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Getting Insured Values Right: The Need for an Appraisal

Since 2020, construction costs in Canada have been rapidly changing. This trend has been fuelled by many factors, but the notable driving forces are the rising cost of building materials and labour shortages across the country.

During the same period, the rate of inflation in Canada has also experienced an upward trajectory. However, the rate that construction costs are increasing far outpaces that of inflation. It is for this reason that a professional insurance appraisal is the only reliable solution for determining the optimal coverage amount for your property insurance.

Major Discrepancies Between Inflation Rates and Construction Costs

Over the years, we have come across hundreds of files where property owners are applying year over year increases that match the rate of inflation. In other cases, a consistent yet arbitrary multiplier has been added, for example, a 3% annual increase. While this may seem like a convenient way to keep up with rising costs, in our experience, we have found that doing this often results in an insured value that is too low and would not provide sufficient coverage in the case of a total loss.

Applying such increases carries a range of associated risks. Property owners must carefully consider their approach in determining insured values.

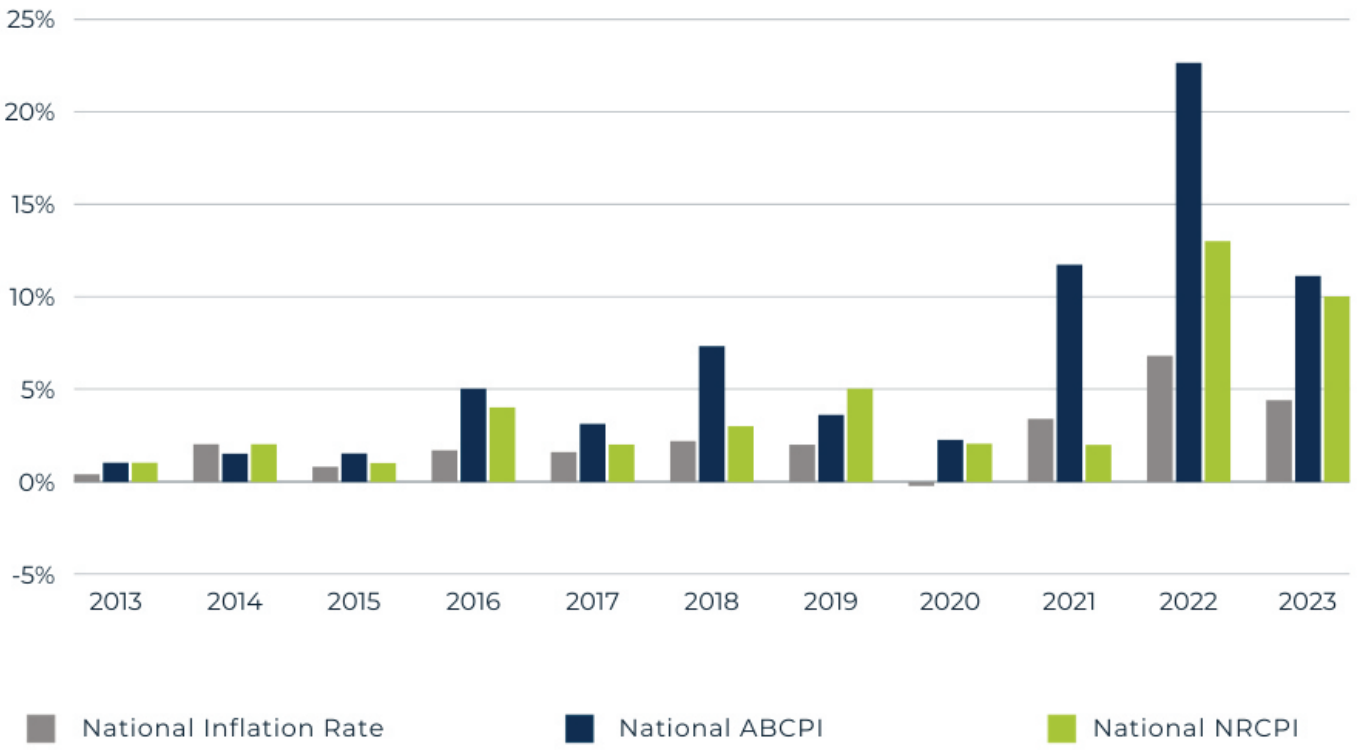
It is important to understand the difference between increases in construction costs and increases in inflation rates. Construction costs refer to the actual cost of building or repairing a structure, while inflation refers to the general increase in the cost of living – mainly the cost of goods and services - over a specific period of time. While construction costs are affected by inflation, they are also influenced by other economic factors, such as the demand for housing, the labour market, building material availability and fluctuating prices, interruptions to the supply chain, and regulatory requirements.

