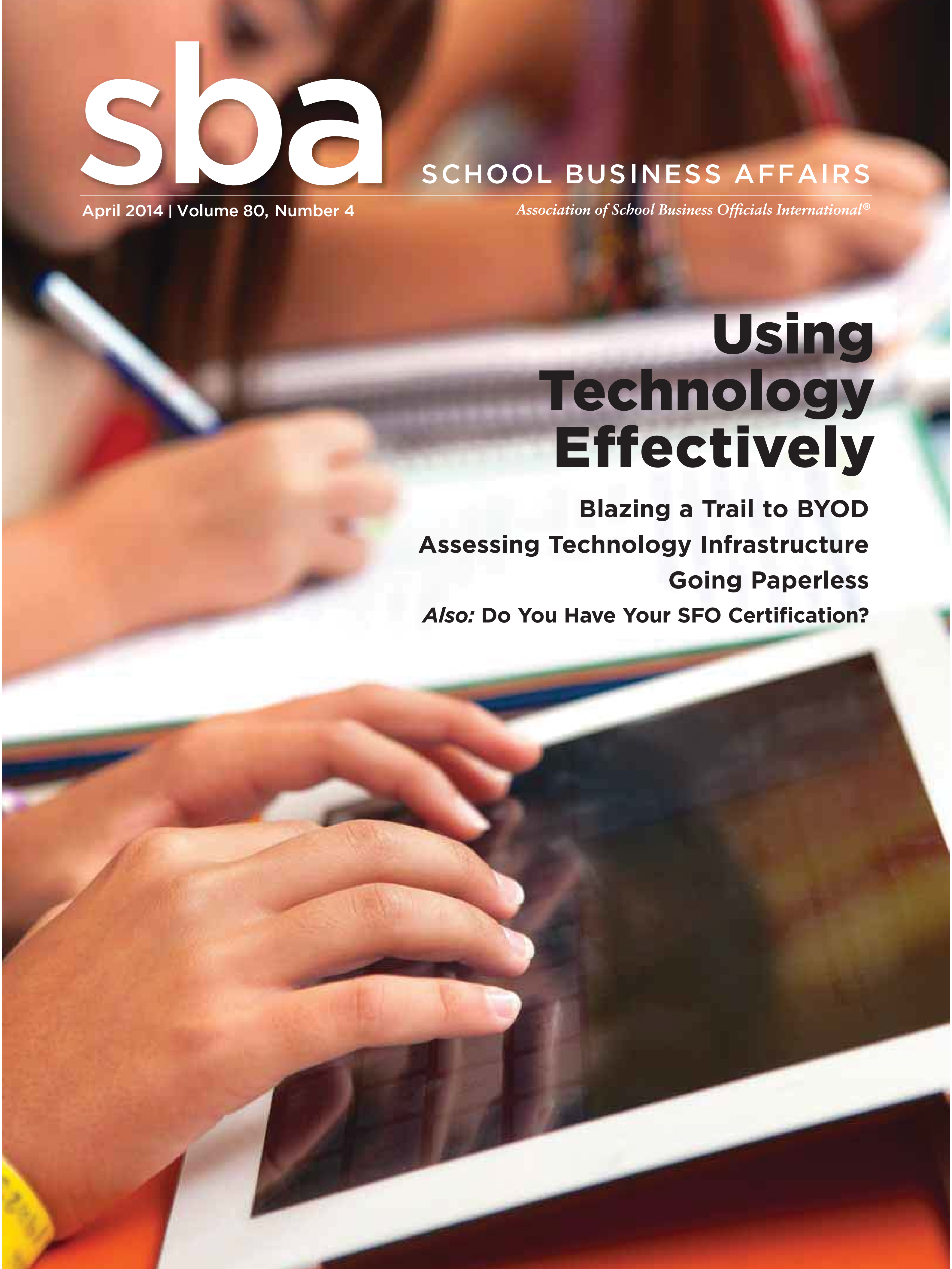

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SCHOOL BUSINESS AFFAIRS

April 2014 | Volume 80, Number 4

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For What It's Worth: Accurate Property Values for Insurance Purposes

Appraising property is like cooking a meal— you need the right recipe and all the ingredients.

