The MEARIE Group

The Reciprocal

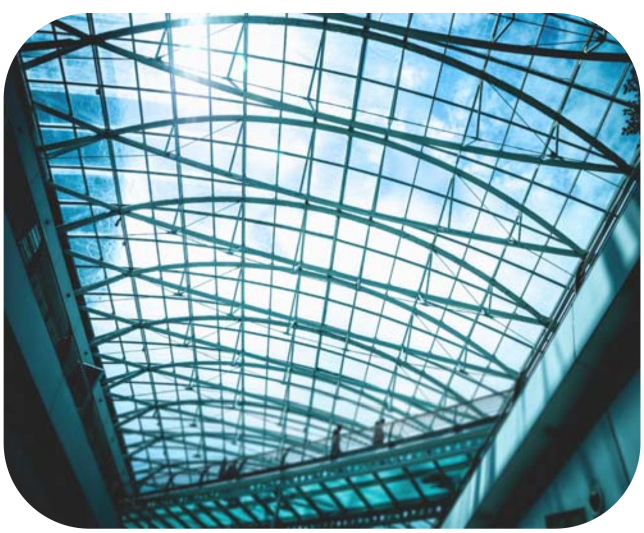
Insurance, Financial & Business Solutions

MAY, 2014

"CYA" – Cover Your Assets!

Insuring company assets - buildings, contents, equipment, distribution stations, unlicensed vehicles, etc. - to the correct value and keeping those values current over time is a critical part of your risk management program. How do you determine if you have enough insurance?

Determining appropriate insurance limits or asset values can be tricky and confusing. Building values will vary depending on the age, type of construction material used, quality of finishing, and geographic location. Reported insurable values of buildings should be the cost to rebuild the property as a rush, priority project, after a total or substantial loss. It is important to consider that the usual economies of scale or scheduling may not be available for an unplanned reconstruction job. Some building materials, such as cement or specialty equipment, and/or skilled labour, may be only available at a premium when you need them. It is possible you may also incur expenses for clean-up and demolition even before re-construction can begin.



Replacement Cost Valuation vs. Actual Cash Value (ACV)
Property insurance policies normally provide a claims settlement based on one of the following valuation calculations: replacement cost or actual cash value. It is important to understand fully how your policy works, particularly since some assets may be treated differently than others in the event of a loss.

If your policy provides replacement cost valuation, your claim will be settled based on the cost of buying or building the new replacement asset of similar kind or quality, with no deduction for depreciation, regardless of the age of the asset. For example, if a five year old transformer is destroyed it would be replaced with a new transformer with the same features.

If your policy provides ACV cost valuation, your claim will be settled based on the cost of buying or building the new replacement asset of similar kind or quality, but will include a deduction in the value for depreciation. This provides indemnification, restoring your asset to the equivalent condition of the previous asset, at the time of loss; therefore the cost for depreciation is taken into account. For example, if a five year old transformer is destroyed, the claim settlement would represent the cost to purchase a five year old transformer, not a brand new transformer.

It is important to remember Replacement Cost Valuation is different from the market value of your building. If you lose your building in a fire, a claim based on Replacement Cost would cover the actual cost of the materials and labour needed to rebuild your building. The value of your land/property is not insurable, just the buildings/structures themselves. Therefore it is important to assess the replacement cost of the buildings, not what you might get if you sold the existing location or bought a similar building at another location.

Co-Insurance Clauses

Another factor to consider is many property insurance policies have a co-insurance clause which may limit the amount of settlement received in the event of a loss, if you have not purchased insurance based on up-to-date values for locations. It is essentially a penalty for not maintaining current replacement values. For example: if your building's replacement value is $2,000,000 and your policy has a 90% co-insurance clause, you are required to report at least a $1,800,000 valuation for insurance. If you had reported a $1,200,000 valuation (66% of the minimum valuation) and then had a $600,000 loss, your insurer would only pay 66% of the loss amount ($400,000). This loss has now cost you $200,000 due to having an insufficient insurance valuation. If however you had $1,800,000 in insurance for the building you would collect 100% of the loss because you had the minimum 90% of value in insurance.

How Does The MEARIE Property Program Treat Asset Valuation?

Claims settlements are based on Replacement Cost for all assets except transformers 26 years of age and older. For these older assets, there is a specific sliding scale calculation used to provide the most coverage possible. **In the spirit of the Reciprocal and its Subscribers, the MEARIE policy does not include a co-insurance clause.** We expect our Subscribers to approach their insurance in full cooperation with the program and therefore assume assets are being accurately valued. **Reporting current asset values based on replacement cost helps MEARIE to maintain the financial integrity of the Reciprocal and our relationship with reinsurance partners.**

Re-Assessing Your Asset Values

It is recommended a review be conducted of all your assets on an annual basis to ensure values are current. But how do you obtain current values? For new locations, the "as built' cost serves as the initial reference point. You may take the cost of individual components and extrapolate across similar locations to obtain current estimates. From this you can annually increase the value based on the "Non-Residential Building Construction Price Index (NRBCPI)" factor for your area from Stats Canada. (It should be noted, this is different from the consumer price index inflation factor.) Continuing to add an inflation factor eventually leads to inaccurate replacement costs. After five years of adding a factor, consideration should be given to undertaking a formal cost replacement evaluation of your assets.

Where you have replaced aging infrastructure, equipment or major station components, the purchase price and labour cost information can be applied across remaining, similar locations to provide a revised/updated estimate. If you do not have a new location or have not recently replaced major components/equipment that could be used as a baseline, you may choose to have a commercial valuation done.

The MEARIE Property Program makes available two valuation tools to aid in estimating replacement values of your locations. For stations, including transformers, the MEARIE Asset Valuation Tool takes into consideration various components such as transformers, switch gear, relays and other typical equipment and calculates a replacement cost estimate. For locations without transformers, such as head offices, service centres or storage facilities, the MEARIE Building Evaluator can provide a current estimate of replacement costs based on building size, construction features and finishing quality.

Don't get caught short and don't get penalized. Keeping your asset values current is an important part of your ongoing risk management program.

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