

The Longitude guide to... Underinsurance

Construction costs, including building repairs, have risen over the last 18 months with all regions of Australia seeing double-digit annual increases. The key contributors to these increases have been low labour supply and material shortages that began during Covid-19 and increased further in 2022.

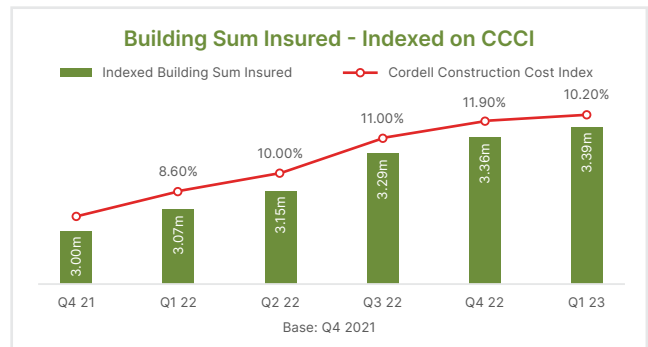
In fact, research conducted by the National Housing Finance and Investment Corporation, for the 2022 fiscal year, concluded that supply constraints had pushed building materials and labour cost inflation to rise at their fastest pace in **nearly 50 years***. This trend continued through the second half of 2022 and whilst there has been a slight downturn in 2023, increases remain in double digits since the beginning of 2022.

This has placed renewed focus on the importance of maintaining the correct building sum insured on a strata scheme's insurance program. Furthermore, there are legislative obligations in all states and territories that require the bodies corporate to insure buildings for full reinstatement and replacement value, meaning the building sum insured should be equal to its condition if it was new. The legislation also makes it clear that the amount should also allow for removal of debris and professional fees.

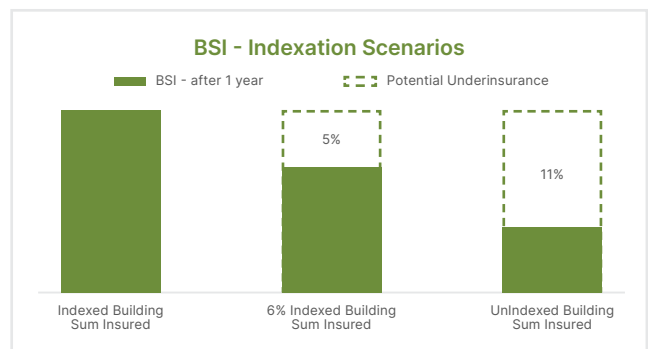


The failure to adequately insure the building for full replacement value does not absolve the bodies corporate from its obligations under the legislation in the event of a total loss. This is because, pursuant to the legislation, the **liability** of the bodies corporate (and therefore lot owners) in respect to the strata scheme is **unlimited**. Therefore, there is a financial incentive for the bodies corporate to ensure that the building sum insured is always adequate.

This graph provides a hypothetical example on a \$3,000,000 building as at the end of 2021 and what its current rebuilding value could be based on Cordell's Construction Cost Index (CCCI)**.



If we then compare this example to the typical indexation provided each year (6%) and what the CCCI indicated for the 2022 year, the underinsurance effect can be clearly seen.



Whilst Longitude provides an indexed building sum insured as a suggested option at each renewal, a total loss if the building sum insured is not indexed at all could leave the body corporate with a short fall of almost \$400,000 which would then need to be covered by the lot owners. As such, the body corporate should regularly review the adequacy of its building sum insured and consider obtaining a valuation of the property conducted by a professional insurance valuer to assist in calculating a current sum insured and help reduce its financial risk due to the effect of underinsurance.

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