Read more about the factors that influence construction costs here.

It is more often the case that the annual inflation rate does not keep pace with actual construction cost increases. In fact, since 2013, annual construction costs increases have surpassed the rate of inflation 8 years out of 11 years.

> **Between 2013 and 2023, the rate of inflation increased by 27% while the residential construction price index and the non-residential construction price index increased 93% and 51% respectively.**

Figure 1. National Construction Cost Increases vs. Rate of Inflation



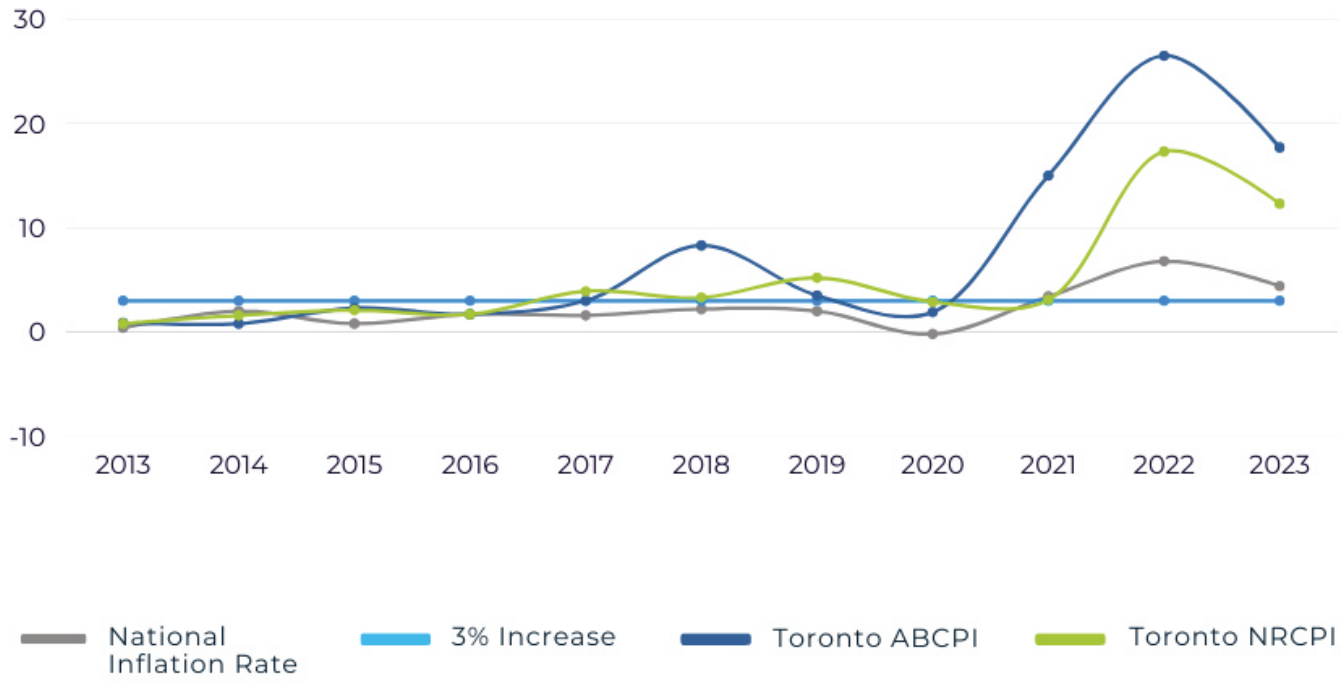
Relying on an annual inflationary factor is likely to leave you underinsured and vulnerable to significant financial losses in the event of a claim. As additional evidence, here are several examples illustrating the significant disparities between overall inflation rates and real construction expenses across Canada

EXAMPLE ONE - TORONTO, ON:

You own a rental apartment in Toronto, Ontario. You last had an appraisal completed in 2013 and the insured value was $5.5M. Since then, rather than renewing your appraisal and receiving annual updates to value, you followed a consistent 3% increase year over year to determine your insurance coverage.

As of 2023, you are currently insuring your property for $7.4M. However, based on the rate that residential construction costs have increased in Toronto, you should be insuring your property for $11.6M. Therefore, you are currently underinsured by more than $4.2M.

