

VALUATION FOR INSURANCE PURPOSE
“THE PERSPECTIVE OF AN INSURER”

Being Text of the Paper Delivered

At The

IN-HOUSE SEMINAR

Organised by

JIDE TAIWO & CO
(Estate Surveyors & Valuers)

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INTRODUCTION

I wish to express my profound gratitude to your management for inviting me to share knowledge with you this morning. It is very interesting to mention that your organisation is the first company in recent memory in the real estate sub-sector of the economy to organize this type of specialized in-house seminar on insurance valuation. I do hope that we will all learn one or two things that will enhance our professional skills in the course of our discussion today.

The subject of our discussion “**valuation for insurance purpose—the perspective of an insurer**”, suggests that the aim of this paper is to present an insurer’s viewpoint on the subject of valuation. Therefore, I consider it very important to start with the definition of the principal concepts we are concerned with here, which are **Insurance, Property and Valuation**.

INSURANCE is one of the risk control mechanisms applicable in risk management. As a loss control measure, insurance is concerned with the transfer of risk to a risk management specialist. The simplest working definition of insurance sees the contract of insurance as where one party called the insured transferred some or all of its identified risks to a professional risk carrier called the insurer for a token fee called the premium, with a promise or undertaken by the latter to indemnify the former in the event of the occurrence of the risk insured against.

Importantly, in a contract of insurance, there must be a property, a limb or liability, which the contract is meant to preserve. Therefore, there is usually one form of estimation (valuation) or the other to determine the quality and worth of the subject matter of the contract. The purpose is to aid the insurer in forming an opinion as to the acceptance of the risk or otherwise, and if to be accepted, at what rate of premium and terms.

PROPERTY is generally defined to mean something owned or a possession. However, in law property means the right to possession or use both of which are sine-qua non to insurable interest; a basic principle of insurance.

Property may be moveable or immovable. Moveable properties include motor vehicles, ocean-going vessels, general equipment etc, while immovable properties are generally real estate which includes building, developed and undeveloped land.

VALUATION simply put, is an estimation (especially by a professional valuer e.g. Jide Taiwo & Co) of a “thing’s” worth or the estimated worth of a “thing”. In the context of this discourse, the thing under reference is identified as the subject matter of insurance, which is usually in various physical forms. Valuation therefore, is the estimation of the value of the subject matter of insurance such as buildings, vehicles, real estate, engineering equipment and ocean-going vessels to mention but a few.

You will agree with me that our subject of discussion can take various dimensions. However, I want to assure you that I would approach it in such a manner that at the end of the day, you will obtain value for your

time. Therefore, the paper will focus and address sequentially the issues bordering on the necessity for valuing property; insurance perception of a property as well as valuation of property in insurance.

WHY VALUE PROPERTY?

Put more generally, why does one need to value a property? The answer to this question can be divergent depending on who is interested in the valuation of the property. The need to value a property may arise from any of the following sources:

Owner of Property: To the owner of a property, the need for valuation may be for such ordinary reason of confirming the current worth or market value of the property to enable him determine his aggregate wealth or net worth.

Government often carries out valuation exercise on their property to enable them put a value on such property, perhaps for eventual sale or to determine lease agreement to be placed on them. However, where government carry out valuation of private individuals properties, it is mainly for the purpose of imposing property tax or determining revenue generation.

Banks/Financial Institutions: In commercial transaction with the banks or other financial institutions, request is often made for collateral securities which in most cases are properties especially buildings and equipment, hence the need for valuation to determine their current

market value with a view, by the banks, of ensuring that whatever credit they are granting is adequately secured by the property being pledged as collateral.

Valuation may also be conducted on a property to determine the current market worth for all intent and purposes.

In insurance, properties are often valued both at the pre-loss (or pre-contract) and post-loss stages to determine the replacement value as against the insured's estimated value with a view to advising the insured against under-insurance or excessive over-insurance. Essentially, the ultimate intention is to ensure that the insured (policyholder) received adequate indemnity in the event of a loss or damage and also to forestall unnecessary dispute in the event of a claim.

PROPERTY AS PERCEIVED IN INSURANCE

In insurance, the word "property" embraces every material thing or physical object to which fortuitous loss or damage may be occasioned. In this context, the legal distinction between real property (i.e. immovable property such as land or buildings) and personal property (temporal or moveable things as opposed to land) has no relevance. It is important to note however that in insurance not all properties are insured under the same class of insurance. Thus different properties are usually insured under the appropriate different classes as indicated below:

➤ **Fire & Property Insurance:** Basically, this includes commercial and residential buildings and contents therein, factory (ies) etc.

➤ **Motor Insurance:** Pleasure cars, commercial vehicles, motorcycles and other specialized vehicles such as trucks, fork-lift, bulldozers etc. form the nucleus of items qualifying for placement under this class.

➤ **Engineering & Electronic Equipment Insurance:** This comprises plant, machinery, electronic equipment, household equipment, boilers, pressure vessels etc.

➤ **Marine Insurance:** Ocean-going vessels, water crafts, fishing trawlers, pleasure craft, yacht etc. dominate this class.

➤ **Householders/Houseowners Insurance:** Buildings as well as the content therein are the subject of interest in this regard.

