

Innovative Solutions. Accurate Valuations.

Insurance Appraisals & the Importance of Insuring to Value

Shaun M. Callahan

## Property Appraisals and the Importance of Insuring to Value

- Speaker: Shaun M. Callahan
- Topics of Discussion
  - What is an appraisal?
  - Why is an insurance appraisal important?
  - The rise of construction costs
  - How are the resulting values of an appraisal established?
  - What is included and excluded in an insurable value?
  - Cost variances based on location
  - Insurance appraisal services and options
  - Sample reports
  - Case study

- An appraisal is an unbiased opinion of value.
- Types of value
  - Fair Market Value – is the estimated amount, expressed in terms of money, that may be reasonably expected for a property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relative facts, as of a specific date.
  - Replacement Cost New – is the current cost new, of a similar new property having the nearest equivalent utility as the property being appraised.
  - Reproduction Cost New – is the current cost of reproducing a new replica of a property with the same or closely similar materials.

## Why is an Insurance Appraisal important?

- An insurance appraisal provides a third party, unbiased valuation of the property's replacement cost.
- If a loss occurs, an appraisal, along with all data acquired during the appraisal, will be available to help expedite the settlement of a claim.
- Obtaining an insurance appraisal demonstrates due diligence on the part of the entity and/or insurance agent.
- Obtaining an insurance appraisal ensures that property is not wastefully overinsured or dangerously underinsured.
- An insurance appraisal assists in placing the property coverage with a carrier by providing documentation needed to write coverage.

A collage of four images: a modern highway interchange, a colorful abstract pattern, a classical building facade with columns, and a group of people silhouettes holding up a structure.

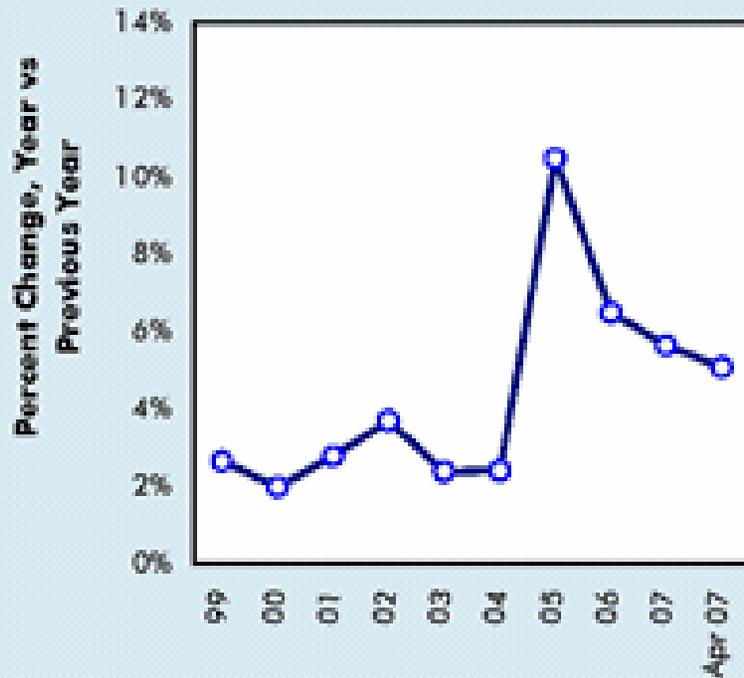
## The rise of construction costs.

- What are the causes?
  - Natural disasters / catastrophic loss
  - Shortage of critical building materials
  - Increased cost of raw materials
  - Shortage of labor
  - Design expectations
  - State-mandated building requirements and code compliancy

