



nerej

Property valuation due to inflation for real estate portfolios - by Spencer Macalaster

October 28, 2022 - Spotlights



Spencer Macalaster

Many real estate property owners often think they should insure the building for what they paid for it or what the current market value might be. This however, does not take into consideration what would happen in the event of an insured property loss that requires rebuilding to the original like-kind condition. What an owner “paid” for a building or what it might be “worth” in the open marketplace versus how much it might cost to rebuild the building for the “insured” value are not the same.

Property valuation modeling (also known as Total Insured Value modeling) is the process of using actuarial and construction data to estimate accurate replacement cost values on individual properties within a real estate portfolio. Property valuation modeling is especially applicable to helping understand the cost to rebuild your real estate portfolios utilizing actuarial data, engineering, and construction costs. Replacement cost valuation resources such as Marshall and Swift, CORE Logic or a detailed appraisal are tools to help establish insured value for a property insurance policy.

Setting aside what the causes of loss may be, the current construction marketplace is rapidly changing and insurance portfolios must be adjusted to make sure accurate values are reflected in the policy before a loss occurs. Carriers utilize valuation modeling to make sure the replacement cost shown on the policy reflects the geographic location of the property and type of construction. Insurance companies utilize models of replacement cost for underwriting, as it is imperative for them to estimate the correlation of risk at the different locations and have a means for estimating their aggregate exposure. In the current insurance marketplace, the property carriers are looking closely at a portfolio’s valuations. Many insureds have utilized the same replacement cost values for years. In today’s construction environment the inflation related increase in materials, cost of labor, and supply chain issues have all contributed to the expectation by carriers to increase replacement costs on every policy at renewal.

Commercial property owners can be proactive about their portfolio’s replacement cost values and exposures by utilizing models provided by their insurance brokers. This starts first with understanding where your property is physically located - whether it is a high risk or a moderate to low risk. Through this modeling appropriate levels of coverage, size of deductible and safety precautions can be assessed. Other factors that need to be taken into consideration when determining the replacement cost include the type (commercial, residential, manufacturing, retail, etc.) of building, the size of the building, type of construction (frame, concrete, metal etc.), type of protection (sprinklers, fire detection, smoke alarms, etc.), as well as exposure to catastrophic events (flood, earthquake, wind storm, etc.).

With any models, it is all about the data. Results are only as good as the information put into them. It is essential that input be accurate so output is the same. The details matter, so when working with a Modeling firm companies should be prepared to provide:

- Address - number, street, city or town, state, zip code and geocodes if available

- Replacement cost values - building, equipment, personal property and business interruption
- Type of construction
- Type of occupancy
- Year built
- Number of stories
- Type of fire protection or other alarm systems

If you know type and age of roof, roof geometry, and roof top mechanical and electrical equipment anchoring, and other so-called secondary modifiers, it is important to include this information. It can be extremely useful for refining results.

Modeling can help you understand the exposures by location, and in the aggregate over multiple locations. Modeling can help find ways to mitigate your exposures through property loss prevention and loss control measures. This also helps structure insurance programs efficiently and economically, negotiating the right coverages, limits and deductibles at a reasonable cost with underwriters.

Following an evaluation and implementation of risk control measures, decisions can be made around how much exposure to retain through deductibles and how much coverage and limit to transfer and buy through your insurance program. If a property owner has multiple buildings that could be exposed to a single event in a specific geographical area, then it is important to look at the aggregate exposure to all loss when making insurance decisions. Modeling provided directly to the property owners is also an effective negotiating tool against a carriers modeling, helping in the negotiation process for improved insurance program design and cost.

Spencer Macalaster is the executive vice president at Risk Strategies Co., Boston, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540