By Mark T. Hessel

Benvenuto! Developing and maintaining reliable property values for insurance reporting is a bit like cooking a traditional Italian meal. There's no perfect recipe, everyone seems to have their own opinion, no one really likes to roll up their sleeves and help, but in the end the best food often has the simplest ingredients.

So why take cooking—or appraisal—advice from someone else? Some 26 years ago I had the good judgment to marry into an Italian family (note: you never marry *one* Italian . . . you get the whole family). Oh yeah, I've also spent the better part of the last 29 years looking at, inspecting, and valuing educational property. So here we go . . . grab that *grembiale* and your current property appraisal binder, and roll up your sleeves.

Step One: Determine the meal and your ingredients.

What are you preparing and what do you need? Without a solid understanding of your requirements and reporting needs, any attempt to go out and do an appraisal may fall short of your desired target. These days, insurers likely are asking for a lot more data than what you see in that appraisal report you just blew the dust off. The time and effort that go into preparing your entire property submittal for renewal each year is significantly increased from, say, 10 or 15 years ago, right?

Secondary characteristics. Roof frame, geometry, and age. Renovation/addition information. Flood zone. Quake zone. Separation of exposures. RMS classification. Elevation. Distance to coast. On and on and on . . . the list of data being requested by underwriters and reinsurers is long and growing. Paying attention to the level of detail and what impact it may or may not have on your rating (thus cost of insurance) is becoming part of your job description, like it or not. Just like choosing between San Marzano or canned tomatoes, what goes into the pot determines the outcome.

Speaking of outcomes, what exactly are you looking to get out of your appraisal? Have you been dragged to the dinner table by someone else? Improved rating? Insurance-to-value? Checking on suspect values? Making sure all your locations are fully accounted for? Did the dust just settle on major bond issue construction? Investigate all the potential benefits of going through this process beforehand, and you'll be better for it.

In cooking, timing is everything. Likewise when it comes to your annual renewal. Make sure you get your review and valuation process started early enough to leave ample time to digest the results. Invite the right team to dinner, too—involving all interested stakeholders early on will keep you from getting *Chopped* (don't worry; you'll have more than 30 minutes for this meal).

Step Two: Let's get cooking.

Do you blanch and peel the tomatoes or just slice, crush, and throw them in there? Fresh basil or dry flake? Fresh garlic or junk in the jar? Do you rush out and grab someone to get numbers on your property, or take the time to research the proper methodology? Understanding *how* to value the property is just as important as actually doing it. You don't need to be the appraisal expert, but learning the basic lingo and knowing the difference between reproduction cost and replacement cost—asking the right questions to ensure your efforts bear fruit—can make your time in the kitchen worthwhile.

Involving all interested stakeholders early on will keep you from getting *Chopped*.

Does your insurer require proof-of-loss documentation on contents? If so, can't you simply use the fixed asset records your accounting department developed for GASB 34 compliance? Those might be an okay place to start, but they won't eliminate your work in that area. Original cost and net book value often have little or nothing to do with what you'll want to recover in the event of a loss.

Twenty-five years ago, undertaking a full appraisal meant you were committing to a comprehensive inventory of all assets—buildings *and* contents. In the mid- to late-1980s appraisal firms developed a more cost-effective strategy known as "modeling." Utilizing all that prior data from full, detailed inventories and appraisals (i.e., counting every chair, table, desk) statistically developed models for each major type of occupancy evolved.

Understanding how to value the property is just as important as actually doing it.

Today this methodology is widely used, but not without caveats. Often the models are applied blindly, without a walkthrough inspection. Significant factors and cost drivers are easily missed if you rush this process. What is the ratio of students to computers? How densely are the classrooms occupied? Are the kitchens full service or simply warming locations served from a main kitchen located elsewhere? What about the libraries? Did you stop to review the total collection counts to assist in the overall valuation analysis? Rushing through this step often leaves your sauce raw. If that's your desired outcome, buy the jar of Ragu.

Content models applied correctly can be a good alternative to performing a more costly, full-blown inventory of your assets, but there are other alternatives as well and asking questions of your insurer and your appraisal firm will assist you in determining the right recipe for your appetite.

When it comes to the buildings, what valuation tool will your appraiser use, and how well do they understand it? Simply saying they use Marshall & Swift or MSB or Means or any other system shouldn't be the end of your discussion. Start with your insurer or agent/broker, and determine exactly what information, methodology, and outcomes they want—and if any additional data or information will benefit you in the underwriting process.

