

## What is the Right Price?

At the heart of America's longest-running game show "The Price is Right®" is a deceptively simple question: "What's it worth?" If the answer was easy, the show would not have lasted 41 years. For more than 7,800 episodes, contestants have been venturing their best guesses about the cost of everyday items. And, time after time, most of those guesses have been wrong.

A similar but far less entertaining contest rages among a very different set of contestants over the valuation of real estate, both residential and commercial. Carriers want covered properties insured to full replacement cost, with premiums to match. Property owners, on the other hand, want low premiums but "full coverage" in the event of a complete or partial loss. Lenders just want their loans secured, but are increasingly reluctant to offer appraisals that others might rely upon to their detriment.

Their collective unease is understandable. In recent years this difficult task has become more so as the cost of new construction moved in anything but a straight line. Perhaps that explains why Florida's state-run carrier, Citizens Property Insurance, elected to rely solely on its chosen software for estimating the replacement cost of homes in 2011, only to reverse course weeks later with legal actions brewing. In the face of this storm, to whom do our contestants turn for valuation advice? The humble—but well-insured—insurance agent and broker.


That is a role brokers should decline. Dabbling by insurance brokers in unfamiliar lines of business has always been ill-advised. Dabbling in other professions entirely—like real estate appraisal—can be downright perilous.

Commercially available 'replacement cost estimator' programs may be used to fill the 'expertise gap,' but those programs, too, have their limitations. They cannot bring order, logic and predictability to the roller coaster U.S. real estate and construction markets.

Yes, they are better—much better—than merely guessing (or ignoring the issue altogether), but if you take a look at the disclaimers attached to those programs, you will see just how sure their creators are of their digital crystal ball's accuracy. They understand better than anyone how many variables affect the outcome and how many alternate scenarios may play out, especially over time.

To make matters worse, third parties like lenders are now attempting to offload their own appraisal burdens onto brokers. They are not customers. They pay no fee or commission. Yet they boldly request copies of the broker's replacement cost estimates with a simple endgame in mind: If there is a shortfall in coverage, blame the broker and force him to pay the difference. Just say no.

Because of the business they are in, lenders are in a far better position, in terms of both volume and resources, to ascertain whether a particular property is adequately insured—at least when it comes to limits. Their reluctance to do so is instructive. They have learned a hard lesson over time: they do not know whether 'the price is right,' and cannot afford to be wrong.

Can you? 

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## Appraisal Best Practices

Do not agree to become an appraiser in the first place. Instead, urge customers—in writing—to have their property (re)appraised by a licensed professional on a regular basis to ensure that the limits in place are, and remain, adequate.

Explain that the replacement cost of a building will likely exceed both the actual cash value and 'purchase price' of a building, often by a significant margin.

Explain what a 'coinsurance penalty' is, and how a loss may not be fully covered even if it is within policy limits.

If you are forced to offer an opinion about replacement cost:

- Document your recommendation that a licensed professional be consulted, as well as the customer's refusal to do so.
  - Make clear to the customer the substantial limitations on your training and experience as an appraiser. Document those warnings.
  - Provide a copy of the replacement cost estimator program's disclaimer if you use one (indicating that your estimate is subject to the same limitations). Replacement cost estimators are affected by a number of variables. Document the information used—such as location, square footage, usage, materials and design—in arriving at an estimate, as well as the source of that information.
  - Explain that construction costs go up every year by varying amounts, depending on market conditions. So should policy limits. A yearly 'inflationary increase' likely will not keep pace with the cost of construction. Request that the carrier confirm that the property is insured to replacement cost such that no coinsurance penalty will apply.
- Above all, place the final decision firmly in your customer's lap.

—M.D.