

LOSS PREVENTION

ASSESSING YOUR BUILDING'S VALUE AND RECONSTRUCTION COST

You have a residential or commercial building that you need to insure. But do you know how to accurately determine its value? It's an important question: if you ever sustain an important loss (for example, after a fire), the amount of compensation you'll receive to rebuild your property will be based on this estimated value. If your estimate is higher than the actual value of your property, you'll be paying a higher premium than you need to. But if your estimate is too low, then you won't get the full amount you need to rebuild. As many as 30% of commercial buildings are under-insured in Canada.¹ Coming up with an estimate can be more complicated than you might think, since a number of variables come into play, including the complexity of the construction, price fluctuations in the cost of materials and labour, and the indirect costs involved in demolition and reconstruction. That's why it's always a good idea to turn to a specialized insurance appraiser.

HOW DO UNDER-VALUATIONS HAPPEN?

Your property might be under-valued if you don't use the proper evaluation method. Property value is often based on evaluations that don't serve the same purpose as insurance:

- ▶ Market value assessment
- ▶ Municipal assessment (for property tax purposes)
- ▶ Actual construction cost (at time of construction, adjusted for cost of living increases)
- ▶ Approximate square footage value
- ▶ Mortgage amount

You can find valuation software on the market. But some of these tools use questions that are too general, tables that only apply to standard buildings, data that isn't up-to-date, or calculations that don't account for factors like cost of living and inflation.

Another contributing factor is the cost of building materials and labour, which can fluctuate for a variety of reasons, including inflation, deflation, demand, and local or international market conditions. That's why it's a good idea to ask a contractor or insurance appraiser for an assessment.

GETTING AND ACCURATE ASSESSMENT

So why can't you just add 25% to the market value of your property? It's a simple enough calculation, but it's not very accurate. For better accuracy, your calculation needs to take into account multiple factors that might influence the reconstruction cost, including:

- ▶ Dimensions and measurements (e.g., perimeter, total square footage, number of floors, wall height)
 - Taller buildings are often subject to additional requirements from regulators like the Régie du bâtiment du Québec (RBQ).
- ▶ Type of building materials (wood, masonry, steel, concrete)
 - The cost of materials varies based on quality, fire resistance, etc.
- ▶ Building use
 - For example, a retirement home will likely be subject to stricter requirements than a standard rental property.
- ▶ Year of construction and the condition of the building (renovated or not)
- ▶ Complexity of the structure (e.g., unique architecture) →



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- ▶ Quality of finishing materials (marble floors, crown moulding, acoustic tiles, etc.)
- ▶ Electrical and mechanical systems and built-in equipment (elevator, automatic sprinkler system, fire alarm, air conditioner, etc.)
- ▶ LEED certification
- ▶ Landscaping and parking areas

OTHER COST CONSIDERATIONS

In addition to the specific features of your building, you also need to factor in indirect costs, which may fluctuate over time, such as: building materials and labour; clean-up, demolition and debris removal; and site clearing and preparation.

Plus, in the event of reconstruction after a loss, your building might be subject to new RBQ standards (see the Building chapter of the Safety Code) and require modifications (e.g., fire safety requirements for tourist accommodations with five or more rooms, daycare centres, retirement homes, rooming houses, office buildings with three or more floors, etc.).²

Any estimated reconstruction cost should also include an extra amount for automatic sprinklers.

And if you decide not to rebuild, your compensation may be reduced by a depreciation factor (e.g., a 1940s building that has never been renovated).

WHAT HAPPENS IF YOU'RE UNDER-INSURED?

If you file a claim, your insurer will pay the agreed upon insurance amount, which is based on the estimated value of your building—not the actual cost of the damage. If the building is a total loss and you're under-insured, you won't get the amount you need to rebuild your property to its pre-loss condition. In other words, you're risking a huge financial hit.

In the event of a partial loss, some insurers will apply an 80% or 90% "co-insurance clause," which means they'll only pay a percentage of the value of the damage. Find out from your insurer whether your policy has a co-insurance clause. If so, you might not be fully compensated in the event of a loss.

RECOMMENDATION

Get a proper appraisal of your property to determine the reconstruction cost—it'll make all the difference between being fully compensated and taking a financial hit in the event of a claim.

That's where a specialized insurance appraiser can help. These specialists will visit your property to conduct their assessment. They'll take into account the specific features of your building, plus all the other factors that could influence the reconstruction cost.

A specialized appraiser is especially recommended if you have an older or more ornate building that was built with materials that might be more difficult to locate now. It's the best way to make sure you're insuring the full value of your property!

One final tip: make sure to update your appraisal whenever you make any modifications to your building, or every three years, to account for changing factors like cost of living increases, labour and building material costs, and new RBQ Safety Code or Construction Code requirements.

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Warning

The information in this fact sheet is of a general nature and is provided for information purposes only. It is not exhaustive.



1. Valeur de reconstruction : le problème tarde à se régler, Le Journal de l'Assurance : <http://journal-assurance.ca/2009/09/25/valeur-de-reconstruction-le-probleme-tarde-a-se-regler/> (only available in French)
2. Builder chapter from the Safety Code, Régie du bâtiment du Québec <https://www.rbq.gouv.qc.ca/en/faq/areas-of-intervention/building/building-chapter-from-the-safety-code.html>

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