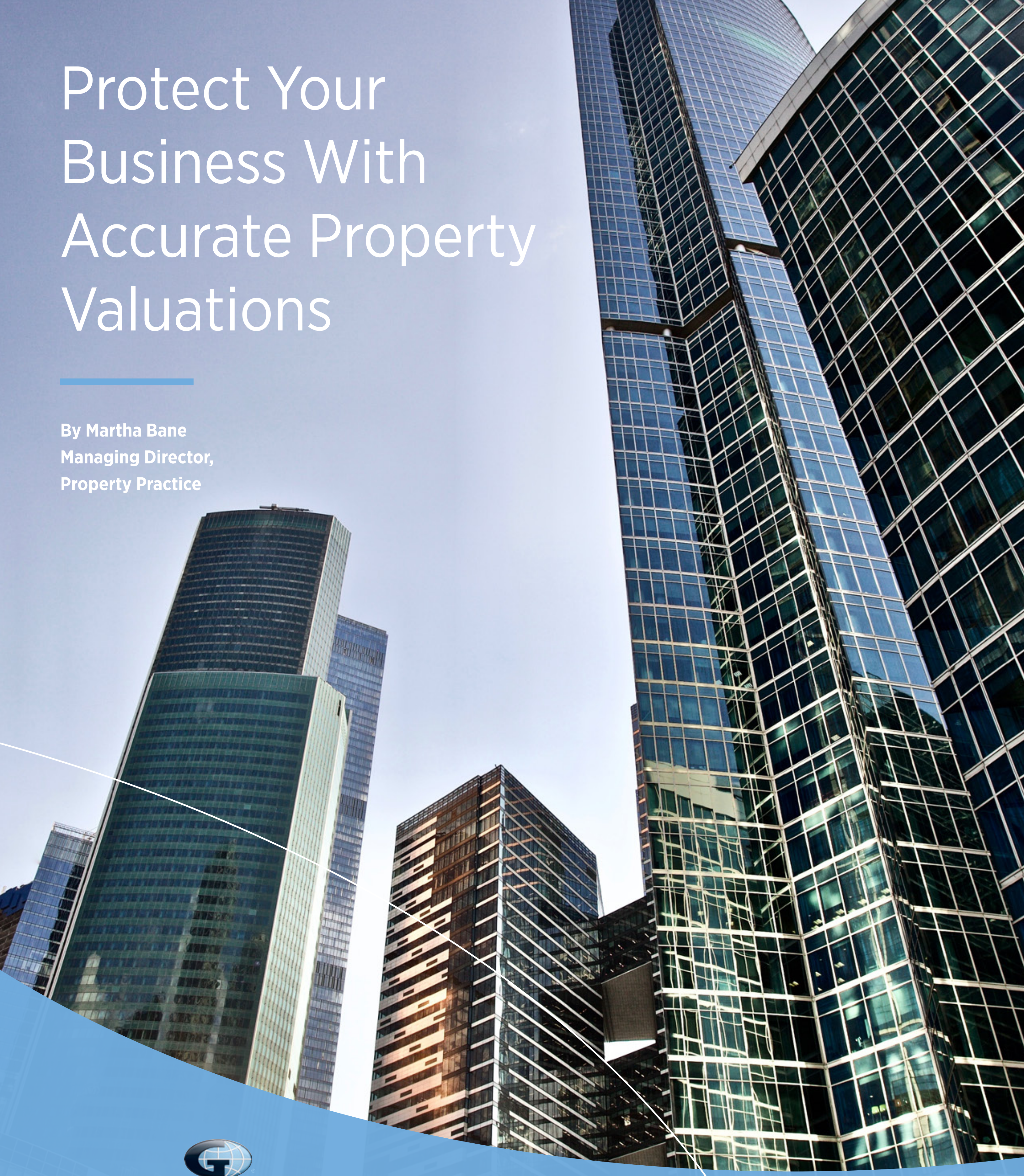

Protect Your Business With Accurate Property Valuations

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Accurately determining a property's value can be a challenge—however, if not done correctly, it may have serious consequences. Inadequate or inaccurate property valuations can lead to financial surprises in the aftermath of a loss, which can also affect your bottom line.

