

Concluding insurable values by trending historic costs

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The property insurance market may be changing from hard to soft; however, underwriters remain steadfast regarding their need for precise and detailed values. Do you know where your property's reported insurable values come from?

Trending historic asset records is one of the most common methods used by companies to arrive at insurable values. The starting point in this process is the historic cost of an asset, usually the initial capitalized cost in a facility's fixed asset accounting system. Some accounting systems have a built-in capability to calculate the current insurable value of an asset.

Trending the historic cost of an asset will indicate the current insurable value of that asset. If applied consistently to all assets in a plant, it should yield a realistic indication of the present insurable value of that plant.

The variety of cost trends available can be confusing. Consultation with your insurance advisors will help you to determine the trend that is most appropriate for your insurable property.

Historic cost defined

Historic cost is defined as the original cost new of the asset in the hands of the first owner. This cost should include freight, tax and installation; all costs originally incurred to make the facility operational whether funded by the insured or through government incentives. The total insurable value should also account for indirect costs e.g., design and engineering fees, licenses permits, training of skilled plant personnel, etc.

The historic cost is then trended by an appropriate cost trend. Sources for the most commonly used cost trends include:

- Marshall & Swift: Marshall Valuation Service
- FM Global: Industrial Cost Trends
- US Department of Labor: Bureau of Labor Statistics
- Engineering News Record: 20 City Average Building Cost Index
- Handy Whitman: Index of Public Utility Construction Costs



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If a company's assets records are well maintained, contain true historic costs and appropriate cost trends are applied with full knowledge of the following limitations, they can be used as a valid tool to use in calculating current insurable values.

- 1. Begin by identifying the insurable property.** Do not include the value of land or site development costs as these investments are not insurable property.
- 2. Consider site improvements.** Landscaping, paved roads, parking lots and retaining walls to name few should be included if covered by the insurance policy.
- 3. Trended asset values will ultimately diverge from the current insurable value.** This is due to the trend factor being generic to an industry and not specific to the subject facility. The rate of inflation and technological advances will affect the time period over which assets can be reliably trended.
- 4. Trending asset costs for more than seven years leads to distorted values.** Not because of the trends themselves, but due to errors/omissions of asset retirement/acquisition recording that tends to creep in to even the best-maintained property records systems.
- 5. There are three values that cannot be used.** Trending the following values will not yield the current insurable value of an asset:
 - Used or secondary market costs
 - Costs allocated for purchase price accounting purposes
 - Internal transfer costs
- 6. To add or not to add?** The cost of renovations to buildings or machinery rebuilds should not be added to the asset's historic cost and subsequently trended, unless the particular asset's capabilities are improved. Since deciding what and what not to add can be thorny, it is best to consult with your insurance advisors.
- 7. Don't exclude expensed assets or those whose "book value" has reached zero.** These items should remain on the list of insurable assets until physically removed or, specifically excluded from insurance coverage.
- 8. Consider foreign sourced assets.** If a high proportion of the assets are sourced from foreign countries, the applicable trends should reflect the rate of inflation in the source country with an allowance for variations in exchange rates.
- 9. Look at assets transferred to and from other divisions.** These should be accounted for by utilizing their historic cost and date of acquisition or full replacement cost new at the time of transfer.
- 10. Detailed insurance underwriting analysis** such as maximum foreseeable loss calculations will require that insurable values be allocated to their respective buildings, information which is rarely captured in a company's books.
- 11. Add in other property.** Property owned by other individuals/companies for whom the insured is responsible should be added to the value concluded by trending fixed asset records.
- 12. What to do about offsite assets.** Offsite assets are common in these days of outsourcing; care should be taken to ensure that their insurable value is dealt with appropriately.

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