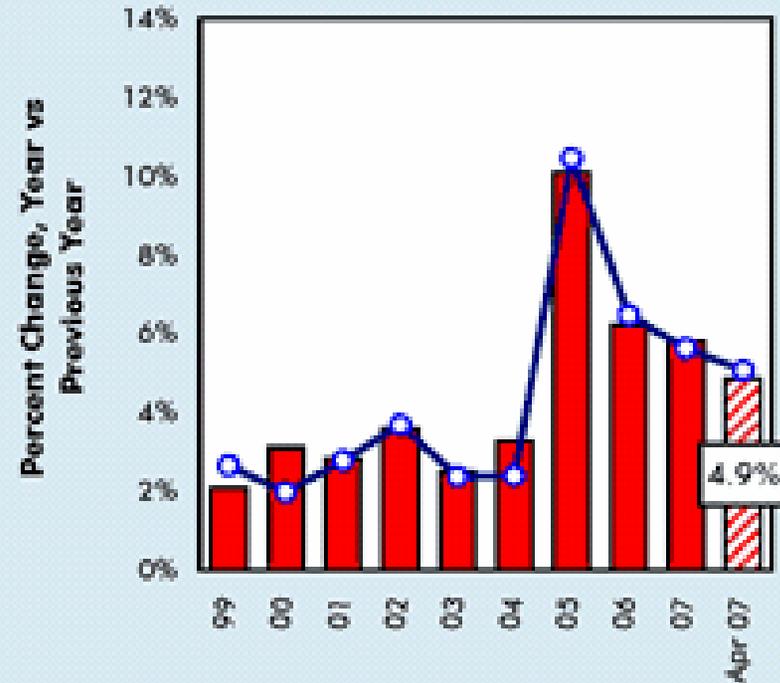
- Catastrophic loss
  - 2004
    - Hurricane Charley - \$15 Billion
    - Hurricane Frances - \$9 Billion
    - Hurricane Ivan - \$14 Billion
    - Hurricane Jeanne - \$6 Billion
  - 2005
    - Hurricane Dennis - \$2 Billion
    - Hurricane Katrina - \$100 Billion
    - Hurricane Rita - \$10 Billion
    - Hurricane Wilma - \$10 Billion

The rise of construction costs.

**NATIONAL 30-CITY AVERAGE**



**ATLANTA, GA**



Data source: Reed Construction Data – RS Means  
 Charts: Reed Construction Data - CanaData

- Raw material specific statistics – Based on an in-house study completed by MAXIMUS in 2006.
  - Oil: Jan 2002 (\$20 per barrel) – July 2006 (\$74 per barrel) = 370%
  - Steel: 2002 to 2006 – Costs have risen approx. 62%
  - Lumber: 2002 to 2006 – Costs have risen approx. 22%
  - Copper: Jan 2002 (0.75 per lb.) – June 2006 (\$3.00 per lb.) = 300%
  - Concrete: 2000 to 2006 – Costs have risen approx. 25%
  - Drywall/Gypsum Products: 2000 to 2006 – Costs have risen approx. 51%

## How are the resulting values of an appraisal established?

- It is undoubtedly a difficult task to not only identify but continuously substantiate values. Multiple sources of value exist, but to rely on one can be dangerous as they all have positive points to pull from.
- Primary sources of construction cost information include:
  - Direct cost information from clients
  - Inquiries with local contractors and architects
  - US Department of Labor – Bureau of Labor Statistics
  - Marshall and Swift
  - RS Means Construction Cost Index
  - Reed Construction Data
  - Producer Price Index
  - Associated General Contractors of America

## What does an “Insurable Value” include?

- Hard costs to construct the building:
  - fees to the main contractor and all subcontractors. These include the original lump sum cost plus any reasonable cost overruns due to change orders and unforeseen conditions.
  - Material costs, include sales tax and freight charges, should be reflective of the current market as of the effective date of the appraisal.
- Miscellaneous fees charged by contractors:
  - Insurance
  - workers compensation
  - sales tax
  - Overhead
  - Profit
  - contingency fees

## What does an “Insurable Value” include?

- Soft costs to design and engineer the building. An argument can be made that these costs would not be recurring for a new building should it suffer a loss. While that may be true to some extent, certainly a design professional would be involved to assess the damages, recreate the drawings, guide the project through the permitting process, and likely provide construction supervision.
- Permit fees, inspection fees, and related compliant costs. Zoning ordinances are considered a separate issue from building codes and are not normally addressed in an insurance appraisal.
- Soft costs to finance the project during a normal construction period are valid and should be included provided that they are considered usual and customary. Complex financing schemes or speculation projects are not valid.

A collage of four images: a modern bridge structure, a colorful abstract pattern, a classical building facade with columns, and a group of people with their arms raised in a celebratory gesture.

## What does an “Insurable Value” exclude?

- The cost of acquiring or developing land. Land is real property that is never insurable by itself.
- Utilities are considered infrastructure costs and are not normally insurable.
- Site improvements (also known as land improvements) are real property costs, which may or may not be insurable depending on their type.
- Building foundations, including piling and/or soil engineering are legitimate construction hard costs, but are typically excluded by the insurance policy. Policy exclusion can vary as in the case of earthquake coverage and should be clearly identified.

## What does an “Insurable Value” exclude?

- Personal property contained within the building.
- Soft costs related to advertising:
  - pre-design reviews
  - soliciting bids
  - employing liaison staff
  - public communications
  - committee oversight
  - executing related accounting, etc...
- These are all considered administrative costs. Administrative costs can range from negligible to more than the total hard costs. This is a grey area and certainly the cause of many differences of opinion between a building’s value vs. what a client insists it actually costs.