Property valuation is the process of determining the replacement cost value of a property and its contents, along with business interruption values, for insurance purposes. Although there are different methods for determining a building's value, replacement cost is the most common and widely accepted valuation for insurance purposes. Building replacement cost covers the cost to repair or replace a building with materials of like kind or quality and does not include the value of the land. It is important to note that it is not purchase price or tax/book value. Contents valuations can be more complex, as equipment replacement time varies widely by industry and needs to be researched in more detail. Business income insurance, also known as business interruption coverage, helps cover lost income and additional expenses when your business is shut down from a covered loss. If calculated correctly, these total insurable values (TIV) should capture the size and scope of a company's property exposures. Property valuations are generally provided to the insurer in a statement of values (SOV).

A Challenging Property Market Further Highlights Underreporting of Property Values

Determining accurate and defensible property values is essential for property insurance and serves as one of the primary factors that drives underwriting decisions. It is important to remember that insurance companies use reported values to determine capacity, terms, pricing, deductible structures and models, and price their catastrophe rates based on these values. Therefore, if values are underreported, the risks will outweigh the premiums collected and could affect an insurer's ability to pay claims.

Providing accurate property values is not only important to your overall risk assessment, but there is also a reputational risk at stake. Inaccurate reporting can result in an insurer losing trust in your company. This could result in stricter terms such as occurrence limit of liability limitations or harsher deductible structures.

In addition, insureds have used blanket policy limits to provide them with the security of knowing that if they reported incorrectly on the SOV and a loss occurred, they would still be able to recover the full amount of the loss. With the increase of occurrences like this, we have also seen a decrease in the availability of blanket policy limits, and an increase in insurers fighting these claims and also pushing litigation.

When a carrier questions the building values reported, most will run their own building valuations and require the amendment of values, or charge premiums based on the often-higher values. This can substantially increase an expected renewal premium.

The Importance of Standardized Reporting

In addition to underreported values, another issue we see regarding property valuation is nonstandardized reporting mythology. Gathering figures for the SOV is seldom done by one person. There are often multiple individuals within an organization that contribute to building out the SOV, including CFOs, accountants, outside vendors, etc. Therefore, a standard should be enforced when gathering the data. For instance, it is important to make sure that everyone uses the same calculation to determine the inflation rate. Establishing a consistent quality standard across all channels will ensure that you obtain the most accurate data.

Increase Your Chances of Getting the Best Property Values With Appraisals

Professional appraisals enable owners and principal stakeholders to protect investments and receive maximum value in a loss. They ensure that you are properly insured by helping minimize potential liability from unanticipated adverse claims resolution due to inaccurate, undervalued property, as well as helping minimize the potential premium cost of overinsuring a property. Benefits of getting an appraisal can include the following:

» Confirms accuracy of building square footage, construction materials/components, construction quality, etc.

» Accurately reflects current valuation for new building construction or renovations that have been completed.

» Provides documentation for proof of loss.

» Provides confidence to underwriters that the values were determined by an experienced, unbiased professional. This differentiator should lead to greater market access, better terms and conditions, more program options, and improved underwriting results.

» Offers due diligence to help support decision-making when considering alternative policy structures, deductible options, and multicarrier shared and layered programs.

Updated appraisals are recommended every three to five years to keep values current. They should be conducted by reputable firms familiar with similar industry facilities. Review construction trend factors and inflation annually and adjust appraisal values accordingly. This approach will generally provide a relatively accurate adjusted value. It is important to note that most appraisal firms will not trend up an appraisal that's more than five years old.

The additional costs associated with LEED-certified buildings are generally not included in standard replacement cost appraisals. The appraisal needs to be amended to include building enhancements if they are significant enough to have a discernable impact on the building's cost. This might consist of engineered wood and composite construction materials, green roof systems, special window treatments and glazing, specialized plumbing and fixtures, greywater systems, and many other components. These additional features should be accounted for and values added to the structure to reflect the correct replacement cost.