Figure 2. Toronto Construction Cost Increases vs. Rate of Inflation vs. 3% Increases



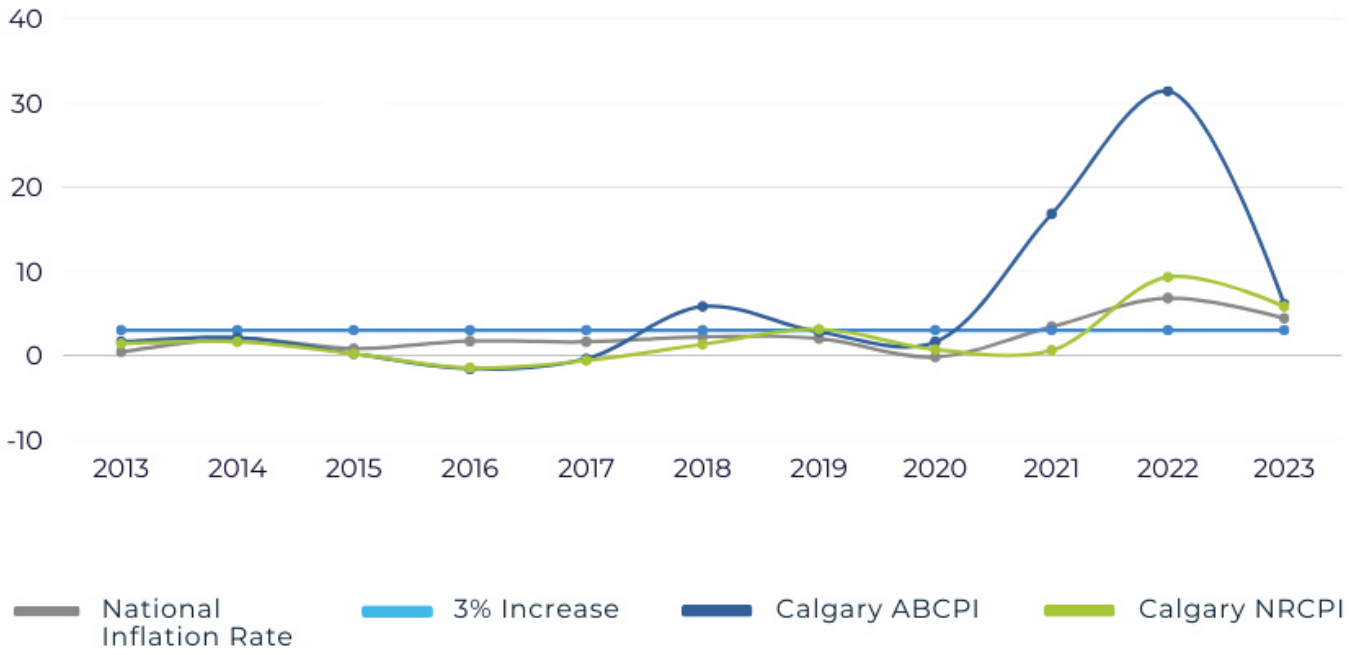
EXAMPLE TWO - CALGARY, AB:

You manage a mixed-use, multi-tower condominium development in Calgary, Alberta. Your last appraisal was in 2020 and you insured your property for $142.2M. Over the past three years, the rate of inflation has been increasing at higher-than-normal levels so you feel confident increasing your insured value for the same percentages.

In 2023, the development is insured for $163.9M. Based on the significant construction cost increases experienced across Alberta during the same time, your property's reconstruction costs in 2023 should be $231.5M – an incredible $67.6M difference.

Read here about the risks of under insurance in strata and condo corporations

Figure 3. Calgary Construction Cost Increases vs. Rate of Inflation vs. 3% Increases