➤ **Aviation Insurance:** This class will include all types of airplane used in civil aviation including supersonic aircraft.

➤ **Oil & Energy Insurance:** Oil platform, tankers, floating barges, tugs etc. are considered in this regard.

Usually, the owner of a property would always put a value on his property and this value may be the actual cost as at the time of acquisition of the property. This is known as the insured's value. But to the insurer, what is important is the replacement cost or reinstatement

value of the property. This is because indemnity at the time of loss or damage is a function of the replacement cost or the reinstatement value of the property. It is for this reason that in insurance of buildings and goods alike, there is reinstatement value condition which in its widest sense means the restoration of the property insured to the condition in which it was immediately before the loss.

Generally, to an insurer not all properties are insurable. However, one of the basic conditions for insurability is that there must be in existence a relationship between the insured and the property (subject matter of insurance) and this is referred to in insurance parlance as *insurable interest*.

To a layman, insurable interest is simply the right of a person to insure a property. Technically put, insurable interest is the relationship existing between the insured and the property recognized by law by which the insured will benefit by its continued safety or be prejudiced by its loss or damage or diminution in value.

VALUATION OF PROPERTY IN INSURANCE

In carrying out valuation for insurance purposes, there is no hard and fast rule. For this reason, the valuation may be conducted in-house (by company staff) where the risk does not require specialized technical skill(s) and the sum insured is not of a high value. In cases where the insurer is presented with a specialized property risk, professional valuers are engaged. However, the client (i.e. the prospective insured

involved) is a major determinant of whether professional valuation of the risk should be carried out. Thus, where the prospect has a vast asset base, the use of a professional valuer deserves a serious consideration.

Strictly speaking, valuation is aimed at determining the market or replacement value of the subject matter of insurance as against the sum insured with a view to making recommendations as to under insurance or excessive over-insurance.

Therefore, to obtain a fair assessment of the subject matter, the valuer must pay attention to minute details of all the constituent elements making up the whole item. Essentially, for an insurer to obtain an independent opinion, it makes business sense to commission an independent valuer to undertake the exercise.

The insurance industry engages the services of loss adjusters and risk surveyors in carrying out property valuations. However, experience has shown that adjusters and surveyors employ the services of professional bodies in the conduct of valuation as the reports of these specialized professional bodies are usually incorporated in their main report to the insurers.

Presently, honourable members of the following professional bodies have contributed in the valuation of properties conducted by the traditional adjusters and surveyors for insurance purposes:

- Nigerian Institute of Estate Surveyors and Valuers

- Nigerian Institute of Quantity Surveyors
- Nigerian Institute of Marine Engineers
- Nigerian Institute of Industrial Engineers
- Nigerian Society of Engineers

It need be mentioned that because of the very high cost of professional fees charged by the well-established big players in the foregoing professions, the fringe players among them enjoy tremendous patronage from the insurance industry.

The techniques and/or approach by loss adjusters and risk surveyors vary from one firm to another. However, there are basic factors that must be taken into consideration and highlighted by a loss adjuster or a risk surveyor in the conduct of their duty. These factors includes but not limited to:

- ♦ Area or location of the property
- ♦ Commercial value of the property at the location
- ♦ The current market value in terms of replacement cost
- ♦ Nature of construction materials used
- ♦ Target risk or Maximum Probable Loss (MPL) etc

Thus, in the valuation of a building for instance, the valuer apart from considering the location of the property, would pay attention to the quality of materials used (either local or imported). For plant, machinery and other engineering risks, the relative ease or otherwise with which the insured items could be sourced need be taken into consideration in the determination of the market or replacement value.

One of the major reasons for property valuation in insurance is to enable insureds have an idea of the characteristics of the risk for risk management purposes. The loss adjusters/surveyors' reports assist the insurers in eliciting information about the risk which form a basis for making critical decisions including recommendations for risk improvement where necessary.

Another area in which valuation plays an important role is that having established the market and replacement values of the property, an adequate premium is charged and paid by the insured thereby guaranteeing adequate indemnity and forestalling under-insurance and the consequent penalty in the event of a loss.

Remuneration for loss adjusters/surveyors for their services may be borne by the insured or the insurers depending on the agreement between the parties. More often than not, insurers bear the cost of such services through the payment of professional fees. Though the service charge is made up of some elements of overhead and logistic expenses, the professional fee is usually tariff-rated by the Nigerian Insurers

Association (NIA). Occasionally, the fees are negotiated between the loss adjusters/surveyors and the insurers.

CONCLUSION

My distinguished audience, though the focus of this paper is not to make us insurers and valuation experts, but you will agree with me that it has enlightened us on many important issues concerning insurance and property valuation. In the foregoing paragraphs, we have been able to define the major concepts involved, answer the question as to why property is valued and considered the insurers perception of property. We also discussed most importantly, the techniques and approach adopted by professionals in the valuation of property as well as their remuneration and the importance of valuation exercise to risk improvement.

I thank you all for giving me your rapt attention during the period of this lecture. Once again, I commend your management and implore them to keep on with this trend of giving staff the opportunity to learn on the job through in-house training. I strongly believe that the knowledge you've gained today will contribute tremendously in your future professional career advancement.

Thank you.