



# APPLIED VALUATION

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# INSURANCE VALUATION

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**EAEQ 3209: LESSON FIVE**

# Purpose of Insurance Valuation



- The purpose of insurance is to compensate you for the actual loss suffered should your property be damaged.
- Under insurance of property can lead to a huge loss if the cover falls short of the damage suffered.
- Over insurance leads to higher and unnecessary premiums.
- This points to the direction that the basis of insurance valuation is *Reinstatement Cost (or Reproduction Cost)*.
- Reinstatement cost (or Reproduction Cost) alone however, is not adequate.



# Methodology

## 4 Key Matters to Consider

### 1. Reinstatement Cost

- In assessing the Reinstatement Cost of a property, the valuer makes two assumptions.
  - a) *First*, that there will be total destruction of the property. This assumption is reasonable because it is the maximum damage that can occur to the property.
  - b) *Second*, that land is not destructible. It is quite remote that land will be destroyed. This means it is the building component only of real estate that is considered in insurance valuation.



# Methodology

## 4 Key Matters to Consider

### 2. Debris Removal

- Following total destruction, there will be building remains, such as broken foundations, walls, etc. on the site.
- These will need to be cleared before any construction can commence.
- An allowance therefore ought to be made for removal of debris.



# Methodology

## 4 Key Matters to Consider

### 3. Professional Fees

- Before you commence construction, you will need an architect to prepare the building plans.
- A quantity surveyor, engineers etc. are equally important to ensure the building is re-constructed to specification, in time and within budget.
- Professional fee should therefore be included in the computation of insurance valuation.



# Methodology

## 4 Key Matters to Consider

### 4. Loss of Rent / Consequential Loss

- Loss of property is instant. However, investigations, assessment of damage, compensation and rebuilding take time.
- It is therefore important to include loss of rent, or cost of alternative accommodation over such reasonable period. This ought to be computed at *current market rent*.
- It may also be necessary to include consequential expenses that may result from such an occurrence e.g. relocation expenses.

# Insurance Value Process

## Stand Alone Unit



### Reinstatement:

1. Re-building costs
2. Professional fees
3. Demolition and removal of debris
4. Loss of rent/cost of alternative accommodation over reconstruction period
5. Costs incidental to the loss e.g. relocation expenses
6. Advise to include Inflation Clause in the policy



# Insurance Value

## Stand Alone Unit



Development	Sq.ft	Rate	Kshs.	Kshs.
Building	2,000	3,500		7,000,000
Site works	Say			
Perimeter wall	300	2,500	750,000	
Concrete yard	1,200	300	360,000	
Septic tank	1	350,000	350,000	
Gate	1	50,000	<u>50,000</u>	<u>1,510,000</u>
Total building				8,510,000
Professional Fees		12%		1,021,200
Debris removal		5%		<u>425,500</u>
				9,956,700
Loss of rent/cost of alternative accommodation/cost relocation		18months	35,000	630,000
<b>Total</b>				<b>10,586,700</b>



# Apartments

- In centralized management, insurance is usually handled collectively and reinstatement cost/reproduction cost may apply.
- In the absence of such system, or where the apartment owners are separately responsible for the insurance of their apartments, the apartment ought to be insured at market value. This will provide safety in the event that one or more apartment owners are not adequately covered. Can you imagine what would happen if one, two or many other apartment owners in a block are not covered? You may never be able to have your apartment back.
- You can, however, be adequately compensated given a similar apartment elsewhere, or a sum equivalent to the market value of your apartment.
- In addition, loss of rent or cost of alternative accommodation and incidental expenses need to be considered.

# Insurance Value Process

## Apartment / Flat



### Market Value:

1. Market Value of the Apartment
2. Loss of rent/cost of alternative accommodation over reconstruction period
3. Costs incidental to the loss e.g. relocation expenses
4. Advise to include Inflation Clause in the policy



# Insurance Value

## Apartment / Flat

Development	Sq.ft	Rate	Kshs.	Kshs.
Market Value (from Market Approach, Cost Approach, Investment Approach)				15,000,000
Loss of rent/cost of alternative accommodation/Loss of rent/cost of alternative accommodation/cost relocation		18months	55,000	990,000
Incidental costs e.g. stamp duty, relocation, etc.		3%		<u>450,000</u>
Insurance Value				16,440,000
<b>Call</b>				<b>16,500,000</b>



# Data Sources

- Construction contracts usually reduced per sq.m/ft.
- Building contractors.
- Quantity surveyors, cost estimators etc.
- Property owners.
- Cost manuals e.g. Ministry of Public works
- Cost index
- Market Values and Market rentals from sales and listings by sales agents, owner information, lawyers etc