It is important to use a reputable appraisal company that adheres to the Uniform Standards of Professional Appraisal Practice (USPAP) and the Code of Professional Ethics and Standards of Professional Practice of the Appraisal Institute.

Our partner, Gallagher Bassett Services, provides proven valuation methods that appraise buildings, contents, machinery, equipment, furniture, fixtures and leasehold improvements to establish true insurance replacement values. They offer a cost estimator report and value verification form, along with orderly and forced liquidation appraisals. Their process includes:

» Establishing the proper level of insurance coverage

» Maintaining up-to-date appraisals

» Assisting clients in the claims process if a loss occurs

The goal of Gallagher Bassett's appraisal process is to provide clients with replacement cost and insurable values for their critical assets, specifically buildings, structures, machinery, equipment, furniture and fixtures. To learn more, visit www.gallagherbassett.com.

Can't Get an Appraisal? Use Validated Tools and Reference Guides

If you cannot get a physical appraisal, a desktop valuation platform can be a useful tool for identifying anomalies in valuation, but it is only as accurate as the data entered. These tools require the user to make certain subjective assessments and incorporate generic assumptions that may not be appropriate for a particular building.

Another way to determine the value of your property is to use the cost of new construction. The replacement costs you report for older properties should align with the costs of constructing a similar building today, in the same geographic region, using current construction materials and adhering to current standards. If you calculate using this method, it is important to consider the direct costs (materials and labor) and the indirect costs (taxes, administrative fees, financing costs, professional fees, etc.).

You can use Insurance Services Office (ISO) or carrier-provided business income (BI) worksheets to help you calculate BI generated in the previous 12 months and estimate income for the next 12 months. Remember to adjust your future projections by incorporating items such as expected sales increases.

Once you have a 12-month income projection, you can estimate the period of restoration. When calculating, it is best to base the estimate on a worst-case scenario. A variety of BI worksheets for various industries and with different methodologies are available. Working with your broker to reflect the most accurate value for your particular exposure and industry need is essential.

Conclusion

2020 has been impacted by catastrophic events such as hurricanes, wildfires, a pandemic and much more. These events have and will continue to impact the property insurance marketplace. Loss trends have continued to outpace pricing models and, as a result, we have seen underwriters focus more on valuations over the year.

The best way to protect your business is to follow the tips described in this paper, and provide the most accurate information to your broker and underwriter. Underwriters will use their own discretion to determine values and corresponding rates in the absence of verifiable data. Gallagher recommends a measured approach to reviewing and updating values, and we are here to assist you with the best methodology to achieve your desired results.

Gallagher is here to help you face your future with confidence. Reach out to your Gallagher advisor for answers to related questions and additional information.

SOURCES:

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Monitoring Key Trends and Finding an Optimal Approach to Property Valuation by Global Risk Consultants

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About the Author

Martha Bane is the managing director of Gallagher's Property practice and a principal in the Real Estate & Hospitality practice. She started her career in insurance in 1994 with General Star Insurance Company. Martha spent six years as a property and inland marine underwriter with Chubb. She specialized in underwriting large national and international property and builders risk programs for real estate, hospitality, healthcare, higher education, financial and municipal clients.

Martha has used this experience to structure, negotiate, and implement large national property and builders risk programs, with an emphasis on catastrophic exposures. Her expertise with complex layered and quota-share programs and senior insurer relationships helps deliver innovative insurance and risk management property solutions to Gallagher's clients.

Martha also manages Gallagher's Los Angeles Real Estate & Hospitality team. The team is made up of 35 insurance professionals specializing in property, casualty, environmental and financial products for Gallagher's real estate and hospitality clients. They currently place coverage in the worldwide insurance marketplace for clients with more than $150 billion in insurable values.

Martha has spoken at numerous industry events on a variety of property insurance-related topics. *Intelligent Insurer* recognized her as an influential woman in reinsurance in 2017, and she received the Women to Watch Award from *Business Insurance* in 2020.

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