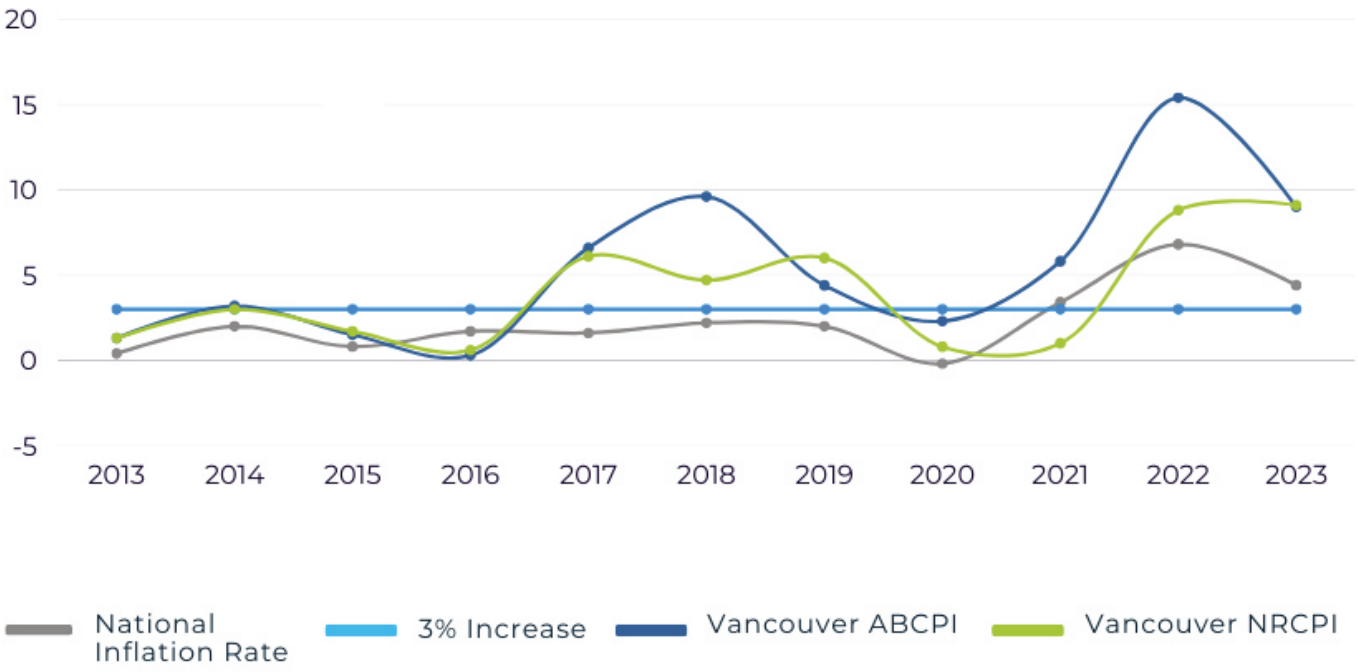


EXAMPLE THREE - VANCOUVER, BC:

You own three boutique hotels in Vancouver, BC, all of which were built between 2014 and 2017. You have never had an appraisal completed and have been increasing the replacement cost value by 4% each year. In 2023, your insurer makes an insurance appraisal a mandatory requirement for placing insurance on your property, so you agree to have a professional appraisal completed on your oldest hotel. In 2014, the cost of construction was $39.6M.

By 2023, you had intended to secure coverage in the amount of $49.4M. However, upon receiving the appraisal, the correct total insurable value should be $57.6M, a discrepancy of $8.2M. Assuming that all of your hotels have encountered comparable percentage increases in replacement costs, your entire portfolio is presently underinsured by 15%.

Figure 4. Vancouver Construction Cost Increases vs. Rate of Inflation vs. 3% Increases



Mitigate Risk with Annual Appraisals

Applying an annual inflationary factor on your property's insurance comes with significant risks. As we have identified, it is critical that increases accurately reflect the true rate of construction cost changes. Additionally, for increases to be applied correctly, an accurate replacement cost estimate must first be determined based on each property.

A reliable replacement cost valuation should consider the unique features of your building, such as its age, size, and materials used. This includes all hard and soft costs required to rebuild a similar property to current building code and standards. The appraisal should also account for all demolition and removal costs, taxes, and fees, and it should also consider the current state of the construction market in relation to the regional location of the property.

Insuring your property to value can help you to avoid self-insuring, co-insurance penalties, or legal repercussions due to non-compliance with provincial legislation. Whether you own a single unit or have an entire portfolio of buildings, the only way to be confident that you are adequately insuring your assets is to obtain an annual insurance appraisal from a trusted, third-party firm.

Peace of Mind with a Normac Replacement Cost Valuation

Normac is Canada's leading provider of insurance appraisals. Our specialized team of appraisers is extensively trained in actual construction costs, condominium and strata law, demolition and debris removal, and possesses deep knowledge of applicable building codes and municipal regulations. This expertise ensures the delivery of accurate valuations.

We routinely review and update our proprietary costing database, enabling us to provide the most current and dependable replacement costs. Our detailed reports, along with complimentary updates, have earned the trust of insurers, insurance brokers, property managers, and property owners alike.

Contact Us

At Normac, our accredited team of appraisers and dedicated client services department ensure that our reliable reports are delivered on time and with little to no disruption to you. We take on all the hard work so you don't have to.

Contact us today for a no-obligation, complimentary proposal.

Request a Quote Today

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