or of gas used for domestic purposes).

By endorsement of the policy, cover can readily be obtained at an additional premium for Special Perils:—

- (1) Explosion from any cause (with certain exclusions);
- (2) Aircraft, aerial devices and articles dropped from them;
- (3) Earthquake;
- (4) Riot and civil commotion (but not war risks);
- (5) Malicious damage (only as an extension of riot cover and usually subject to an “excess”);
- (6) Storm, tempest, flood and burst pipes (usually subject to an “excess”); and
- (7) Impact by road vehicles, horses and cattle.

In addition to the above, a list is set out below which is intended to be a guide to policies which may be relevant to property ownership:—

Property owners' liability	covering liability to third parties.
Employer's liability	covering liability to employees, which is now compulsory by law.
Lift	covering damage from breakdown and liability to third parties, and inspections required by the Factories and Machinery Act 1967.
Engineering and electrical	covering damage from breakdown to pumps, burners, motor operating ventilation, etc.
Boilers and pressure	covering explosions, failure, and the damage resulting to the property, and to surrounding property of third parties. There are statutory requirements under the Factories and Machinery Act relating to the inspection of boilers, etc.

Conclusion

The subject area of property insurance is growing more complicated and increasingly expensive. The property owner is therefore more likely to require professional advice to ensure that what might be his most valuable asset does not turn into his most costly liability.

In the field of property insurance, the property manager/valuer has three main responsibilities. Firstly, to ensure that the sum insured is appropriate to recover all possible losses relating to the property. Secondly to ensure that the policy contains sufficient cover for all likely forms of damage which might occur to or within the property and allows for the recovery of any subsequent losses resulting from the temporary uninhabitable state of the property.

Thirdly, and of growing importance, the property manager should ensure that the property is designed and managed in such a way to reduce the possibility of damage through fire or other causes. The inclusion of sprinkler systems, adequate fire-fighting equipment, efficient fire doors and alternative, compartmentalised fire escapes reduces the risk of fire damage and therefore is likely to reduce the premium to insure the property.

More important, in the age of high rise construction, greater emphasis on fire protection may result in the saving of lives as well as the saving of money.