A collage of four images: a modern highway interchange, a colorful abstract pattern, a classical building facade with columns, and a group of people with their arms raised in a celebratory gesture.

Cost variances based on location.

- Local sales taxes
- Local wage taxes
- Inspection practices
- Licenses, codes, and fees
- Proximity to building material sources
- Local weather conditions (high wind, extreme temps, etc...)
- Seismic and earthquake zones
- Abnormal shortages of material and labor
- Hillside construction
- Downtown / congested areas
- Remote locations

A dark grey horizontal bar containing the text "Insurance appraisal services include:" in a white, sans-serif font. The background of the slide features a collage of images: a highway interchange, a colorful abstract pattern, a classical building facade, and a group of people in business attire.

- Valuation for replacement and reproduction costs
- Certified appraisal reports for underwriting, proof-of-loss substantiation, and disaster assistance documentation
- Equipment and contents appraisals
- Valuation of insurable land improvements
- Flood zone classification
- GPS coordinate recording
- Perpetuation of insurable values

**Entity:** 00 SAMPLE CITY  
**Site:** 03 SAMPLE CITY PUBLIC SAFETY BUILDING  
**Building:** 01 PUBLIC SAFETY BUILDING  
 1234 PUBLIC SAFETY LANE  
 SAMPLE CITY, WA 99999  
**Department:** 00 NON-DEPARTMENTAL  
**Year Built:** 1988 **Year Acquired:** 1988  
**Nbr. of Stories:** 3 **Square Footage:** 133,003  
**Basement:** NO **Adds/Renovations:** NO  
**Occupancy:** GPS POLICE STATION  
**Frame Type:** FPS FIRE-PROOFED STEEL  
**ISO Class:** 5 MODIFIED FIRE RESISTIVE  
**GPS Latitude:** 26°32.351666 N  
**GPS Longitude:** -81°45.9735 W  
**Fire Protection:** SPRINKLER SYSTEM  
 INTRUSION SYSTEM  
 FIRE ALARM - MANUAL  
 FIRE ALARM - AUTOMATIC



### GENERAL BUILDING CHARACTERISTICS

**Exterior Walls:** REINFORCED CONCRETE, GLASS METAL CURTAIN  
**Roofing:** BUILT-UP SMOOTH,  
**Foundation:** CONCRETE FOUNDATION WALLS, CONCRETE SLAB ON GROUND  
**Floor Finish:** ASPHALT TILE, CARPETING  
**Ceiling Finish:** ACOUSTICAL,  
**Partitions:** CONCRETE BLOCK, DRYWALL/STUDS

**Services:**  
 ELECTRICAL  
 PLUMBING  
 HEATING - ELECTRIC BASEBOARD  
 HEATING - ROOF TOP  
 AIR CONDITIONING - ROOF TOP

**Features:**  
 FREIGHT ELEVATOR  
 BACKUP GENERATOR  
 LOADING DOCK  
 WALK-IN FREEZER  
 COVERED ENTRANCE WAY  
 ROOF TOP STRUCTURE

**Notes:**  
 SERVICES AND OCCUPANCY FOR THIS STRUCTURE ARE ABOVE AVERAGE AND ALL LAW ENFORCEMENT RELATED. INCLUDES ADMINISTRATION AND PHYSICAL CONTAINMENT FACILITIES. TECHNOLOGICAL ASPECTS ARE ABOVE AVERAGE TO INCLUDE FULL INTERNAL NETWORKING CAPABILITIES. SECURITY SYSTEMS ARE STANDARD FOR THE CLASS OF OCCUPANCY.

### VALUATION CONCLUSIONS

<b>Replacement Cost New:</b>	18,621,000
<b>Exclusion Amount:</b>	931,000
<b>Replacement Cost Less Exclusions:</b>	17,690,000
<b>Actual Cash Value:</b>	18,621,000
<b>Exclusion Amount:</b>	931,000
<b>Actual Cash Value Less Exclusions:</b>	17,690,000
<b>Contents Value:</b>	4,958,400
<b>EDP Equipment Value:</b>	0
<b>Property In The Open:</b>	0

- 2004 Property Listing
  - \$50K Blanket Policy
  - 420 Structures Listed in the SOV
  - \$230,946,800 – Building Value
  - \$106,418,900 – Personal Property
  - \$337,365,700 – TIV
- 2005 Property Listing
  - Insure to Value
  - 879 Structures
  - \$440,558,050 – Building Value
  - \$159,981,100 – Personal Property
  - \$600,539,150 – TIV
  - 459 Building Adds - \$263,173,450

