



How are you determining your insurable values?

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In recent years, construction costs throughout Canada have escalated at an accelerated rate; this has been magnified in provinces such as Saskatchewan that have experienced 'hyper-inflation.' This escalation is due to a combination of factors, including steep price increases for many building materials, and rising labour costs due to a shortage of skilled labour in the building trades. These cost increases are magnified in certain areas as a result of the boom in the oil and natural resources sectors. Increases to construction costs have been significantly higher than the general inflation rate across Saskatchewan since 2008.

Because of these price increases, many public sector properties risk being under-insured. It may be time to ensure your properties' insurable value is reliable.

COMMON PITFALLS

It is not uncommon to overlook the importance of accurately determining the replacement cost of properties. As a result, the insurable value you report may have come from a variety of less-than-reliable sources including:

1) *Use of Developer's Construction Costs*

The reported insurable value may have been based on the developer's construction cost. This amount may not include 'soft costs' such as fees for architects, development, and general contractors. These are significant costs that should be included in the insurable value of the municipal property schedule.

A developer with multiple projects can also achieve efficiencies on material and labour costs. The reduction in these costs may result in a lower construction cost for the subject property that may not be achieved in the event of a loss and reconstruction of a single building. Our experience has shown that in Saskatchewan, developer's construction cost can be approximately 20 to 40 per cent less than the replacement cost of the subject property.

2) *Extended Indexing of Insurable Value*

Once an insurable value exists, many insurers/insurance brokers may use the annual Consumer Price Index (CPI) to update the insurable value of the subject property for an extended period. The

annual CPI has been reported in the three per cent range in recent years. In contrast, construction costs in Saskatchewan have seen periods that averaged twice this amount; this can be exacerbated for special-use facilities such as arenas or water treatment. If the original construction cost being indexed is incorrect, it can compound the error as time goes on. Lastly, even with a correct original construction cost, and accurate inflation index factors, an insurable value should not be indexed up for more than three to five consecutive years.

3) *Estimates from Unqualified Parties*

In an attempt to save costs, some organizations may develop a replacement-cost estimate on a cost-per-square-foot basis only. This methodology is not reliable since it may not consider location, construction quality and many of the important specialty features of municipal properties. Many of the construction details of municipal properties can only be verified by a physical inspection and comprehensive review of the architectural and site plans. In addition, the firm that completes the estimate should have specific architectural-costing experience

versus market-value appraisal experience. Market-value appraisals consider many other factors that are not relevant to the insurable value.

GETTING IT RIGHT

An insurance appraisal is the most accurate way to determine the current insurable value of your property. It is a formal estimate or opinion of value on a property as of a specified date.

The insurable value should be based on the Replacement Cost New of the building construction and if required, associated site improvements. This value is based on a physical inspection, review of the building plans (architectural and site), and the development of current construction costs.

Appraisal firms use various construction costs from published sources including Marshall & Swift/Boeck, R.S. Means Construction Cost Data, and Handscornb's Yardstick for Costing. A reputable appraisal firm will also cross reference this data with actual construction costs (including soft costs) reported by contractors and developers to account for regional influences where there have been significant market shifts.

Finally, construction costs of similar facilities appraised should be used as a benchmark test to ensure the insurable value is correct. It is important that the insurance appraisal firm you engage uses many of the above resources to develop an accurate insurable value for your property.

QUALIFICATIONS OF REPUTABLE APPRAISAL FIRMS

To select a reputable appraisal firm, look for these qualifications:

- The firm carries a minimum of \$5 million errors and omissions insurance.
- The appraisers have an educational background in architectural costing or engineering.
- The appraisers are experienced at completing insurance appraisals for public sector entities in your area.
- The appraisal service includes both above-grade and below-grade assets.
- The appraisal service complies with the Uniform Standards of Professional Appraisal Practice.
- The appraisers review architectural plans, and site plans, as best available.

In conclusion, it is prudent for all municipalities to measure the origin of your insurable values for your property assets.

With the significant rise in construction costs in Saskatchewan since 2008, and the scrutiny of the public, it is important for municipal officials to understand your insurable value schedules.

To highlight this, here is an example. In 2006, a basic pre-engineered steel building in Saskatoon could be constructed for \$65 per square foot. Today, depending on the interior finishes (office to warehouse ratio) that same building is in the range of \$100 to \$110 per square foot! For specialty-use properties in non-urban settings this type of change is even further magnified.

If your organization is under-insured and suffers a loss, there could be serious financial and legal implications for your municipality. On the other hand, if you are over-insured, precious civic funds are being spent on premium payments, which could be used elsewhere. ▼



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