And while you have your consultant's ear, make sure you review your specific policy language for exactly what value they will cover (or won't cover, based on the exclusions). Involving those with similar vested interests will keep you all out of Alton's *Cutthroat Kitchen*.

Step Three: Keep stirring that pot.

No sense getting a project started and just walking away from it. Following things through, staying involved in the process, and keeping an eye on the clock will pay dividends.

Once the initial valuation is complete, how will you keep it current going forward? What sets of trending factors are available to you and are they appropriate for your circumstances? How frequently should you have the property reappraised? If you are a large entity with multiple campuses, does it make sense to phase in the valuation process or future updates?

Trending, or adjusting for inflationary factors annually, is not as straight-forward as it seems. Some business managers choose not to do it at all and just wait for the next round of appraisals. Perhaps this is not so wise, especially these days. Table 1 shows how general construction costs have swung dramatically in recent years (see 2004–2011). Turner is just one of many possible indicators consulting and valuation firms have at their disposal to keep a thumb on the pulse of inflation. Perhaps the most widely used, Marshall Valuation Service, provides regional and even local factors on a quarterly basis. The relatively wild swings depicted in Table 1 are national averages—in certain regions of the United States, variances were even greater, especially in many coastal areas. The key here is that once you determine an index to use, stick with it year to year because they all have different input and model assumptions.

Table 1. Turner Building Cost Index: 2013 Third-Quarter Forecast

Quarter	Index	% Change
3rd Quarter 2013	868	1.05
2nd Quarter 2013	859	1.18
1st Quarter 2013	849	1.19
4th Quarter 2012	839	0.84
Year	**Average Index**	**% Change**
2012	830	2.1
2011	812	1.6
2010	799	-4.0
2009	832	-8.4
2008	908	6.3
2007	854	7.7
2006	793	10.6
2005	717	9.5
2004	655	5.4
2003	621	0.3
2002	619	1.0-
2001	613	3.0
2000	595	4.4

The Turner Building Cost Index is determined by the following factors considered on a nationwide basis: labor rates and productivity, material prices, and the competitive condition of the marketplace.

Source: Turner Construction. www.turnerconstruction.com/cost-index.

These inflationary forces also have had an influence on the frequency of full appraisals/reappraisals for many. Shorter cycles during periods like this are typically recommended. Waiting more than five to seven years before having the property reevaluated can often lead to undesired surprises the next time you have a loss. You let that sauce sit in the pan on low for too long without stirring and you know the results: order a pizza and start scraping the mess out of the bottom of the pan because you just ruined the sauce.

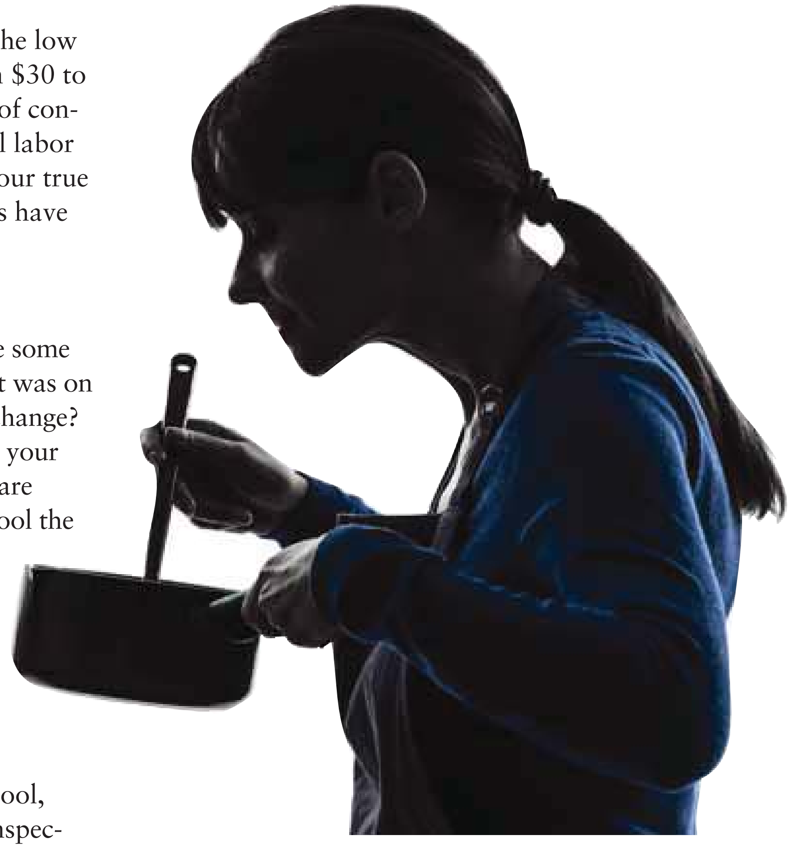
A common misconception is that overall costs of construction have decreased during the recent economic downturn. After all, housing values dipped—dramatically in some areas—right? Confusing market value with replacement cost is like putting too much sugar in the sauce. You think it's the right thing to do . . . until you actually taste it—yuck. The cost of school construction has clearly outpaced general construction over the last 10 years. Specifically, according to Paul Abramson's "Trends Since 1995" in the February 2013 issue of *School Planning & Management Construction Report*, median costs per square foot have increased as follows:

