INSIGHTS
RISK & INSURANCE

Don't Let These Common Property Valuation Mistakes Ruin Your Insurable Values

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Know the risks of inaccurate insurable property values.

Do you know the insurable value of your property?

Most risk managers would instinctively say "yes, of course!" Correctly valued property, after all, underpins a successful insurance program and ensures that all buildings, equipment and inventory that need to be replaced after a loss will indeed be covered.

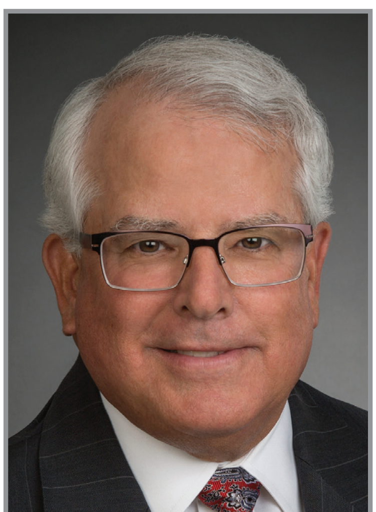
"When people talk about values, they tend to forget the multiple impacts to a business. Things like loss estimates on the account, reinsurance issues, etc. all stem from identifying accurate insurable value", says Rick Lunt, Global Manager – Valuation Services of Global Risk Consultants.

Accurate insurable values matter to carriers, too. Insurers and re-insurers increasingly depend on catastrophe models to assess the accumulation risk in their portfolios, but those models are ineffective if the wrong values are fed into them. If a carrier can rely on their insured's values, it helps both parties build a more trusting relationship.

Establishing accurate insurable values, however, is not as straightforward as it may seem.

"Insurable values don't just appear in a financial statement," Lunt said. "You have to work to develop credible insurable values and keep them updated."

Here are some mistakes commonly made when determining insurable values:



Rick Lunt
Global Manager
- Valuation Services

1. Relying on Depreciated Value

Often times, the depreciated value of buildings, equipment and other property is pulled from financial statements, but that number is not a true reflection of replacement cost.

"Depreciated value is often brought into the insurance discussion when really it is not relevant to developing insurable replacement costs. What you really need to know is replacement cost, as defined by your insurance policy," Lunt said.

To get at building replacement costs, companies may consult a professional contractor or in-house construction staff, utilize a building estimating tool, or rely on a replacement cost appraisal. For personal property, true replacement costs can be established with assistance from in-house engineering and purchasing staffs, discussions with equipment manufacturers and suppliers, or with a replacement cost appraisal.

2. Not Utilizing Proper Cost Indices

Unfortunately, determining correct values in the first place is only half the battle. The other half is keeping the values current and aligned with inflationary cost indices and market trends. Many times, decision makers fail to factor in these trends and let their insurable values gradually fall out of date.

"If the goal is to identify the current replacement cost of a piece of equipment that is five years old, there is a need to recognize the value of the original acquisition cost and apply inflationary cost trends to determine an approximate, current replacement value," Lunt said.

If inflation runs at 2-3% per year, reported insurable values can be off 15% or more five years down the road should proper cost indexes not be applied.

Like inflation, the ups and downs of the construction market may have a significant impact on insurable replacement costs. Even if new construction is flat nationally, an insured's specific location may be in a pocket experiencing a building boom, which may boost construction costs. "It's important to be aware of how the construction market is performing on a local level, rather than just relying on available information regarding national trends," Lunt said.

3. Outdated Asset Records

The use of capital asset records is often a good starting point to begin developing insurable values. Based on the original acquisition cost of machinery and equipment, the application of proper cost trends can provide a reasonable estimate of current insurable replacement values. This approach, while a good one, is reliant upon the accuracy of the asset records themselves, which is based on how often records are updated in regards to the addition of new equipment, the retirement of old equipment, and the policy for expensing small items that are no longer on the books.

For example, tooling may be expensed on the books, yet still be functional and in production.

"In manufacturing plants, for example, things like tooling for equipment, dies and fixtures get written off quickly, but they are necessary for the operation of that equipment and need to be accounted for," Lunt said.

From raw materials through to finished products, inventory can be a large component of insurable value. Decision makers should be aware of how finished goods are valued – either at selling price or cost. Most importantly, decision makers must be aware of how this value is established, and care should be taken to ensure that the reported value approach matches the provided coverage.

"Cost is available from the Balance Sheet and is often reported, but selling price may be the proper insurable value," Lunt said. "In developing insurable values, coming up with selling price may be more of a challenge than simply using the cost/market value figure from financial statements, two very different figures."

Turn to a Trusted Consultant

An experienced and trustworthy valuation service provider can help get the numbers right. Many third-party providers, however, work on a project-by-project basis. The relationship doesn't extend past the actual valuation. That can be problematic if risk managers have follow-up questions or need recommendations on how to keep their values updated.

Global Risk Consultants (GRC) has long provided fire protection engineering, boiler and machinery, and other loss control services to clients. With a customer focus at the forefront, GRC expanded its service portfolio to include property valuation in January 2017, providing the service after identifying the opportunity to provide clients yet another unbundled loss control solution.

Lunt, who has years of experience as a professional appraiser, brings a unique perspective to integrating this service into an unbundled risk management program. With his valuable knowledge and experience on the carrier side, Lunt now heads up this GRC team worldwide.

"Unlike some other providers in this space, we take a consultative approach," Lunt said. "We want to build lasting relationships with our clients, provide them with advice and guidance, answer questions, and act as their partner."

The new valuation team will work with clients' needs and within their budgets, providing everything from simple analyses in the form of desktop estimates, all the way through to on-site inspections.

"An on-site visit may not always be necessary if we can get enough information from past appraisals, asset records, building construction cost data, etc. But seeing property in person is always the best way to determine its value," Lunt said.

"At Global Risk Consultants, it's all about bringing technical expertise to the client. We're focused on bringing the best information possible to the customer to build long-term partnerships."

To learn more about Global Risk Consultants' property valuation services, visit https://www.globalriskconsultants.com/.

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