- High School Construction Up 62% ($214/sf)
- Middle School Construction Up 48% ($193/sf)
- Elementary School Construction Up 58% ($205/sf)

Let's compare these increases to more general construction costs over the same period:

- Marshall & Swift (blended average) Up 47%
- Turner Building Cost Index Up 34%

Now, before you think you can apply those costs per square foot directly to your own portfolio of property, understand this: they are national medians, *and* the low and high quartile figures show swings of between $30 to $60/sf in either direction, depending on the type of construction. Regional construction factors and local labor rates still play major roles in determining what your true costs will look like, but safely assume few regions have been flat in this time frame.



Step Four: Taste the sauce.

So, you've carefully followed your recipe and have some preliminary values. How do they compare to what was on the old statement of values? Higher? Lower? No change? I doubt it's the latter, but even if it is, having done your homework and produced reports and data which are accurate and updated should prove to be a great tool the next time you look to the markets for coverage.

Remember to request your reports in hard-copy *and* electronic formats. Paper with pictures is wonderful, but without the data electronically, the binders will just start collecting dust again. It's your information . . . get it back the way you need it.

If your property coverage is with a statewide pool, chances are good you have regularly scheduled inspections and appraisals. Just because your pool's underwriting team has done most of the prep work doesn't mean you won't be asked to participate in the process. You'll see the benefits of their efforts as they work with the reinsurance markets—your assistance pays dividends.

If you're in traditional insurance markets for coverage, you likely have an active agent/broker assisting you. Either way, empower yourself with the tools necessary to understand and contribute to the successful implementation of your next property appraisal. In our house, if you cook you get to watch the clean-up (and I like to use *lots* of pots and pans . . .).

Set the table—you're ready to eat! Mangia! Mangia!

Mark T. Hessel is vice president of HCA Asset Management, LLC. Email: mhessel@hcamgt.com

Common Core State Standards: Assessing Student Progress

Forty-six states and the District of Columbia have adopted the Common Core State Standards (CCSS). One of the most important decisions that state policymakers will face in the coming months is how to assess students' progress toward these new standards.

New Assessments: A Guide for State Policymakers, released by the Alliance for Excellent Education, presents four key questions that state policymakers should ask about proposed new assessments related to the Common Core State Standards:

What do the assessments measure? To provide information on student performance against the standards, the assessments should measure the full range of the standards, not just those that are easiest to measure.

How do the assessments help teachers? Assessments can help instruction by providing teachers with rich information on student strengths and areas needing additional help.

How do the assessments help students and parents? Assessments can help student learning by making the expectations clear.

How much do the assessments cost? The PARCC assessments are expected to cost $29.50 per pupil, about the median of what its member states currently pay for tests, while Smarter Balanced assessments are expected to cost $22.50 per pupil ($27.50 if states buy the interim and formative assessments as well).

While acknowledging that cost is an important consideration, New Assessments encourages states to look at the other side of the ledger and consider the benefits of the new assessments.

New Assessments: A Guide for State Policymakers is available at http://all4ed.org/reports-factsheets/new-assessments-a-guide-for-state-policymakers/.